The University of California
Retirement Savings Program

Prepared for the UCRS Advisory Board:

Addition of ROTH accounts to RSP offering

Originally presented: June 19, 2020

Addendum presented: February 26, 2021

UNIVERSITY OF CALIFORNIA Retirement Savings Program

Comparison of Pretax and Roth features

	Pretax 403(b)/457(b)	Designated Roth 403(b) /457(b)
Employee Elective Contributions	Made with ***before-tax dollars***.	Made with ***after-tax dollars***.
Maximum Elective Contribution	*Aggregate** employee elective contributions limited to $19,500 in 2020 (plus an additional $6,500 in 2020 for employees age 50 or over). *Share aggregate** employee elective as Designated Roth 403(b) /457(b)Account, if also offered.	*Share aggregate** employee elective with Pretax 403(b)/457(b) Account, if also offered.
Taxation of Withdrawals	Withdrawals of contributions and earnings **are** subject to Federal and most State income taxes.	Withdrawals of contributions and earnings are **not** taxed provided it's a **qualified distribution** – the account is held for at least 5 years and made: •On account of disability, •On or after death, or •On or after attainment of age 59½.
Required Distributions	Distributions must begin no later than age 72 (age 70 ½ if reached age 70 ½ before January 1, 2020), unless still working.	Same as Pretax 403(b)/457(b) Account, but not subject to taxation.

* You can split your annual elective deferrals between designated Roth contributions and traditional pre-tax contributions, but your combined contributions can't exceed the deferral limit - $19,500 in 2020 ($26,000 in 2020 if you're eligible for catch-up contributions).

Conditions for tax-free Roth distributions

What is a qualified distribution from a designated Roth account?
Generally a distribution that is made after a 5-taxable-year period of participation and is either:

1. made on or after the date you attain age 59½
2. made after your death, or
3. attributable to your being disabled.

If a distribution is made to your alternate payee or beneficiary, then your age, death or disability is used to determine whether the distribution is qualified.

A qualified distribution from a designated Roth account is not included in your gross income.

What is a 5-taxable-year period of participation? How is it calculated?
It begins on the first day of your taxable year for which you first made designated Roth contributions to the plan. It ends when five consecutive taxable years have passed. If you make a direct rollover from a designated Roth account under another plan, the 5-taxable-year period for the recipient plan begins on the first day of the taxable year that you made designated Roth contributions to the other plan, if earlier.

What happens if I take a distribution from my designated Roth account before the end of the 5-taxable-year period?
It is a nonqualified distribution. You must include the earnings portion of the nonqualified distribution in gross income. However, the basis (or contributions) portion of the nonqualified distribution is not included in gross income. The basis portion of the distribution is determined by multiplying the amount of the nonqualified distribution by the ratio of designated Roth contributions to the total designated Roth account balance.

Roth versus Pretax outcomes

Scenario: Tax rates are the <u>same</u> at time of contributions and withdrawal

The pretax and Roth options yield the same net distribution amount.

	Pretax 403(b)/457(b)	Roth 403(b)/457(b)
Pre-tax income	$5,000	$5,000
Taxes[1] at contribution	0	1,000
Initial contribution	5,000	4,000
Balance after 20 yrs[2]	20,000	16,000
Taxes[1] at distribution		
principal	1,000	0
earnings	3,000	0
Net distribution amount	**$16,000**	**$16,000**

[1] Assumes 20% federal tax rate

[2] Assumes initial contribution grows x4 during 20 yr accumulation period

Current and future estimated tax brackets

The table below shows estimated 2040 and 2060 income ranges for each tax bracket, assuming the current rate schedule is unchanged.

