

How Do We Evaluate Whether to Allow Roth Contributions to Our 401(k) Plan?

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QUESTION: Some of our employees have asked for the opportunity to make designated Roth contributions to our 401(k) plan. Must we allow Roth contributions? If not, what factors should we consider when deciding whether that feature makes sense for our plan?

ANSWER: Designated Roth contributions are not required to be offered under a 401(k) plan; they are a design option. Evaluating the Roth option requires weighing the potential benefits, additional complexity, risks for participants, and administrative burdens for your plan. As you probably know, Roth contributions differ from other elective deferrals in two key tax respects. First, they are irrevocably designated to be made on an after-tax, rather than on a pre-tax basis. Second, if all applicable requirements are met and the distribution constitutes a “qualified distribution,” the earnings will not be subject to federal income tax when distributed. (To be “qualified,” a distribution generally must occur after a five-year waiting period and after the participant’s death, disability, or attainment of age 59-1/2.) Because of the different tax treatment, plans must maintain separate accounts for designated Roth contributions.

Importantly, if your plan allows catch-up contributions (for participants age 50 or older), the SECURE 2.0 Act requires that certain catch-up contributions by higher-income individuals be treated as Roth contributions beginning in 2026. This may affect your decision on offering a Roth option, since plans that allow catch-up contributions will need to be able to facilitate Roth treatment at that time.

Here are factors to consider when deciding whether Roth contributions are right for your plan:

- *Hedge Against Tax-Rate Increases Carries Some Risk.* The Roth option provides participants an opportunity to mitigate the risk of higher income tax rates in retirement. However, should tax rates decline, or if participants are in lower tax brackets during retirement, Roth contributions may give them less after-tax retirement income than comparable pre-tax contributions. The result could also be worse than that of ordinary elective deferrals if Roth amounts are not held long enough to make distributions of earnings tax-free.
- *Opportunity to Exceed Roth IRA Limitations.* Participants who might have been eligible to make Roth IRA contributions can get similar tax treatment on much larger designated Roth contributions to a 401(k) plan (in 2024, \$23,000 for designated Roth contributions versus \$7,000 for a Roth IRA). Catch-up contributions for individuals 50 or older are also considerably higher for designated Roth contributions (in 2024, \$7,500 for designated Roth contributions versus \$1,000 for a Roth IRA). Beginning January 1, 2025, the catch-up limit for designated Roth contributions is further increased, as indexed for inflation, for individuals who attain ages 60, 61, 62, and 63 (generally, \$11,250 for 2025). Additionally, higher-paid participants who are not eligible to make Roth IRA contributions due to the income cap on Roth IRA eligibility would be able to make designated Roth contributions to your plan.

- *Automatic Contributions and Roth Conversions.* Plans with automatic deferrals can provide that, in the absence of an affirmative election, a portion of default deferrals will be treated as designated Roth contributions. And plans offering Roth contributions can offer participants the opportunity to convert pre-tax deferrals to Roth contributions within the plan, commonly referred to as “in-plan Roth conversions.”
- *Complexity of the Decision and Communication.* Participants deciding whether to make Roth contributions will need to consider current and future tax rates, their investment alternatives, the risk that they will need a distribution before they qualify for the tax-free distribution of earnings (which would trigger taxation of the earnings), and the loss of some rollover options. Summary plan descriptions and other participant communications will be more complex.
- *Complexity of Plan Administration.* The separate accounting required for Roth contributions may result in higher plan costs and increase the risk of error. (One common mistake is treating elected contributions as pre-tax when the participant elected Roth contributions, or vice versa.) And because Roth contributions are treated as elective deferrals for other purposes—including nondiscrimination requirements, vesting rules, and distribution restrictions—plan administration will be more complex.
- *Plan Amendment.* An amendment to implement designated Roth contributions must be adopted no later than the end of the plan year in which the plan amendment is effective.

Before adding permissive Roth contributions, you should feel comfortable that plan participants can derive enough benefit from the Roth opportunity to make it worth the risks and burdens. However, if your plan offers catch-up contributions, you should start planning now to be able to facilitate the Roth catch-up contributions required by the SECURE 2.0 Act. For more information, see EBIA’s 401(k) Plans manual at Sections VIII.E (“Roth Contributions”), VIII.F.8 (“Catch-Up Contributions Made by Certain Higher-Income Participants”), and XIV.J.1.c (“Qualified Distributions of Designated Roth Contributions”).

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