Employee Elective Deferrals

A 401(k) plan is a retirement savings benefit offered by your employer. Participating in the 401(k) allows you to make contributions via payroll deduction as a pre-tax or Roth after-tax deferral. Earnings on your contributions grow tax-deferred or tax-free until distributed. The deferral type varies by plan as not all plans will allow for Roth after-tax deferral.

EMPLOYEE CONTRIBUTIONS

Pre-Tax Deferral

Pre-tax deferrals are deducted from your gross pay **before** any federal income taxes are withheld. In most states, the 401(k) contribution is not subject to state income tax. Pre-tax contributions are included in income for the calculation of Social Security taxes. The remaining amount of your paycheck is subject to current federal and most state income taxes.

Roth After-Tax Deferral

Roth after-tax deferrals are deducted from your gross pay **after** all applicable taxes (Federal, State, Social Security, etc.) are withheld. Earnings are tax-free as long as they are considered qualified:

- A distribution is made after a 5-taxable-year period of participation.[1]
- You are age 59 ½ or older **or** you experience death or disability

[1]Learn more on about distributions from Roth accounts.

For example: Alice makes $1,200.00 gross pay biweekly. She wants to know the difference between a pre-tax deferral and Roth after-tax deferral. This example uses a rate of 10%.[2]

	Pre-Tax Deferral	Roth After-Tax Deferral
Compensation amount	$1,200.00	$1,200.00
Pre-tax deferral	- $120.00	- $0
Amount subject to income tax	$1,080.00	$1,200.00
Taxes paid	- $76.00	- $90.00
Social Security and Medicare	- $91.80	- $91.80
Pay after taxes	$912.20	$1,018.20
Roth (after-tax) deferral	- $0	- $120.00
Net pay	**$912.20**	**$898.20**

Takeaways

- The deferral amount is the same: $120.00 per paycheck
- The net paycheck difference is $11.80, which is the difference in taxes paid.

[2]This example assumes $91.80 was deducted from the Employee's paycheck for Social Security, Medicare, and income taxes for a Single individual.

EMPLOYER CONTRIBUTIONS

There are several different ways your employer can contribute money into your retirement account; however, any type of employer contribution will currently always be pre-tax.[3] Employer contributions may also require special conditions to meet before an employee can receive the contribution, such as a required number of hours worked or their employment status on the last day of the plan year.

Below are the most common sources.

Matching

With a matching contribution, the employer matches part or all of the eligible employee's contribution. An employee must defer from their salary into the plan to receive a matching contribution. Matching contributions are usually discretionary, meaning the employer can decide each year whether to make a contribution and how much to contribute.

> **For example:**
>
> Alice defers 5% of her salary. The employer matches 100% of compensation up to 4% of deferral.
>
> Alice's gross pay is **$1,000.00** x 5% deferral = **$50.00**
>
> Since the employer is only matching the deferrals up to 4%, the employer match is **$1,000.00** x 4% = **$40.00**

Profit Sharing

Profit sharing contributions are just that—a predetermined, equal percentage of company profits is contributed to all eligible employee accounts. Unlike with a matching contribution, employees do not need to defer from their salary into the plan to be eligible to receive a profit sharing contribution.[4]

> **For example:**
>
> Alice does not defer this year but meets the special conditions (working 1,000 hours and employed on the last day of the plan year) to receive a profit sharing contribution at the end of the year. Her employer elects to contribute a profit sharing amount equal to 4% of each eligible participant's salary.
>
> Alice's gross annual salary is **$28,800.00** x 4% profit sharing = **$1,152.00**

When participating in your employer-sponsored 401(k) plan, be sure to review the plan contribution options and employer matching benefits so you can maximize the amount you save toward your retirement.

[3] In the Setting Every Community Up for Retirement Enhancement (SECURE) Act 2.0, employers may permit participants to designate employer matching and nonelective contributions as Roth contributions. Further guidance is expected from the IRS. Our materials will be updated as we receive additional guidance.

[4] Special allocation conditions may apply dependent on the plan's design. A profit sharing contribution may also be required to correct failed annual compliance testing.