

ROTH 401(K) ACCOUNTS

As of January 1, 2006, employers may now permit plan participants to make Roth 401(k) contributions under their 401(k) plans. Modeled after the Roth IRA, Roth 401(k) contributions are made on an after-tax basis and both the contributions and earnings on those contributions can be withdrawn tax free from the plan. Roth contributions are a separate type of employee elective contribution under a 401(k) plan, and employers may offer this option in conjunction with pre-tax elective deferrals.

Roth 401(k) accounts, however, have a significant advantage to Roth IRAs. Roth 401(k) contributions are not subject to the Roth IRA contribution limit (i.e., \$5,000 in 2006), but are instead subject to Section 402(g) of the Internal Revenue Code (the "Code") limit on contributions, under which the sum of Roth 401(k) and pre-tax elective deferrals cannot exceed \$15,000 in 2006. Moreover, if permitted by a plan, employees age 50 or older may elect to make additional "catch up" contributions in the form of Roth 401(k) contributions.

Generally, Roth 401(k) accounts are subject to the same Code rules that apply to other 401(k) contributions. Roth 401(k) contributions must be included in plan's nondiscrimination testing, and Roth 401(k) contributions will be subject to the minimum required distribution rules at age 70 ½. Contributions must also be nonforfeitable when made and generally cannot be withdrawn from the plan while in-service before age 59½ except for financial hardship.

Distributions of Roth contributions and any earnings thereon are free from federal taxation provided the distributions are qualified. Generally, a "qualified distribution" is a distribution made five years after the participant's first Roth contribution to a plan that permits this type of contribution, and that is made on account of a participant attaining age 59½, death or becoming disabled. Upon a separation from service, an employee may roll over a qualified or unqualified distribution to another eligible plan or Roth IRA without adverse tax consequences.

Requirements to Implement a Roth 401(k) Account

- **Plan Amendment** - Plans must be amended to permit Roth 401(k) contributions. The IRS recently released a sample plan amendment for plan sponsors who want to offer Roth contributions.
- **HR Requirements** - Roth contributions are treated as taxable wages subject to income and FICA withholding. Plan administrators will need to update their recordkeeping systems for these contributions and payroll administrators will need to update their systems for different income tax reporting requirements.
- **Third Party Administrator** - Roth contributions must be accounted for separately. The Plan should communicate with its third-party administrator to ensure that it can meet this requirement and properly report distributions. In addition, a participant must be permitted to change his Roth 401(k) contribution as to future contributions at least annually.
- **Participant Notification** - Because this will be a new contribution type under the plan, the plan administrator should notify participants well in advance of the implementation date.

EMPLOYEE BENEFITS ALERT

If you are interested in adding this new feature to your plan, the Eckert Seamans Employee Benefits Group can assist you with preparing the required plan amendment and taking other required steps to implement Roth 401(k) contributions.

*The **Employee Benefits Alert** is intended to keep readers current on matters affecting employee benefits, and is not intended to be legal advice. If you have any questions, please call **Cory Hirsch** at 412.566.5940, **Kathryn A. English** at 412.566.1226, **Michael J. Herzog** at 412.566.6130, **John J. Kearns, III** at 412.566.2075, **Sandra R. Mihok** at 412.566.1903, **Paul M. Yenerall** at 412.566.1944, or any other attorney with whom you have been working.*