A GUIDE TO

Pre-Tax and Roth Contributions

MNDCP Minnesota Deferred Compensation Plan

Tax Flexibility for Your Retirement Income

The Minnesota Deferred Compensation Plan (MNDCP) offers you the opportunity to save Pre-Tax dollars, Roth After-Tax dollars or both. There are different tax advantages to each choice. This guide provides information that may help you decide which type of contribution is the better option for you. Ask your employer if you are allowed to make Roth contributions to your MNDCP account.

PRE-TAX ▶ Pre-tax contributions are tax-deferred. This means that taxes aren't withheld when you contribute, which lowers your current taxable income by the amount you contribute. Instead, you pay federal and state (if applicable) income taxes at the time you take a withdrawal of your money.

ROTH AFTER-TAX ▶ Roth contributions are made with after-tax dollars. This means you have already paid taxes on the funds contributed. The contributions and any investment earnings are tax-free at the time you take a qualified withdrawal of your money.

Tax-free qualified withdrawals may be particularly important when you need to withdraw a large amount in one year. Some examples include large medical expenses, extensive travel or to purchase a new car.

Benefits of MNDCP

Convenient Investing

Money is automatically set aside using automatic payroll deductions

Investment Flexibility

Select from a menu of investment options offered by the MNDCP

Higher Contribution Limits

You can contribute more into an MNDCP account than into an IRA

Comparing Pre-Tax & Roth After-Tax Options

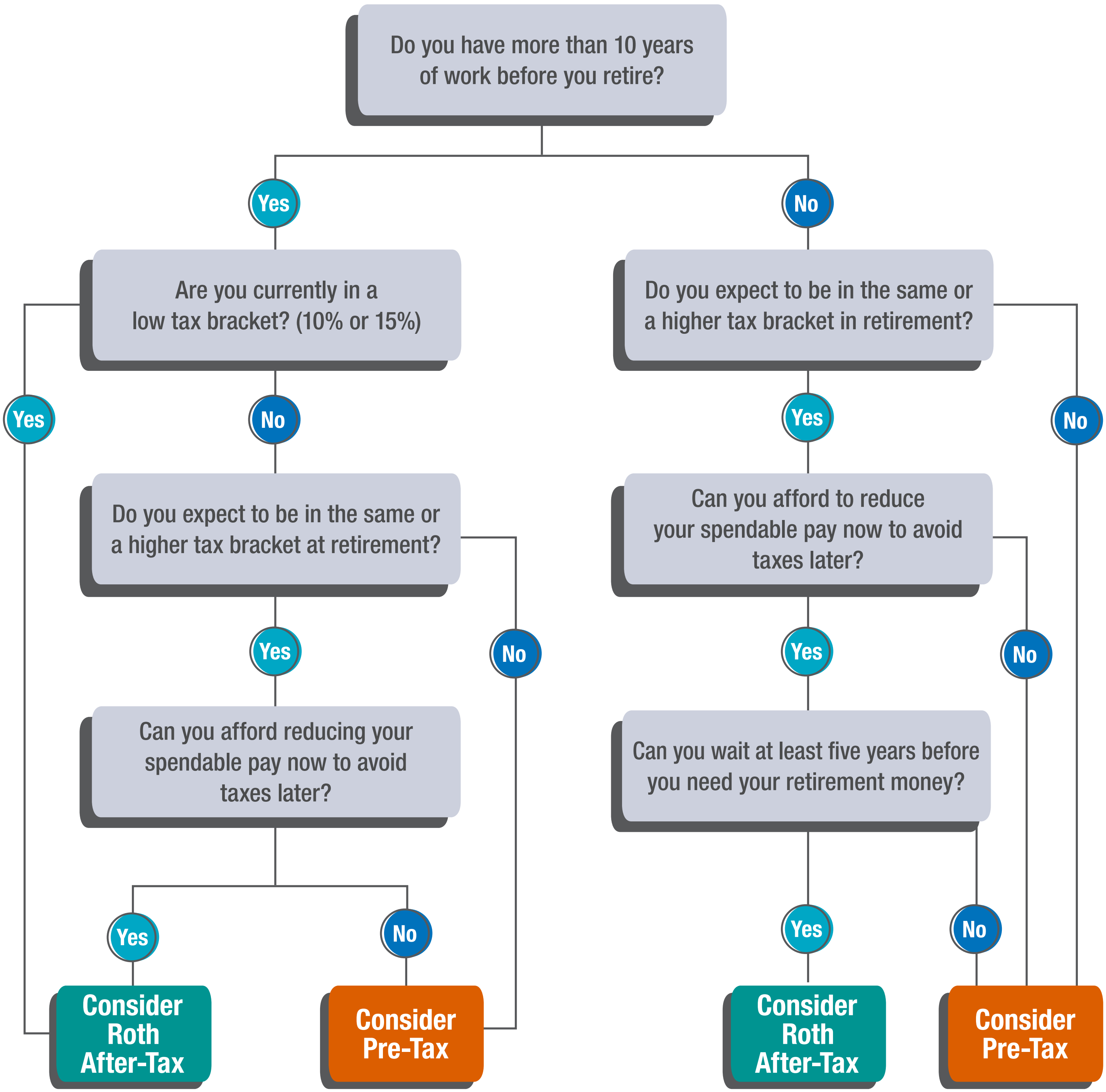
	PRE-TAX	ROTH AFTER-TAX
When you contribute	Pre-tax contributions are deducted from your paycheck before income taxes are withheld. This reduces your current taxable income.	Roth contributions are subject to federal, state, and local (if applicable) income tax withholding.
Investment earnings	Any earnings grow tax-deferred.	Any earnings grow tax-free.
When you withdraw	Contributions and any earnings are taxable as ordinary income.	Contributions and any earnings are tax-free assuming the withdrawal meets the definition of a "qualified distribution.*"
Required Minimum Distribution (RMD)	The IRS requires annual minimum distributions to begin the year you turn age 72 or retire, whichever is later. A 50% IRS penalty tax applies to any RMD amount not distributed.	
You can benefit if you	• Expect to be in a lower tax bracket later in life • Want to reduce your current income taxes	• Expect to be in a higher tax bracket later in life • Are in a lower tax bracket today or have other large tax deductions • Want tax-free withdrawals later in life • Want the option of not taking RMD amounts at age 72 (if you rollover to a Roth IRA)* • Want to save after-tax dollars in a Roth IRA but your earnings exceed the Roth IRA income limitations.

