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# Retirement Plan Newsletter | Q2 2025: 401(k) Roth In-Plan Conversions

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## Does your 401(k) plan allow for participants to convert pre-tax dollars to Roth (after-tax) dollars inside the plan? This is typically called a Roth in-plan conversion, and not every plan allows it. However, it can be a powerful tool for employees and can potentially provide long-term tax benefits.

Contributions to a traditional 401(k) are typically made with pre-tax money, meaning you don't pay income tax on the contributions or any earnings until you withdraw the funds. These days, almost every 401(k) plan also allows for contributions to be made with Roth (after-tax) dollars. With Roth contributions, your contribution is taxed at the time it is made, but it grows tax-free and any withdrawals in retirement are entirely tax-free if you meet certain conditions (reaching age 59 ½ and having made your first Roth 401(k) contribution at least five years ago).

But what about those contributions participants have already made to the pre-tax bucket? Can they change those to Roth? They can, provided the plan document allows it. However, there are important factors to consider before an employee makes the decision to convert.

The most important consideration involves taxes on the conversion. When someone converts a portion of their pre-tax 401(k) to a Roth 401(k) account, the converted amount is treated as taxable income for that year. (The 10% early withdrawal penalty is waived when a person under the age of 59 ½ makes an in-plan Roth 401(k) conversion.) It is important to plan to cover those taxes when filing and to think about how additional income will affect your tax bracket.

The participant should also consider the five-year rule for Roth accounts. The rules here can get complicated depending on if you are referring to Roth IRAs, Roth 401(k)s or Roth conversions. For the purpose of this discussion, the participant must wait five years from the year of conversion before withdrawing the converted Roth funds.

Another consideration is Required Minimum Distributions (RMDs). Pre-tax 401(k) contributions are subject to RMDs but as of 2024, Roth 401(k) contributions are no longer subject to those rules. Therefore, a Roth in-plan conversion could also be considered and used as an estate planning tool.

If the plan document doesn't currently allow Roth in-plan conversions, you will need to amend it. This can typically be done by contacting your bundled provider or your Third Party Administrator (TPA). In our opinion, this is an important

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tool for employees and should be added when convenient.

# MEGA BACKDOOR ROTH

A mega backdoor Roth is an additional strategy that allows someone to potentially save more Roth 401(k) money than the standard contribution limits allow. Typically, high-income individuals who are otherwise restricted from contributing to a Roth IRA due to income limits utilize this strategy.

It is important to note that a mega backdoor Roth is not available to many employees because the plan must not only allow Roth contributions and Roth in-plan conversions, or in-service withdrawals, but also allow after- tax contributions. These after-tax contributions are not to be confused with Roth contributions, because all the earnings on these after-tax contributions are pre-tax. Most retirement plans do not offer after-tax contributions, and we would recommend a discussion with your retirement plan advisor before amending the plan to allow them.

If you only make pre-tax and Roth contributions to your 401(k), then the most you can contribute is $23,500 if under the age of 50 ($31,000 if age 50+, and $34,750 if age 60 to 63). However, if the plan allows after-tax contributions, you can increase your total savings to $70,000 ($77,500 if age 50+, and $81,250 if age 60 to 63). Using this Mega Backdoor Roth strategy, you then convert all your after-tax contributions to Roth, either through the in-plan conversion provision or to a Roth IRA using the in-service withdrawal provision. This can be an involved process, so we would suggest any employee who may be interested to consult their own financial or tax advisor.

Grimes has a dedicated team that specializes in providing investment advisory services to retirement plan fiduciaries and their employees. We assist clients with investment selection and monitoring, fee benchmarking, plan design, and employee education. If you have any questions, please reach out to us.

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