

**NATIONAL BENEFIT SERVICES, INC.**  
**CLIENT BRIEFING**  
**December 2006**

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**ROTH 401(k):**  
**GIVING EMPLOYEES A CHOICE**

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**Introduction**

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**R**oth 401(k) previously set to expire after 2010 has been made permanent by the recently passed Pension Protection Act of 2006, the subject of our prior *Client Briefings*.

With the uncertainty now removed about the Roth 401(k)'s fate, many retirement plan sponsors are now adding this option to their 401(k) plans. Those plan sponsors that haven't should consider adding it in order to:

- Provide participants with the opportunity to diversify their future tax burden, and
- Keep their plans competitive with other employers.

This *Client Briefing* will provide you with frequently asked questions (FAQs) about Roth 401(k) in question and answer format to help you decide whether it should be added to your plan.

**Roth 401(k) FAQs**

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**What actually is a Roth 401(k)?**

It is a recently added provision in the tax law that can be added to a 401(k) plan to allow employees to designate some or all of their elective deferrals as Roth contributions.

**What is the tax treatment of these contribution?**

Like a Roth IRA, these contributions are made on an after-tax basis, the earnings on which compound on a tax-deferred basis, and can be taken on tax-free basis after age 59 ½ if certain conditions are met.

**How is a Roth 401(k) different from a Roth IRA?**

Roth 401(k) is a supercharged version of the Roth IRA. The following chart shows you why.

	Roth 401(k)	Roth IRA
Limit in 2006	\$15,000 plus \$5,000 catch-up.	\$4,000 plus \$1,000 catch-up.
Who's Eligible	All plan participants.	Income limits.
Payroll Deduction	Yes.	Usually not.
\$ Cost Averaging	Yes.	Usually Not.
"Free Money"	Yes, may be matched.	No.

**Can I contribute to both a traditional 401(k) on a pre-tax basis and a Roth 401(k) on an after-tax basis?**

Yes, but your total contributions to both cannot exceed the annual 401(k) limit, \$15,000 in 2006 which increases to \$15,500 in 2007 plus the \$5,000 catch-up if you are age 50 or older.

**Are Roth 401(k) contributions included in the annual discrimination testing.**

Yes, both traditional pre-tax 401(k) and Roth after-tax 401(k) contributions must be included in the annual discrimination testing.

**What happens if the plan does not pass the discrimination tests, and money has to be returned to a highly compensated employee (HCE).**

The Roth provision we have added to client plans allows the HCE to decide whether traditional pre-tax 401(k) or Roth after-tax contributions are returned first.

**Can a participant access his or her Roth contributions while employed?**

A Roth account is subject to the same restrictions as the traditional 401(k): at severance of employment, death, disability, retirement or at age 59 ½ if the plan so provides.

**Is the Roth 401(k) account available for plan loans?**

Yes, if provided for in the plan.

**Can a Roth 401(k) be rolled over?**

Yes, to a Roth IRA.

**How does a plan participant qualify for a tax free distribution of his or her Roth account?**

Tax free distributions must be “qualified”. That is:

- Withdrawals must be made after age 59 ½; on death, or disability; and
- Contributions must have been in the plan for at least 5 years.

**Who can benefit from a Roth 401(k)?**

Roth 401(k) might appeal to participants who:

- Expect tax rates to rise, and want to lock in their current tax rate; or .
- Expect to be in a higher tax bracket at retirement; or
- Are prohibited from contributing to a Roth IRA; or

- Want to diversify their future tax burden.

**Does Roth 401(k) have to be adopted by a 401(k) plan sponsor?**

No. Roth 401(k) is an optional provision that can be added by an employer.

**Can an employer add Roth 401(k) at any time?**

Yes, but the sooner the better. A participant who wants to take advantage of the favorable tax treatment has to have 5 years of participation.

**How is a Roth 401(k) feature added to a plan?**

There are five basic steps to add Roth 401(k):

1. Amend the plan to include Roth 401(k).
2. Update the Summary Plan Description.
3. Provide educational materials to employees.
4. Modify the payroll system for after-tax contributions.
5. Confirm that the plan recordkeeper can separately account for Roth contributions.

**About National Benefit Services, Inc.**

Founded in 1978, National Benefit Services, Inc. provides retirement plan consulting and administrative services for a wide range of privately held and publicly traded employers.

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