



ROTH 401(K) DEFERRALS

FAQS

■ **What are Roth deferrals and how do they differ from regular deferrals (pre-tax) to a 401(k) plan?**

In a “traditional” 401(k) plan, participants may elect to defer a portion of their current pay to the plan. These deferrals (known as “regular deferrals (pre-tax)”) are excluded from taxable income when deferred, but are taxed, along with earnings, when distributed from the plan. Thus, tax on regular deferrals and earnings is postponed.

Roth deferrals are made from after-tax pay. However, there is no taxation of the earnings attributable to the Roth deferrals when a “qualified” distribution of the Roth earnings is made from the plan. The result is that a distribution of the Roth earnings may be tax-free, rather than tax-postponed.

■ **Must a 401(k) plan offer the option of making Roth deferrals?**

No. This is a plan design issue. It is the choice of the 401(k) plan sponsor whether employees will be permitted to make Roth deferrals.

■ **May a 401(k) plan permit both regular deferrals (pre-tax) and after-tax Roth deferrals?**

Yes. The 401(k) plan sponsor may permit employees to make either of these deferrals. However, for simplicity, some sponsors may design their 401(k) plans to only permit participants to choose one type of deferral for a plan year.

■ **What are the primary differences between Roth deferrals to a 401(k) plan and an individual’s contributions to a Roth IRA?**

There are two key distinctions: (1) the different contribution limits, and (2) the individuals who are eligible to make the contributions.

The maximum amount that may be contributed to a 401(k) plan (either as Roth and/or as regular deferrals) is larger than the amount that may be contributed to a Roth IRA [for 2009, \$16,500 to a 401(k) plan (\$22,000, if the employee is able to make catch-up contributions) vs. \$5,000 to an IRA (\$6,000, if the individual is able to make catch-up contributions)].

In addition, an individual may be precluded from making a Roth IRA contribution if the individual has gross income in excess of certain dollar amounts. This restriction does not apply to Roth deferrals to a 401(k) plan. There are no restrictions on an employee’s ability to make Roth deferrals to a 401(k) plan solely because of the employee’s income.

■ **What is the maximum amount of Roth deferrals that an employee may make to a 401(k) plan?**

Even though the tax effect of Roth deferrals differs from regular deferrals, both are elective deferrals for purposes of the law. Accordingly, there is no distinction between the two types of deferrals in determining the contribution limits (as well as certain other operational requirements).

The deferral limit that applies to regular deferrals also applies to Roth deferrals. The 2009 calendar-year limit is \$16,500 (this may increase in future years based on cost-of-living increases). Furthermore, this maximum limit applies to the total of all Roth deferrals and regular deferrals to any 401(k) plan (or 403(b) plan).

ROTH 401(K) DEFERRALS (CONTINUED)

■ **May a participant who has attained age 50 by the end of a calendar year make “catch-up” contributions during the calendar year that are Roth deferrals?**

Yes. The catch-up rules that permit a participant who has attained age 50 by the end of the calendar year to make additional regular deferrals, also apply to Roth deferrals. However, the catch-up limit (\$5,500 for 2009) for a particular calendar year is determined by totaling all Roth deferrals and regular deferrals.

■ **When can distributions of Roth deferrals and earnings be made?**

Because Roth deferrals to a 401(k) plan are treated in the same manner as regular deferrals, the same distribution restrictions apply. In general, a distribution may only be made upon a hardship (but not the earnings), the attainment of age 59½, death, disability, or termination of employment.

■ **Can Roth deferrals to a 401(k) plan be used to make participant loans or to purchase life insurance?**

Yes. Roth deferrals in a 401(k) plan are subject to the same rules that apply to regular deferrals in a 401(k) plan. Unlike amounts in a Roth IRA, Roth deferrals in a 401(k) plan may be used to make participant loans and to purchase life insurance for the participant. These are optional provisions that a sponsor may permit.

■ **What is a “qualified” distribution?**

In order to avoid the taxation of earnings attributable to Roth deferrals, a distribution from the plan must be a “qualified” distribution. A “qualified” distribution is a distribution that is made after the participant attains age 59½, becomes disabled or dies. In addition, a “qualified” distribution occurs only if the distribution is made after the end of the five-year period beginning with the calendar year in which the participant first made a Roth deferral to the 401(k) plan (or to a prior plan if there is a rollover of Roth deferrals from the prior plan to the 401(k) plan).

