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Tax Newsletter

New Tax Angles to Roth 401(k) Plans
Changes under SECURE 2.0 Act

Although you are probably quite familiar with traditional 401(k) plans, you may know less about a variation, the Roth 401(k). This “newfangled” version of the 401(k) has actually been around for almost two decades. But the recent “SECURE 2.0” Act has created more interest in Roth 401(k)s.

If your employer currently does not offer a Roth 401(k) option, it will likely do so soon, because of the latest tax changes.

Basic premise: A Roth 401(k) combines several elements of traditional 401(k) plans and Roth IRAs for designated accounts. Like a traditional 401(k) plan, eligible employees can elect to defer part of their salary to a Roth-type account, up to annual limits indexed for inflation. The employer may also provide matching contributions based on a percentage of salary. Contributions and earnings continue to compound within the account without any current tax.

For 2024, a Roth 401(k) participant elect to defer up to $23,000 of their salary, plus they can add an extra $7,500 in “catch-up contributions” if they are age 50 or over, for a maximum total of $30,500. In comparison, regular Roth IRA contributions for 2024 are limited to $7,000, or $8,000 if age 50 or over. Also, the ability to contribute to a Roth IRA is phased out for high-income taxpayers, but there’s no corresponding restriction for Roth 401(k)s.

However, unlike a traditional 401(k), contributions to an employee's Roth 401(k) account are made through payroll withholding with *after-tax* dollars instead of *pre-tax* dollars. Therefore, you cannot realize one important benefit of traditional 401(k)s.

On the other side of the coin, qualified distributions from a Roth 401(k) made after the account has been in existence at least five years are completely exempt from federal income tax, just like qualified distributions from a Roth IRA. But regular 401(k) distributions are taxed at ordinary income rates currently topping out at 37%.

For this purpose, "qualified distributions" include any distributions—

- Made after the participant has attained age 59½; or
- Made due to death or disability.

Note: Qualified distributions from a Roth IRA also include withdrawals used to pay for “first-time homebuyer expenses” (up to a lifetime limit of $10,000).

This means that you can take a Roth 401(k) distribution after age 59½ without paying a penny of federal income tax, compared to the sizeable tax bill that is often due when traditional 401(k) plan owners receive distributions. Therefore, Roth 401(k) plans may appeal to certain high-income employees.

Update: SECURE 2.0 makes several critical changes in the rules, including the following:

- Normally, participants and beneficiaries older than a specified age must take required minimum distributions (RMDs) from traditional 401(k) accounts each year. This requirement also applied to Roth 401(k)s (unlike Roth IRAs). SECURE 2.0 raises the age threshold for RMDs from age 72, increased from 70½ by the initial SECURE Act, to age 73 (scheduled to increase to age 75 in 2033).

- SECURE 2.0 repeals the mandatory RMD rules for Roth 401(k) owners, beginning in 2024, eliminating a major drawback. However, beneficiaries of Roth 401(k)s still must take RMDs under complex rules.

- Catch-up contributions to 401(k) plans must be made to designated Roth accounts for employees earning more than $145,000 a year. This provision was scheduled to begin in 2024, but has been postponed to 2026 to allow employers more time to accommodate the change. So your company may be adding this feature shortly.

Should you switch from a traditional 401(k) to a Roth 401(k) under the current rules? It depends on your situation. Seek guidance from your professional advisors.

Q's and A's on Charitable Donations
When to bunch year-end gifts

Are you like millions of Americans who used to itemize deductions every year but do not do so anymore? Due to a myriad of provisions in the Tax Cuts and Jobs Act (TCJA) affecting individual taxpayers from 2018 through 2025, your approach may change year-to-year. It is not "automatic" anymore.

If you can get a clear handle on whether you will itemize in 2024, it may change your charitable gift-giving at year-end. The conventional wisdom is to "bunch" charitable contributions in a year you expect to itemize.

Q. How much can itemizers deduct?

A. The tax law limits are generous. Currently, if you make monetary contributions, you may deduct the full amount of your donations, up to 60% of your adjusted gross income (AGI). The limit is 30% of your AGI for gifts of property.

Added tax incentive: If you donate appreciated property that you have owned for more than a year, you can deduct the property's fair market value (FMV) on the donation date instead of its cost. Thus, if you are contemplating a large gift of appreciated property like securities or artwork, do it in a year you expect to itemize.

Q. Do you need any special documentation to substantiate your charitable deduction claims?

A. Yes. For monetary contributions of $250 or more, obtain a written acknowledgement from the charitable organization. For cash contributions under $250, you must have a bank record or written receipt from the charitable organization.

Other rules apply to gifts of property. For property valued above $500, but not over $5,000, your records must also include the following:

- The way you acquired the property (e.g., purchase, gift, bequest, inheritance or exchange);
- The approximate date you received the property or, if produced for you, when the property was substantially completed; and
- The cost or other basis, and any adjustments to the basis, of the property.

Finally, if you claim a deduction for property valued over $5,000, you must obtain an independent appraisal of the property.

Q. When is a charitable donation considered to be completed?

A. The controlling date is the date of delivery. For instance, if you give or mail a check to a charity, the donation is generally complete on that date, not when the charity cashes the check. Similarly, a donation by credit card is made on the date that it is charged. Thus, you can deduct a donation made online in December on your 2024 return—even if you actually pay the credit card company in January.

Q. Can you claim any deduction if you do not itemize?

A. No. Previously, non-itemizers could deduct up to $300 of monetary contributions ($600 for joint filers), but this tax break is no longer available. It is all-or-nothing.

Practical idea: See where you stand right now. Depending on your situation, you may move charitable gifts into 2024 or postpone them to 2025 or later. Your professional tax advisor can help you with these decisions.

Tap Into Key Tax Break

A self-employed client asked: Can I use Section 179 to deduct the cost of a laptop I just bought for both business and personal use?

Answer: Yes, if the laptop is placed in service this year, but you can only write off the portion attributable to business use. For example, if you use a laptop or other electronic device 50% for business and 50% personally, the deductible amount is limited to 50% of the total cost.

In addition, you may write off the cost of off-the-shelf software programs used for business purposes. Again, the deduction is based on the percentage of business use.

Facts and Figures
Timely points of particular interest

Extra Security—The federal government is ensuring greater protection of your sensitive tax information. Under a new Federal Trade Commission (FTC) rule, tax return professionals and other tax practitioners must use **multifactor authentication** (MFA) for their businesses, including any access to client data. What's more, the use of MFA is not merely a suggestion—the FTC requires it!

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