**Abstract:** As highly compensated employee (HCE) 401(k) plan participants approach retirement, a potentially useful tax-efficient IRA rollover technique may be a valuable savings tool. This brief article reviews IRS rules about how HCEs can allocate both pretax and after-tax employee contribution 401(k) assets between standard and Roth IRAs.

**IRS permits high-earner Roth IRA rollover opportunity**

Are you a highly compensated employee (HCE) approaching retirement? If so, and you have a 401(k), you should consider a potentially useful tax-efficient IRA rollover technique. The IRS has specific rules about how participants such as you can allocate accumulated 401(k) plan assets based on pretax and after-tax employee contributions between standard IRAs and Roth IRAs.

**High-earner dilemma**

In 2017, the top pretax contribution that participants can make to a 401(k) is $18,000 ($24,000 for those 50 and older). Plans that permit after-tax contributions (several do) allow participants to contribute a total of $54,000 ($36,000 above the $18,000 pretax contribution limit). While some highly compensated supersavers may have significant accumulations of after-tax contributions in their 401(k) accounts, the tax law income caps block the highest paid HCEs from opening a Roth IRA.

However, under IRS rules, these participants can roll dollars representing their after-tax 401(k) contributions directly into a new Roth IRA when they retire or no longer work for the companies. Thus, they’ll ultimately be able to withdraw the dollars representing the original after-tax contributions — and subsequent earnings on those dollars — tax-free.

**An example**

Participants can contribute rollover dollars to conventional and Roth IRAs on a pro-rata basis. For example, suppose a retiring participant had $1 million in his 401(k) plan account, $600,000 of which represents contributions. Suppose further that 70% of that $600,000 represents pretax contributions, and 30% is from after-tax contributions. IRS guidance clarifies that the participant can roll $700,000 (70% of the $1 million) into a conventional IRA, and $300,000 (30% of the $1 million) into a Roth IRA.

The IRS rules allow the retiree to roll over not only the after-tax contributions, but the earnings on those after-tax contributions (40% of the $300,000, or $120,000) to the Roth IRA provided that the $120,000 will be taxable for the year of the rollover.

Alternatively, the IRS rules allow the retiree to delay taxation on the earnings attributable to the after-tax contributions ($120,000) until the money is distributed by contributing that amount to a conventional IRA, and the remaining $180,000 to the Roth IRA.

Under each approach, the subsequent growth in the Roth IRA will be tax-free when withdrawn. Partial rollovers can also be made, and the same principles apply.

**Golden years ahead**

HCEs face some complex decisions when it comes to retirement planning. Let our firm help you make the right moves now for your golden years ahead.

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