■ **What happens if a distribution is not a “qualified” distribution?**

If a distribution from a participant’s Roth deferral account is not “qualified,” then the portion of the distribution in excess of the participant’s Roth deferrals is taxable. In other words, any distributed earnings attributable to Roth deferrals lose their nontaxable character when a distribution is not “qualified,” which is the primary benefit of making Roth deferrals. In addition, if a distribution is not “qualified,” then the distribution of these taxable earnings may be subject to a 10% premature distribution penalty tax.

■ **Are Roth deferrals to a 401(k) plan subject to nondiscrimination testing?**

Yes. The nondiscrimination test that applies to these deferrals is called the “ADP Test” (Actual Deferral Percentage test). This ADP test compares the deferrals (including both regular (pre-tax) and Roth deferrals) of highly compensated employees and non-highly compensated employees. If the ADP test fails, then either the plan must distribute some of the deferrals to the highly compensated employees or the plan sponsor must make additional contributions to the non-highly compensated employees.

■ **May Roth deferrals be made to a safe harbor 401(k) plan?**

Yes. A safe harbor plan satisfies the 401(k) nondiscrimination requirement (ADP test) by providing certain employer contributions and satisfying other requirements. Roth deferrals would be eligible for any employer matching contributions provided by the plan, if the plan satisfies the safe harbor requirement with matching contributions.

■ **May Roth deferrals be matched by the employer?**

Yes, a plan sponsor may design the plan to provide that deferrals will be matched, including Roth deferrals. However, employer matching contributions are pre-tax contributions. If matching contributions are not rolled over when distributed, then the distribution of the matching contributions is taxable as ordinary income (not tax-free) and may be subject to the 10% premature distribution penalty tax.

ROTH 401(K) DEFERRALS (CONTINUED)

■ **May a participant who makes Roth deferrals to a 401(k) plan also receive a profit sharing plan contribution?**

Yes. A 401(k) plan may permit any combination of deferrals (regular (pre-tax) or Roth), matching contributions, or profit sharing contributions. The qualified plan rules that limit the total contributions that may be made to any participant's account would apply.

■ **How does an employee indicate the intention to make Roth deferrals rather than regular deferrals?**

An employee makes a deferral election. As part of the election, the employee must designate which type of deferral is to be made. Once a deferral is made to the plan based on the participant's election, it is irrevocable. In other words, a deferral goes into a 401(k) plan either as a regular deferral (pre-tax) or as a Roth deferral. The character of the deferral as either regular (pre-tax) or Roth may not be subsequently changed.

■ **How does a 401(k) plan administrator distinguish between regular deferrals and Roth deferrals?**

The plan administrator is required to separately account for the Roth deferrals and the regular deferrals. This is to ensure that distributions are correctly reported to the IRS and participants.

■ **When must a 401(k) plan distribute Roth deferrals (including earnings)?**

Roth deferrals are subject to the same required minimum distribution rules that apply to other amounts in a tax-qualified retirement plan. These rules generally require distributions to begin soon after the later of a participant attaining age 70½ or the participant retiring. Also, upon the participant's death, any remaining account balance is subject to death distribution rules that require distributions from the Roth deferral account to occur over a period of years or over the life expectancy of the participant's designated beneficiary, subject to certain rollover rights of a surviving spouse.

■ **May a participant avoid having to commence distributions of Roth deferrals (and earnings) at age 70½ (or if later, after the participant retires)?**

Yes. Rolling over Roth deferrals (and earnings) from a 401(k) plan to a Roth IRA avoids the application of the required minimum distribution rules (but not the death distribution rules). In other words, for estate planning purposes, distributions from a Roth IRA can be postponed beyond age 70½.

■ **May a participant roll over a distribution from the participant's Roth deferral account?**

Yes. However, a participant may only roll over a distribution of a Roth deferral account to a Roth IRA, or to another 401(k) plan or 403(b) plan that has Roth deferral provisions.

■ **May a participant roll over a distribution from a Roth IRA into a 401(k) plan?**

In most cases, no. The only exception is if the Roth IRA was established and maintained exclusively to hold Roth deferrals and earnings that were rolled over from a 401(k) plan or a 403(b) plan. If the Roth IRA includes any other Roth amounts (e.g., contributions that were made directly to an IRA or Roth IRA), then the Roth IRA cannot be rolled over to a 401(k) plan.

■ **May a retirement plan other than a 401(k) plan have Roth accounts?**

Yes. A 403(b) plan (also known as a "tax-sheltered annuity" plan) established by certain educational or charitable organizations also may permit Roth deferrals.