ECONOMIC GROUP PENSION SERVICES

ADDITIONAL ROTH CONTRIBUTIONS

For owner-only 401(k) plans

The tax code allows 401(k) plans to include Roth accounts in addition to traditional tax-deductible accounts. The key features of Roth accounts are:

1. The accounts grow tax-free. While Roth contributions are not tax-deductible, the investment earnings are not taxed once in the plan, and when withdrawn, the entire amount is tax-free, so the investment earnings are never taxed.
2. The investment earnings escape the additional 3.8% tax on investment income for high earners.
3. Roth 401(k) accounts may be rolled over to Roth IRAs, where they are exempt from required minimum distributions at age 72 (age 70-1/2 if attained before 1/1/2020).

Most higher-income taxpayers cannot make individual Roth IRA contributions due to limits in the tax code. However, business owners who already contribute to both a defined benefit plan and a 401(k) plan have a unique opportunity to make Roth contributions to their 401(k) plan.

If an owner-only (or owner and spouse only) business has both defined benefit and 401(k) plans, some of the maximum allowable contribution available to the 401(k) plan cannot be deducted due to IRS limits. This unused contribution limit can fund a Roth account in the 401(k) plan. Here is an example for one participant using the 2021 IRS limits:

Deductible 401(k) and Catch-up Contributions	$19,500
Maximum Deductible Profit Sharing Contribution	$17,400
Total Deductible Contribution	$36,900
Total Maximum Contribution Available	$58,000
Remaining Contribution Available	$21,100

The remaining $21,100 may be contributed by the business owner personally to the plan and then immediately converted to a Roth account. This contribution is not tax-deductible, but once it is in the plan, it will grow tax-free, and the eventual withdrawal of this account can be tax-free.