* Roth qualified distributions: A qualified distribution is tax-free if the withdrawal is made on or after age 59½ or after your death and five years have passed since you made your first Roth contribution. If your distribution does not meet these requirements, any earnings on your Roth contributions are taxable.

As with any financial decision, you are encouraged to discuss moving money between accounts, including rollovers, with a financial advisor and to consider costs, risks, investment options and limitations prior to investing.

What is the Best Path for You?

Answer the questions below based on your individual circumstances, including your age and your tax rate today and potential rate in retirement. Follow the path to determine which option may be best for you.



The chart assumes you are contributing the same amount to the plan, whether you choose a traditional pre-tax contribution or a Roth after-tax contribution. With that approach, your spendable pay would be reduced during your working years by the amount of tax paid on the Roth after-tax contributions.

This chart is only intended to be a tool that can indicate which type of contribution might be right for you and is not intended to be tax, legal, or accounting advice. Your specific circumstances are not taken into account and may call for a different approach than the one indicated in the chart. Before deciding on a type of contribution, talk with a professional who can take into account any special factors that apply to you.

You Can Choose BOTH

A combination of Pre-Tax and Roth After-Tax contributions may be right for you if:

You like the idea of tax-free retirement income, but also like the current tax deduction on your pre-tax contributions.

You believe your taxes in retirement will be about the same or are unsure where taxes are headed in the future.

You would like the flexibility to optimize your tax strategy year-to-year as you withdraw your retirement income.

