Retirement Plan
Update

Wealth Management

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Because the time is now...

Make the most of your 401(k)

A 401(k) plan provides a convenient vehicle for saving for retirement, allowing you to contribute up to $19,500 in 2020 and additional amounts if you're aged 50 or older. There are two types of 401(k) plans: traditional and Roth-style plans. Traditional plans feature pretax contributions, which are taxed at ordinary rates when withdrawn in retirement. Roth plans offer after-tax contributions, but qualified withdrawals are tax free. With either plan type, employers may elect to match part or all of the contributions you make to your plan.

401(k) plans typically offer several options in which to invest contributions. If you leave your company, you may have the option to remain in the plan, or you can roll over the accumulated balance into an IRA or other retirement plan in a tax-free transaction. However, if you choose to physically receive part or all of your retirement account balance, you will typically have to pay taxes and penalties. Aside from terminating employment, funds cannot be withdrawn before age 59½ except in cases of extreme hardship. However, some 401(k)s allow you to borrow as much as 50% of your vested account balance, up to $50,000.

As more Americans shoulder the responsibility of funding their own retirement, many rely increasingly on their 401(k) retirement plans to provide the means to pursue their investment goals. That's because 401(k) plans offer a variety of attractive features that make investing for the future easy and potentially profitable.

Continued on page 2

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Continued from page 1

What is a 401(k) plan?

A 401(k) plan is an employee-funded savings plan for retirement. For 2020, you may contribute up to $19,500 of your salary to a special account set up by your company, although individual plans may have lower limits on the amount you can contribute. Individuals aged 50 and older can contribute an additional $6,500 in 2020, so-called "catch-up" contributions.

How are 401(k) plans taxed?

401(k) plan accounts come in two varieties: traditional and Roth.

With a traditional 401(k) plan account, you may defer taxes on the portion of your salary contributed to the plan until the funds are withdrawn in retirement, at which point contributions and earnings are taxed as ordinary income.[1] In addition, because the amount of your pretax contribution is deducted directly from your paycheck, your taxable income is reduced, which in turn lowers your current tax burden.

A Roth 401(k) plan account features after-tax contributions but tax-free withdrawals in retirement. Under a Roth plan, there is no immediate tax benefit. However, plan balances have the potential to grow tax free; you pay no taxes on qualified distributions.

Matching contributions

One of the biggest advantages of a 401(k) plan is that employers may match part or all of the contributions you make to your plan. Typically, an employer will match a portion of your contributions, for example, 50% of your first 6%. Matching contributions are maintained in a separate tax-deferred account, which is taxable when withdrawn. Total contributions, including employee and employer portions, cannot exceed $57,000 in 2020. Note that employer contributions may require a "vesting" period before you have full claim to the money and their investment earnings.

Distributions

Qualified distributions from traditional plan accounts and from the earnings portion of Roth accounts are permitted after age 59½ (or age 55 if you are separating from service with the employer from whose plan the distributions are withdrawn), although there are certain exceptions for hardship withdrawals. Distributions from employee contributions to a Roth account may be taken penalty free at any time. If a distribution is not qualified, a 10% additional federal tax will apply in addition to ordinary income taxes on all pretax contributions and earnings.

When you change jobs

When you change jobs or retire, you generally have four different options for your plan balance:

1. Keep your account in your former employer's plan, if permitted
2. Transfer balances to your new employer's plan
3. Roll over the balance into an IRA
4. Take a cash distribution

The first three options generally entail no immediate tax consequences; however, taking a cash distribution will usually trigger 20% withholding, a 10% additional federal tax if taken before age 59½, and ordinary income tax on pretax contributions and earnings.

Borrowing from your plan

One potential advantage of many 401(k) plans is that you may borrow as much as 50% of your vested account balance, up to $50,000. In most cases, if you systematically pay back the loan with interest within five years, there are no penalties assessed to you. If you leave the company, however, you may have to pay back the loan in full, depending on your plan's rules. In addition, loans not repaid to the plan by the due date of your federal tax return are considered withdrawals and will be taxed and penalized accordingly.[2]

Choosing investments

Most plans provide you with several options in which to invest your contributions. Such options may include stocks for growth, bonds for income, or cash equivalents for protection of principal. This flexibility allows you to spread out your contributions, or diversify, among different types of investments, which can help keep your retirement portfolio from being overly susceptible to different events that could affect the markets.

401(k) advantages

- Pretax contributions and tax-deferred earnings on traditional plans
- Tax-free withdrawals for qualified distributions from Roth-style plans
- Choice among different asset classes and investment vehicles
- Potential for employer matching contributions
- Ability to borrow from your plan under certain circumstances

A 401(k) plan can become the cornerstone of your personal retirement savings program, providing the foundation for your financial future. Consult with your plan administrator or financial professional to help you determine how your employer's 401(k) plan could help make your financial future more confident.

