

The Roth 401(k) Plan

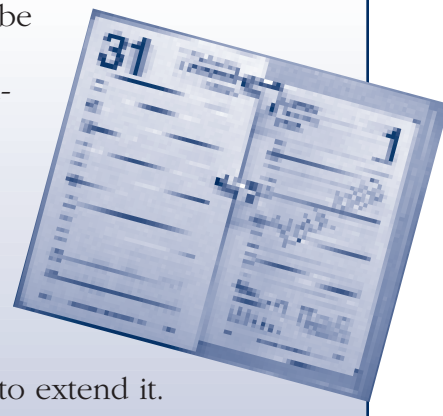
SPECIAL ISSUE

The new Roth 401(k) plan is receiving a lot of attention and generating much discussion. Introduced as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, the Roth 401(k) is scheduled to kick off on Jan. 1, 2006.

Businesses are starting to think about the potential value Roth 401(k)s may provide for their employees. Although Roth 401(k) regulations are not final yet, time spent considering their implications may be

worthwhile so you'll be ready to launch your plan when the regulations are final.

Keep in mind that this option is very time sensitive. The entire 2001 tax act is currently scheduled to end after 2010, unless Congress acts to extend it.



It's time to decide about the Roth 401(k) option

To switch or not to switch ... that is the question. Most employers wonder whether the Roth 401(k) will really be beneficial for their employees.

Employers also face the challenge of communicating effectively with employees about the differences between a traditional 401(k) and the Roth 401(k).

What's the difference?

Unlike traditional 401(k)s, which offer tax-deferred growth, Roth 401(k)s require participants to pay their taxes up front in exchange for tax-free growth. If you put \$15,000 in a traditional 401(k), you literally slice \$15,000 off your taxable income for the year.

Under a Roth 401(k), only the employee deferrals will grow tax-free inside the account. Employer matching contributions made under the plan will need to be tracked separately and will grow tax-deferred just as they do currently.

In a Roth 401(k), income taxes are

paid at the participants' regular income tax rates at the time of contribution. Earnings and withdrawals are not taxed if they begin after age 59½ and if five years have elapsed from the date of the first contribution to the plan.

Those people who think they will be in a higher tax bracket when they retire are probably better off choosing the Roth 401(k) and paying the tax now. Of course, no one knows exactly what the federal tax rate will be at retirement.

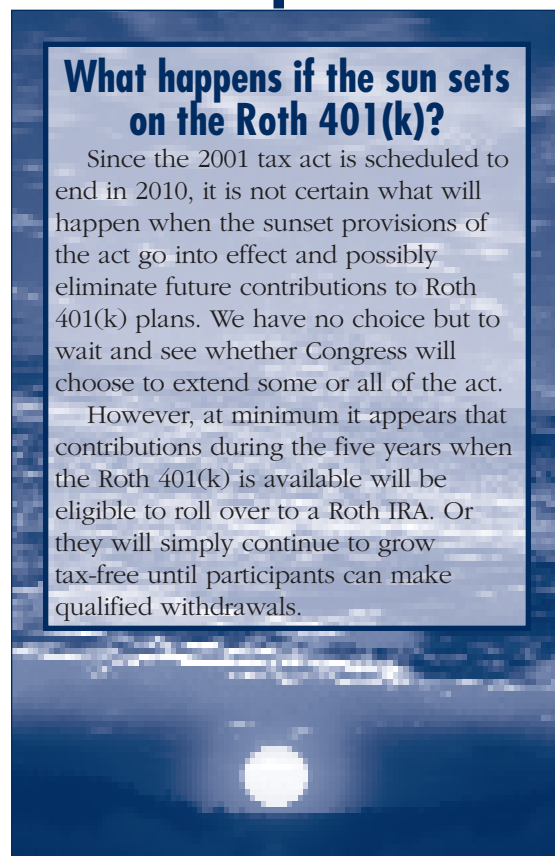
In a traditional 401(k) plan, participants must take minimum distributions beginning the year after they turn 70½. A Roth 401(k) can be rolled into a Roth IRA if the participant leaves the company, relieving the participant from taking minimum distributions. This could prove to be a valuable planning option

see **Time to decide** on other side

What happens if the sun sets on the Roth 401(k)?

Since the 2001 tax act is scheduled to end in 2010, it is not certain what will happen when the sunset provisions of the act go into effect and possibly eliminate future contributions to Roth 401(k) plans. We have no choice but to wait and see whether Congress will choose to extend some or all of the act.

However, at minimum it appears that contributions during the five years when the Roth 401(k) is available will be eligible to roll over to a Roth IRA. Or they will simply continue to grow tax-free until participants can make qualified withdrawals.



Time to decide *continued from other side*

if the participant's goal is to pass the IRA along to heirs.

However, keep in mind that, although Roth IRAs are not subject to required minimum distributions during the owner's lifetime, they are subject to required minimum distributions after the death of the owner.

Why should I add another plan?

If you now offer a 401(k) to your company, adopting the Roth 401(k) plan may be a tremendous chance for you and your employees to add another way to accumulate retirement savings. With both 401(k) plans, participants can save up to \$15,000 in contributions for 2006, plus another \$5,000 in catch-up contributions if they turn 50 or older in that year.

Even those who are currently ineligible to contribute to a Roth IRA because of income limitations can contribute to the Roth 401(k). Maximum annual contributions to a Roth IRA are phased out for a single person who earns between

\$95,000 and \$110,000 and for couples filing jointly who earn between \$150,000 and \$160,000. These limitations do not apply to the Roth 401(k).

How do I begin?

If you decide to add the Roth 401(k) option to your own plan, you should keep in mind a few administrative issues:

- * You will need to formally amend your traditional 401(k) plan to add the Roth 401(k) option.
- * Payroll records will need to reflect after-tax Roth 401(k) contributions separately from pretax 401(k)



How traditional and Roth 401(k)s stack up

Assuming \$15,000 investment and 33 percent tax bracket with accumulation over time of \$45,000.

| Traditional 401(k) | | Roth 401(k) | |
|---|-----------------|--|-----------------|
| Initial investment | \$15,000 | Initial investment | \$22,500 |
| Accumulation | \$45,000 | Upfront tax | 33% |
| Tax at distribution | 33% | After-tax investment | \$15,000 |
| | | Accumulation | \$45,000 |
| After-tax total upon withdrawal | \$34,000 | Tax-free total upon withdrawal | \$45,000 |
| Because all of the contributions are tax-deferred, participants do not pay income taxes until distribution. | | Because participants pay taxes on contributions up front, accumulation in their accounts are tax-free. | |

contributions. This task is similar to what might have been done in the past for voluntary after-tax contributions.

The third-party administrator for your plan must be notified to begin separate tracking and record keeping for the Roth and traditional 401(k)s. There may be an additional cost for the new tracking and record keeping services, but the increase should not be significant.

There is sure to be plenty of interest from employees who will need clear guidance as to which 401(k) – or what combination of 401(k) plans – will make the most sense for them. Companies that decide to offer the Roth 401(k) may benefit from retirement plan advisers who can help employees decide between the two types of 401(k) plans.

Our firm can help by supplying useful 401(k) decision-making tools for plan participants. Please contact us for help in making this important decision for your company. ♦

The technical information in this newsletter is necessarily brief. No final conclusion on these topics should be drawn without further review and consultation. Please be advised that, based on current IRS rules and standards, the advice contained herein is not intended to be used, nor can it be used, for the avoidance of any tax penalty assessed by the IRS.

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