Retirement

SECTION 401(k)

Presented for

Valued Client

Presented by

John M. Webster

HMS Insurance Associates, Inc.

johnwebster@financialguide.com

443-632-3436

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The Concept…

- A 401(k) plan is an employer-sponsored, qualified retirement account that an employee funds by deferring a portion of compensation.
- Employee contributions to 401(k) plans are often supplemented by matching or discretionary employer contributions.

The Attraction…

- The employee is not currently taxed on salary deferred into a 401(k) plan up to certain limits—in other words, employees make contributions with pre-tax dollars.
- The exception is a contribution designated as a Roth deferral (if allowed by the 401(k) plan). An employee's contributions to a Roth 401(k) are subject to current taxation, but the earnings on those after-tax contributions will later be distributed tax free, assuming certain criteria are met.
- The employer receives a tax deduction, within prescribed limits, for any contributions made to the plan.
- Earnings accumulate in a 401(k) plan on a tax-deferred basis.

Contributions…

- There are annual limits on elective employee deferrals to a 401(k) plan, with additional "catch-up" contributions permitted for participants age 50 and over. Within these limits, employees may elect the amount of salary they want to defer. Catch-up contributions must be allowed under the terms of the plan or they are unavailable.
- The annual limit for participants under age 50 is $18,000 in 2017. For participants age 50 and over, the limit is $24,000. These limits are adjusted annually for inflation.
- Limits may be reduced if the employee participates in other deferral arrangements, such as a 401(k) sponsored by another employer, a 403(b) tax-deferred annuity or a 457(b) plan.
- Since many employers match all or a portion of an employee's deferral (or simply make additional contributions), the total amount actually contributed on behalf of an employee can exceed these limits. But the total amount from all sources cannot exceed the Section 415 limit for defined contribution arrangements—the lesser of 100% of compensation or $54,000 in 2017.

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Other Requirements…

- A 401(k) plan must meet the nondiscrimination requirements that apply to all qualified plans, along with other unique 401(k) requirements.
- Employees' elective deferrals must be fully vested at all times.
- There can be no discrimination between highly compensated employees (HCEs) and non-highly compensated employees (non-HCEs). Deferrals by HCEs are limited by the average deferrals of non-HCEs.
- Employer matching contribution rules must apply uniformly to all employees.
- Employee distributions cannot be based on completion of a certain period of participation or a certain number of years of service.

Withdrawals…

- While a 10% penalty tax generally applies to withdrawals taken before age 59½, employees may avoid this penalty under certain conditions, including:
    - The employee leaves the employer after age 55, dies or becomes totally disabled.
    - The employee receives distributions as a series of substantially equal periodic payments for life (or life expectancy).
    - The employee receives the distribution for medical care, within certain limitations.
    - The distribution is payable to an alternate payee under a "qualified domestic relations order" as defined by the IRS or by state law.
    - The distribution is to correct an earlier excess contribution or excess elective deferral.
- Withdrawals are generally taxed as ordinary income, except to the extent they represent a return of the employee's after-tax contributions.
- Required minimum distributions (RMDs) must generally begin no later than April 1 of the year following the year the employee reaches age 70½. However, employees may defer RMDs until actual retirement if it occurs after age 70½, unless they own more than 5% of the company. The plan terms must provide for the exception.

The Bottom Line…

401(k) plans offer an efficient, tax-advantaged way to prepare for retirement, often with a boost from employer contributions. The key to maximizing potential 401(k) retirement income is to start early, take full advantage of any matching or discretionary employer contributions, and defer as much out of current earnings as the contribution limits allow.

SUMMARY

What Is a 401(k)?

A 401(k) plan is an employer-sponsored qualified retirement plan allowing employees to defer a portion of their compensation. Employee deferrals are often supplemented by employer contributions.

How Are 401(k) Contributions Determined?

There are annual limits on how much an employee can defer. For employees under age 50, deferrals can't be more than $18,000 in 2017. Additional "catch-up" contributions permit participants age 50 and over to defer up to $24,000. These amounts are indexed annually for inflation.

These limits apply to the sum of all of the employee's deferrals to similar employer-sponsored defined contribution arrangements. In other words, 401(k) deferrals may be reduced if the employee also participates in other arrangements such as another employer's 401(k) plan, 403(b) tax-deferred annuity or 457(b) plan.

Since many employers match all or a portion of each employee's contribution (or simply make additional contributions), the total amount actually deposited into the employee's account can exceed the individual limit. Overall "annual additions" to an employee's 401(k) plan accounts from all sources—employee deferrals, employer matching contributions, possible employer profit-sharing contributions, etc.—cannot exceed the IRS Section 415 limit for defined contribution plans, which is the lesser of 100% of compensation or $54,000 in 2017.

What Is the Tax Treatment?

Elective deferrals are not included in an employee's gross income, which means that contributions are made with pre-tax dollars. Also, earnings inside a 401(k) plan accumulate on a tax-deferred basis.

The employer also gets a tax deduction, within certain limits, for contributions to the plan.

Employee withdrawals at retirement that exceed any nondeductible contributions made during the accumulation period (Roth contributions, for example) are generally taxed to the employee as ordinary income.

What About Distributions?

As noted, withdrawals from a 401(k) account generally are taxed as ordinary income unless they represent a return of after-tax contributions. Also, if a participant takes a withdrawal prior to age 59½, the participant will pay a 10% penalty tax on the taxable amount unless certain exceptions apply.

Required minimum distributions (RMDs) generally must begin no later than April 1 of the year following the year when the participant reaches age 70½. In some cases, however, the participant may defer RMDs until actual retirement, if it occurs later than that age. This special exception to the age 70½ rule applies only to participants who own 5% or less of the employing company.

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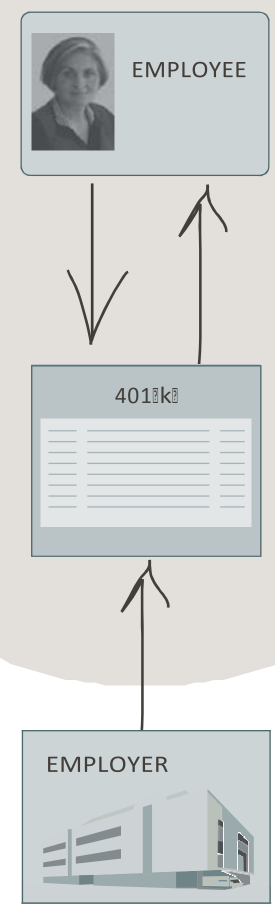

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An employee elects to defer a portion of salary into a 401(k) plan subject to annual contribution limits (which increase at age 50). (Any Roth deferrals are currently taxed but may then be withdrawn tax free when certain requirements are met.)

2

The employer may make matching and discretionary contributions to the plan. These contributions are deductible to the employer (subject to general limits) and tax deferred to the employee.

3

Earnings inside the plan grow tax deferred, allowing for greater accumulation.

4

The employee may begin taking distributions from the plan at age 59½, and must begin taking distributions by age 70½ or actual retirement, if later. Early distributions face a 10% penalty (with some exceptions). Distributions are taxed as ordinary income.

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