[1]Penalty-free "coronavirus-related" distributions (CRDs) may be available in 2020 under the CARES Act.

[2]Higher loan limits and delayed repayment terms may apply for certain loans in 2020 under the CARES Act.

Stock investing involves risk, including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise, and bonds are subject to availability and change in price. An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund may seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund. Diversification and asset allocation do not ensure a profit or protect against a loss.

What the CARES Act means for retirement plan participants

Questions and answers on parts of the law that are relevant to participants in qualified retirement plans.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act offers about $2 trillion in funds to help the nation weather the pandemic. The portions of the law that are particularly relevant to individuals who participate in qualified retirement plans are highlighted in the questions and answers that follow.

Please be aware that the CARES Act does not require retirement plans to include the early distribution and loan provisions discussed below. Participants should check with their plan to determine which options, if any, are available to them.

May participants affected by the coronavirus take an early distribution from their retirement plan without incurring a penalty?

Possibly, if their plan provides for "coronavirus-related distributions" and they qualify for the distribution. Under the CARES Act, coronavirus-related distributions of up to $100,000 from a retirement plan or individual retirement account (IRA) made to a qualifying individual are not subject to the 10% additional tax that generally applies to distributions taken before age 59½.

What is the time frame for taking these penalty-free distributions?

Distributions may be taken on or after January 1, 2020, and before December 31, 2020.

Who qualifies for the distributions?

Individuals who are diagnosed with the virus SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention qualify, as do individuals whose spouse or dependent is diagnosed with the virus or disease. Other qualifying individuals include those who experience adverse financial consequences as a result of:

- Being quarantined, furloughed, laid off, or having work hours reduced due to the SARS virus or coronavirus disease
- Being unable to work due to lack of child care due to the virus or disease
- Closing or reducing hours of a business they own or operate due to the virus or disease
- Other factors as determined by the Treasury Secretary

How are coronavirus-related distributions taxed?

The taxable amount of a coronavirus-related distribution is included in gross income ratably over three tax years. Alternatively, taxpayers may elect to include the entire taxable amount in income in the year received.

May distributions be repaid to the plan or IRA?

Yes. Individuals may repay the amount distributed by making one or more contributions at any time during the three-year period following the date of distribution. These repayments would be treated as rollover contributions and would not be subject to income tax or to the retirement plan's contribution limits. Rollovers could be made to either the plan or another IRA.

Continued on page 4

Continued from page 3

Are plan loan limits increased by the CARES Act?

Yes. The law doubles the current retirement plan loan limits to the lesser of $100,000 or 100% of the participant's vested account balance in the plan. The increased loan limits are effective for the 180-day period beginning March 27, 2020 and ending on September 22, 2020. These increased loan limits are only applicable in retirement plans that have adopted them, and participants may take advantage of the higher limits and the loan repayment relief described next only if they qualify. The qualifying conditions are the same as those outlined above for coronavirus-related distributions.

Are plan loan repayments affected?

Yes. If their plan so provides, qualifying individuals with an outstanding loan (on or after March 27, 2020) can delay loan repayments due during the period from March 27, 2020 to December 31, 2020 for up to one year.

Are required minimum distributions (RMDs) affected by the CARES Act?

Yes. The law permits 2020 RMDs from defined contribution retirement plans (and 2019 RMDs that need to be taken by April 1, 2020) to be delayed for one year. Individuals who have already taken these RMDs may roll the amounts into their retirement plan if the plan allows.

Does this RMD relief only apply to 401(k) plans?

No. Other defined contribution plans, such as Section 403(b) plans, Section 457(b) plans, and IRAs, are included in the RMD waiver.

Does the CARES Act provide additional help for individuals?

Yes. Other important provisions include:

- **Recovery rebate for individuals.** Individuals will be eligible for a 2020 advance refundable tax credit of up to $1,200 ($2,400 for married couples filing a joint return), plus $500 for each child under 17 years old. This rebate will be reduced by 5% of adjusted gross income (AGI) in excess of $150,000 for a joint return, $112,500 for a head of household, and $75,000 for all others. Returns filed for 2019 will be used to determine AGI for rebate purposes. Alternatively, if a 2019 return hasn't been filed yet, the IRS will use a taxpayer's 2018 return (or if no 2018 return has been filed, the individual's Form SSA-1099, Social Security Benefit Statement, or Form RRB-1099, Social Security Equivalent Benefit Statement).
- **Charitable contributions.** For tax year 2020, taxpayers who do not itemize their deductions may deduct from gross income up to $300 of cash contributions to qualified charitable organizations.
- **Employer payments of student loans.** Employees may exclude from income student loan repayments made after March 27, 2020 and before January 1, 2021 under an employer's educational assistance program, subject to the overall annual limit of $5,250 that applies to these programs.

As always, you should consult with your retirement plan administrator for information about your plan's specific provisions and your tax advisor for guidance on how to best navigate this new law and what portions of it are most relevant to you and your financial situation.

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