

ROLLOVER OF AFTER-TAX CONTRIBUTIONS IN 401K PLANS

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Although many 401(k) plans now allow participants to contribute “after-tax” contributions to a ROTH option, most plans in the past only allowed after-tax traditional contributions. If your 401(k) balance contains both pretax and after-tax traditional amounts and you are retiring and rolling over the balances to an IRA, the IRS now allows you to roll over the after-tax portion of the distribution to a ROTH IRA instead of a traditional IRA. Electing to use the ROTH IRA IS A NO-BRAINER!!

Let me illustrate the two options of either depositing the after-tax amount in a ROTH or in a traditional IRA using an example.

Example: you withdraw for rollover \$500,000 from your 401(k) consisting of \$400,000 in pretax and \$100,000 in after-tax amounts. In 10 years the total grows to \$1,000,000.

Option 1 - \$100,000 deposited into a ROTH and \$400,000 into a traditional IRA. In 10 years the \$100,000 has grown to \$200,000. If you need to take a distribution (minimum required or otherwise), it can come from and be based only on the balance in the traditional IRA (\$800,000). The balance in the ROTH can be taken tax-free at any time or can be left to grow tax-free until you die.

Option 2 – all \$500,000 is put into a traditional IRA. If you take a distribution, it will come partially from the pretax amount and partially from the after-tax amount (see the numbers below). Most important, the \$100,000 doesn’t grow tax-free and it is included in the balance of the traditional IRA for calculating the minimum required distribution (MRD). This is true even if the \$100,000 was originally deposited into a separate traditional IRA account.

	Option 1		Option 2	
	ROTH	Taxable	Non-Taxable	Taxable
Original distribution	\$ 100,000	\$ 400,000	\$ 100,000	\$ 400,000
10-year growth	100,000	400,000	-	500,000
Balance at 10 years	200,000	800,000	100,000	900,000
\$50,000 MRD		(50,000)	(5,000)	(45,000)
Carry forward balance	\$ 200,000	\$ 750,000	\$ 95,000	\$ 855,000

If you are about to face this decision, contact your tax advisor because once made, it can’t be reversed.



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