	Income Now		Income in Retirement			
marginal tax rate	2020 (actual)		2040 (estimate)		2060 (estimate)	
	low	high	low	high	low	high
10%	$ -	$ 9,875	$ -	$ 14,674	$ -	$ 21,804
12%	$ 9,876	$ 40,125	$ 14,675	$ 59,624	$ 21,807	$ 88,598
22%	$ 40,126	$ 85,525	$ 59,625	$ 127,086	$ 88,600	$ 188,843
24%	$ 85,526	$ 163,300	$ 127,087	$ 242,655	$ 188,845	$ 360,573
32%	$ 163,301	$ 207,350	$ 242,657	$ 308,111	$ 360,575	$ 457,837
35%	$ 207,351	$ 518,400	$ 308,113	$ 770,315	$ 457,839	$ 1,144,648
37%	$ 518,400		$ 770,315		$ 1,144,648	$ -

Based on 2020 federal tax brackets for single filers. Estimate assumes tax brackets are indexed to 2% inflation rate.

Who may prefer a Roth option?

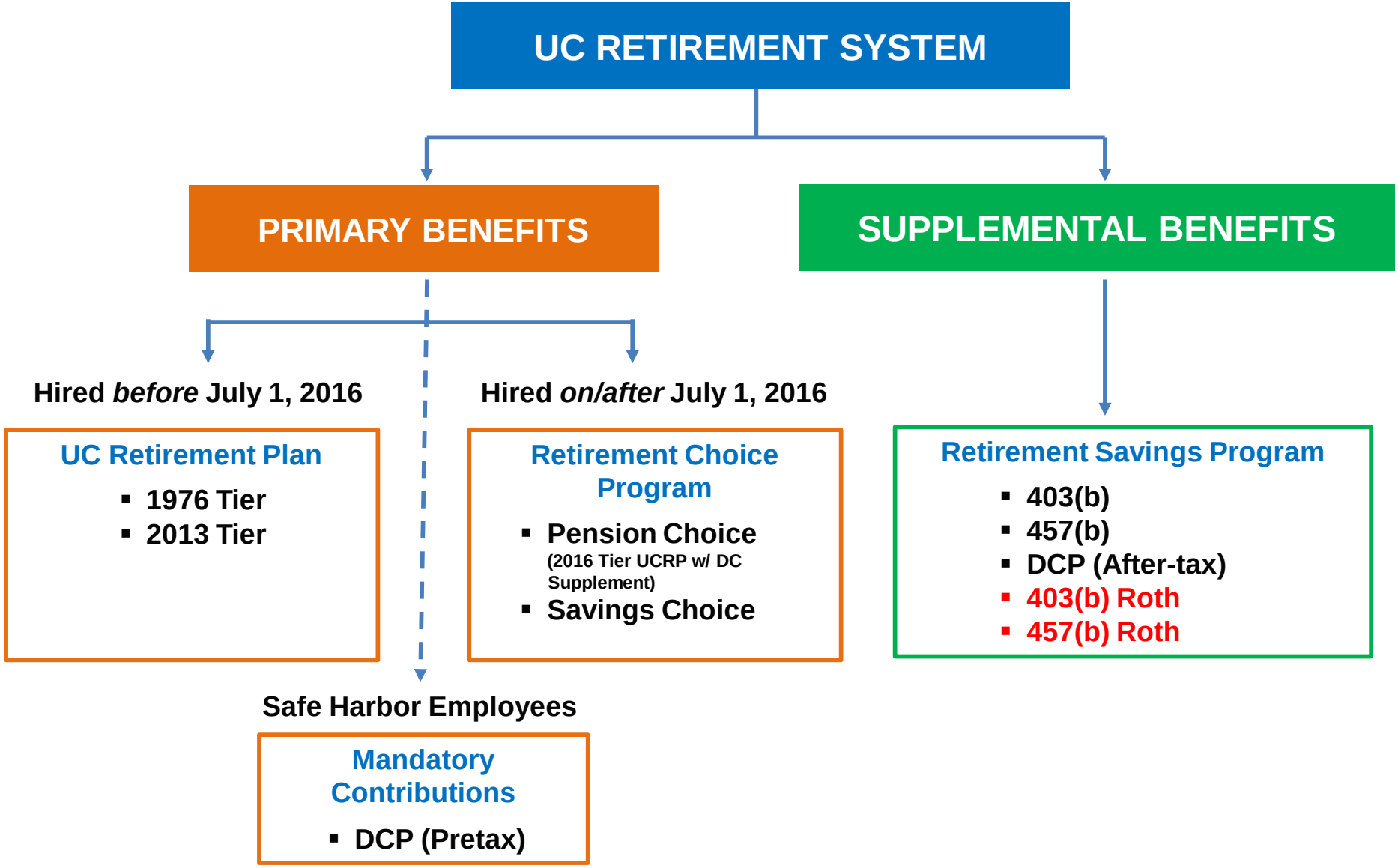
- Want qualified tax-free distributions in retirement.
  - Expect to be subject to a higher tax rate in retirement.
  - Want tax diversification of having both after-tax and tax-deferred assets as a hedge against potential tax increases.
  - Have a long retirement horizon that will allow time to accumulate significant tax-free earnings which can be withdrawn tax-free.