This information is provided for educational use only and is not intended as advice. Please consult with a professional to discuss these types of tax considerations before making a decision. MSRS representatives are not able to personally advise on your decision.

Frequently Asked Questions

What are the features of the Roth?

- Roth contributions are deducted from your pay on an after-tax basis unlike pre-tax contributions that reduce your current taxable income.
- A distribution of your Roth contributions and any earnings are tax-free as long as it is a "qualified distribution."

What is a "qualified distribution"?

A Roth distribution is tax-free, or qualified as long as a two-prong test is met.

1. When a 5-year holding period is satisfied. The 5-year holding period begins on the first day of the taxable year in which you made an initial Roth contribution to your MNDCP account. It ends when 5 consecutive taxable years have passed.
2. The distribution occurs on or after age 59½ (assuming you have separated from service, are disabled, or a distribution is made to your beneficiary(ies) after your death).

Can I contribute both pre-tax and after-tax dollars?

Yes. You may designate some or the entire amount as a Roth after-tax contribution or a traditional pre-tax contribution, or both. And, you can make adjustments at any time.

If a distribution is not "qualified," how is it taxed?

A distribution taken before the end of the 5-year holding period or prior to age 59½ is considered a "non-qualified distribution." Any earnings would be taxed as ordinary income; however, the contribution portion of the distribution is tax-free since taxes were already paid on that portion.

How much can I contribute?

Your combined pre-tax and Roth after-tax contributions can't exceed the IRS annual limits. The limits change each year. Refer to the MSRS website or contact us to inquire about the limits.

Can I contribute after-tax dollars to both MNDCP and a Roth IRA?

Yes, assuming you qualify for a Roth IRA (based on income limits). Participation in an employer-sponsored retirement plan like your MNDCP 457(b), a 403(b), or a 401(k) does not limit the contribution amount to a Roth IRA. You could contribute the maximum amount to a Roth 457 plan and, if eligible, to a Roth IRA.

How do I start making Roth contributions?

If your employer allows Roth after-tax contributions, you can make changes by calling the MSRS Service Center or by accessing your Account Online.

Note: State of Minnesota employees can make changes by calling the MSRS Service Center or on the state employee Self-Service website.

How will contributing after-tax dollars affect my take-home pay?

It could reduce it. Unlike traditional pre-tax contributions, Roth after-tax contributions won't reduce your current taxable income. So you'll actually be paying taxes on a higher amount, which could reduce your take-home pay.

	PRE-TAX CONTRIBUTIONS	ROTH AFTER-TAX CONTRIBUTIONS
Gross Income	$50,000	$50,000
Pre-Tax Contribution	-$5,000	N/A
Taxable Income	$45,000	$50,000
25% Income Tax Rate	-$11,000	-$12,500
After-Tax Income	$33,750	$37,500
Roth After-Tax Contribution	N/A	-$5,000
Take-Home Pay	$33,750	$32,500

Contributing Roth after-tax dollars may also affect your ability to take other tax credits and deductions (for example, student loan deductions, medical expense deductions, and child care tax credits). Whether you qualify for these credits and deductions depends on your income level. Since Roth contributions won't reduce your adjusted taxable income, your eligibility for these tax reductions could be impacted.

Questions?

Contact the MSRS Service Center:
1.800.657.5757 or 651.296.2761

Go online:
www.msrs.state.mn.us

Email us:
info@msrs.us

Make an appointment to speak with a retirement representative at one of our offices.

Locations

St. Paul - Main Office
60 Empire Drive, Suite 300
St. Paul, MN 55103
Monday – Friday 8 a.m. - 4:30 p.m.

Additional Offices
Addresses and hours of operation available online.

- Duluth
- St. Cloud
- Mankato
- Detroit Lakes

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MSRS

Minnesota State Retirement System
MNDCP Minnesota Deferred Compensation Plan
HCSP Health Care Savings Plan

1.800.657.5757 or 651.296.2761
www.msrs.state.mn.us

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