

Retirement Planning Opportunities

Roth 401(k) Plans – Tax Free Distributions

Roth 401(k) Plans

Your clients can now add Roth deferral accounts to their 401(k) plans. The participants can then make after-tax Roth deferrals to the plan.

This is an optional provision, however, so your clients can decide whether or not to allow for Roth 401(k) salary deferrals. Additionally, unlike the Roth IRA, there are no income limitation rules for these Roth 401(k) deferrals. Participants at any income level can elect to make them.

Both Pre-Tax and After-Tax Salary Deferrals Allowed

These after-tax deferrals do not necessarily replace the pre-tax deferrals. The 401(k) plan can be structured so the participants can choose to make their salary deferrals entirely pre-tax or a combination of pre-tax and after-tax.

Maximum Deferrals

The maximum elective salary deferral for each participant will not change. It will remain \$15,500* for 2008, regardless of whether the participant makes pre-tax or after-tax deferrals. Participants who are age 50 or older can still defer an additional \$5,000* in 2008, and this catch-up contribution can be made to the Roth 401(k) account.

Pre-Tax Matching Contributions

The matching contributions are always made on a pre-tax basis even for Roth after-tax deferrals.

*Both these deferral limits are indexed for inflation and may increase in the future.

Tax Free Distributions

Distributions from a 401(k) plan may be made upon:

- Death
- Disability
- Termination of Employment
- Attainment of age 59 1/2
- Hardship

Qualified distributions from the Roth 401(k) accounts may be income tax free. To be qualified distributions, the distributions must be made due to death, disability or attainment of age 59 1/2 and they are made after the five-year exclusion period. The five year exclusion period begins on the earlier of:

- the first year that a Roth account is set up in the plan or,
- if a Roth rollover is made, the first taxable year that a Roth contribution is made.

When your clients take qualified distributions like those described above, the earnings on their Roth 401(k) accounts are income tax-free.

Rollovers Possible to Roth IRAs or Other Roth Accounts

Participants can roll qualified distributions from their Roth accounts over to Roth IRAs or to another 401(k) or 403(b) plan with Roth 401(k) or Roth 403(b) accounts. Rollovers from Roth IRAs to Roth 401(k) accounts are not allowed.

Pre-Tax Contributions Cannot Be Converted

The participants must designate

whether their deferrals are pre-tax or after-tax prior to the date of contribution. They cannot change these contributions from pre-tax to after-tax after the contributions are made.

Additionally existing pre-tax deferrals cannot be converted into Roth after-tax deferrals.

Loans May Be Available

The assets in the Roth 401(k) accounts are available for loans as long as the plan document allows for loans.

ADP/ACP Tests

The Roth deferrals are included with and treated like pre-tax elective deferrals for the purposes of the ADP test. And, even though they are after-tax, the Roth contributions are not included with the after-tax contributions for the ACP tests.

What Administrative Changes Are Needed?

If an employer wants to include Roth deferrals in his or her 401(k) plan, then he or she must adopt an amendment by the end of the plan year in which the plan first sets up Roth accounts. The plan servicing firm will also need to keep track of some additional separate accounts so the employer may incur some additional administrative costs.

Need More Information?

Don't hesitate to contact me for additional information.

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