- Are unable to optimize outside Roth IRA.
  - Cannot have a Roth IRA due to IRS income restrictions.
  - Want to make Roth contributions in excess of Roth IRA limits.

- Want the option to postpone required minimum distributions at age 72 (requires rollover to a Roth IRA).

- Want to pass on assets tax-free to heirs.

UC Retirement System Benefit Portfolio



Alternatives that provide after-tax benefits

Roth Individual Retirement Account (direct)

Roth IRAs are available through outside financial institutions. The maximum contributions in 2020 is $6,000 ($7,000 if age 50+) for those making up to $124,000 single/$196,000 married (modified adjusted gross income). Gradual reduction which disappears completely at $139,000 single/$206,000 married.

Additional benefits: First time home purchase eligible for qualified distribution; No MRDs while owner is alive.

Roth IRA (via UC DCP After-tax Account)

High income employees who are unable to maximize Roth IRA contributions can convert their DC Plan After-tax Account monies into a Roth IRA.

Additional benefits: The contribution limit is higher than would be allowed through a 403(b) or 457(b) plan – generally, $19,500 vs $57,000. First time home purchase eligible for qualified distribution; No MRDs while owner is alive.

Decision and implementation

- ❑ Plan Administrator assessment and recommendation
- ❑ UC Board of Regents approval
- ❑ UCPath and Fidelity systems programming
- ❑ Communications and education redesign
- ❑ Systemwide staff training (local benefits, UCPath and RASC service teams)

Addendum

For discussion February 26, 2021

UNIVERSITY OF CALIFORNIA Retirement Savings Program

Current and future estimated tax brackets

inflation rate: 2% | years from 2020: 11 | years from 2020: 20 | years from 2020: 40

marginal tax rate	2020 (actual)		2031 (estimate)		2040 (estimate)		2060 (estimate)	
	low	high	low	high	low	high	low	high
10%	$ -	$ 9,875	$ -	$ 12,038	$ -	$ 14,674	$ -	$ 21,804
12%	$ 9,876	$ 40,125	$ 12,039	$ 48,912	$ 14,675	$ 59,624	$ 21,807	$ 88,598
22%	$ 40,126	$ 85,525	$ 48,913	$ 104,254	$ 59,625	$ 127,086	$ 88,600	$ 188,843
24%	$ 85,526	$ 163,300	$ 104,256	$ 199,062	$ 127,087	$ 242,655	$ 188,845	$ 360,573
32%	$ 163,301	$ 207,350	$ 199,063	$ 252,758	$ 242,657	$ 308,111	$ 360,575	$ 457,837
35%	$ 207,351	$ 518,400	$ 252,760	$ 631,927	$ 308,113	$ 770,315	$ 457,839	$ 1,144,648
37%	$ 518,400		$ 631,927	$ -	$ 770,315		$ 1,144,648	$ -

Jay - Hired as Assistant Professor

Hire age:		27	**Retire age:**	67	(40 yrs of service)
Hire date:		2020	**Retire date:**	2060	
Starting pay:	$	70,000	**2020 marginal tax rate:**	22%	
Annual increase		4%			
Pay in 2031:	$	107,762	**2031 marginal tax rate:**	24%	
Pay in 2040:	$	153,379	**2040 marginal tax rate:**	24%	
Pay in 2060:	$	336,071	**2060 marginal tax rate:**	24%	Pension = 100% of pay