

Roth 401(k): The Final Regulations Have Arrived - and None Too Soon

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Effective January 1, 2006, 401(k) plans may be amended to allow for Roth contributions. On December 30, 2005, the Treasury Department issued Final Regulations containing much of the guidance needed to add this option to a 401(k) plan. Highlights of these regulations provide the following guidance:

Plan Document

Before the Roth option is available to participants, the plan document must be amended to allow for designated Roth contributions. Plan sponsors may amend a plan at any time to apply the designated Roth contribution provisions going forward. There will be no retroactive designated Roth contributions.

In those cases where the plan provides automatic ("negative") deferral elections, the plan document will have to identify whether the contribution, absent the participant's designation, is a pre-tax elective contribution, a designated Roth contribution, or a combination of the two. Default to a designated Roth contribution is irrevocable.

Designated Roth Contributions

- Designated Roth contributions are defined as elective contributions.
- Designated Roth contributions are, at all times, nonforfeitable.
- The distribution restrictions generally applicable to pre-tax elective contributions will apply to designated Roth contributions.
- Designated Roth contributions are accounted for under the actual deferral percentage test in the same manner as pre-tax elective contributions.
- Catch-up contributions may be designated Roth contributions.
- Designated Roth contributions may be borrowed under the

plan's participant loan program.

- Designated Roth contributions may be made by any person eligible to participate in the plan -- even participants whose income makes them ineligible to make contributions outside the plan to a Roth IRA.

Election is Irrevocable

Once a participant designates his or her contribution as a Roth contribution, the designation is irrevocable. The election is made as the participant's elective deferral election which will either be designated as pre-tax or Roth. There will be no opportunity to move Roth dollars to pre-tax elective contribution dollars or vice versa.

Employer Treatment

The employer will treat the designated Roth contribution as includible in the employee's income when he or she would have received it but for the contribution election. The designated Roth contribution will be treated as wages subject to applicable withholding requirements.

Separate Accounts

The plan must maintain separate Roth accounts for each participant electing to make a designated Roth contribution. The account will track its own distributions, earnings, gains, losses, credits, and other charges, separately allocated on a reasonable and consistent basis. Direct rollovers of Roth accounts are to be allocated to a separate Roth account (or they may be rolled over to a Roth IRA) consistent with the rollover rules.

Roth Alone is Not Enough

A 401(k) plan that offers the opportunity to make a designated Roth contribution must also permit pre-tax elective contributions. Each participant who makes contributions could have both types of separate accounts; however both accounts are combined for purposes of the Code's annual limit on elective deferrals.

No Matching or Forfeiture Allocations

The employer may match designated Roth contributions, but the matching contributions cannot be placed in the Roth account. Additionally, there will be no allocation of forfeitures from any other benefit structure under the plan to a Roth account.

Minimum Distribution Requirements

With a Roth IRA, the minimum distribution requirements do not apply. The regulations, however, provide that a Roth 401(k) account is subject to minimum distribution requirements.

ADP Failure Corrections

A highly compensated employee who is to receive a refund of elective contributions in order to assist the plan in passing the ADP test and who has made both pre-tax and designated Roth contributions during the year of the failure may elect whether the excess contributions will come from pre-tax elective contributions or designated Roth contributions.

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