

## Reference Chart

Here is quick summary of the features and benefits of a Traditional 401(k), Roth 401(k) and Roth IRA:

	Traditional 401(k)	Roth 401(k)	Roth IRA
Employer Sponsored	Yes	Yes	No
Income Eligibility	No income limits	No income limits	In general, modified adjusted gross income of \$122,000 for single individuals or \$183,000 for married couples filing jointing in 2012.
Contributions	Pre-tax	After-tax	After-tax
Contribution Limits	\$17,000 in 2012 for Traditional & Roth 401(k). \$5,500 catch-up for those over 50.	\$17,000 in 2012 for Traditional & Roth 401(k) combined. \$5,500 catch-up for those over 50.	\$5,000 in 2012. \$1,000 catch-up for those over 50.
Investment Earnings	Tax-Deferred	Tax-free, if qualified	Tax-free, if qualified
Withdrawals	Taxable	Tax-free, if qualified	Tax-free, if qualified
Distribution Restrictions	Death, disability, termination of employment, plan termination, attainment of age 59 1/2 or normal retirement age and financial hardship (deferrals only)	Death, disability, termination of employment, plan termination, attainment of age 59 1/2 or normal retirement age and financial hardship (deferrals only)	Not applicable
Qualified Distribution Requirements	No qualified distribution requirements	Distributions must occur at least 5 years following the first Roth 401(k) contribution and either death, disability or attainment of age 59 1/2	Distributions must occur at least 5 years following the first Roth IRA contribution and due to death, disability, first-time home purchase or attainment of age 59 1/2
Minimum Distribution Requirements	Age 70 1/2	Age 70 1/2 - <i>No minimum distributions required if rolled over to a Roth IRA</i>	No minimum distribution requirements
Rollover Considerations	Traditional 401(k) to another traditional 401(k) or an IRA	Roth 401(k) to a Roth IRA or to another retirement program with a Roth feature*	Roth IRA to Roth IRA (No Roth IRA to Roth 401(k) allowed)
Vesting	100% immediate	100% immediate	Not applicable

# What Plan Sponsors Need To Know About the Roth 401(k)

## Key Features of the Roth 401(k)

You have heard of the Roth 401(k). But you may not know the specifics of this retirement plan. We at Pension Plan Specialists present this document with up-to-date information about the plan.

- ◆ The Roth 401(k) is an optional plan feature
  - ◆ Employees at *any income* level may make contributions
  - ◆ Employers make contributions on a pre-tax basis
  - ◆ Qualified distributions remain tax-free if they meet certain requirements\*
  - ◆ Contributions remain available for participant loans, if the plan allows loans
  - ◆ Contributions may be matched on a pre-tax basis. (*Pre-tax employer contributions are subject to ordinary income tax upon withdrawal and may be subject to an additional 10% federal income tax penalty if taken prior to age 59 1/2.*)
  - ◆ Terminated employees get the option of rolling over their Roth 401(k) account to a Roth IRA or another plan with a Roth 401(k) feature
  - ◆ Roth 401(k) contribution designations are for future contributions only; existing pre-tax 401(k) contributions cannot be converted into Roth after-tax 401(k) contributions at this time unless you have attained age 59 1/2
- \* Distribution of earnings eligible for tax-free treatment if made after five years following the first Roth 401(k) contribution, and due to death, disability or attainment of age 59 1/2.*

**Myth** *Roth 401(k) requires a separate investment product.*

**Reality** *Roth 401(k) is an optional feature that may be incorporated into an existing plan design. No distinct product is required.*

**Myth** *Roth 401(k) can only be structured as a stand-alone retirement program.*

**Reality** *Roth 401(k) is a feature added to a 401(k) plan. It is nothing more than an additional contribution source integrated into an existing retirement program.*

**Myth** *Roth 401(k) replaces traditional after-tax contributions.*

**Reality** *This is not always the case. A plan sponsor may still offer traditional after-tax contributions.*



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## Make 401(k) Contributions as Pre-tax, After-tax or Both

If a Roth 401(k) feature gets added to a 401(k) plan, your plan participants face the decision of how and when they want their contributions taxed. But there is no one right answer. We at Pension Plan Specialists want to provide you and your participants with as much information and education necessary to make an intelligent decision. The following Question & Answer section provides you with details about common issues facing plan participants.

### General Questions

#### How are contributions made to a Roth 401(k)?

Participants can direct their salary contributions into a Roth 401(k) “bucket,” traditional 401(k) “bucket,” or a combination of both. These contributions can equal \$17,000.

#### Can catch-up contributions be designated as Roth 401(k) contributions?

Yes. Participants are eligible to designate all or a portion of their age 50+ catch-up contributions (\$5,500) as Roth 401(k) contributions.

#### How will matching contributions be treated?

Regardless of the employee contribution type, your matching contribution will always be made on a pre-tax basis, and is taxable upon withdrawal.

#### Can a participant designate their contributions as pre-tax (traditional) or after-tax (Roth) after the contribution has already been made?

No. A Roth 401(k) designation must be made prior to the date it is contributed. In addition, both traditional and Roth 401(k) amounts are tested together in the discrimination (ADP) test. A plan cannot “recharacterize” pre-tax 401(k) contributions as “Roth” to avoid potential refunds.

#### How are Roth 401(k) contributions different from Roth IRA contributions? Will one affect the other?

Roth 401(k) and Roth IRA contributions are separate and distinct. Contributions made to either type of account will not affect contributions to the other. Unlike Roth IRAs, a Roth 401(k) feature allows for participants of any income level to designate Roth 401(k) contributions to their retirement plan. No separate income limitation rules apply (generally, income limitations for Roth IRAs are modified adjusted gross income of \$122,000 for single individuals and \$183,000 for married couples filing jointly in 2012).

#### What are the considerations for employees who are looking to maximize their 401(k) benefits?

For those who choose to pay their tax liability during their working years to receive tax-free benefits at retirement, a Roth 401(k) feature may be an option to consider. Additionally, if you feel tax rates may increase between now and retirement, you may want to consider a Roth 401(k).

### Distribution & Rollover Questions

#### What are the rules around Roth 401(k) distributions?

For purposes of distribution eligibility, Roth 401(k) amounts are treated the same as pre-tax 401(k) amounts.

Distributions may be made upon:

- ◆ Severance of service
- ◆ Death
- ◆ Disability
- ◆ Attainment of age 59 ½
- ◆ Financial hardship (*EE contributions only*)

For tax-free treatment, the distribution must be a qualified distribution, i.e. made *after* the five-year non-exclusion period, and due to death, disability, or attainment of age 59 ½.

#### What is the five-year non-exclusion period?

The five taxable year period begins with the earlier of:

- ◆ The first tax year for which a designated “Roth” account is established under the plan or,
- ◆ If a Roth rollover contribution is made, the first taxable year the individual first made a designated Roth contribution to the other applicable retirement plan.

#### Can traditional 401(k) contributions be converted to Roth 401(k) contributions?

Yes. Current regulations allow for conversion from traditional to Roth 401(k). Plan participants that have attained age 59 ½ have the ability to convert Pre-tax 401(k) contributions.

#### Are Roth 401(k) contributions available for participant loans?

Yes. Roth 401(k) contributions are available for participant loans. Specific plan provisions should be reviewed to determine appropriateness.

#### How do Roth 401(k) and Roth IRA withdrawals differ?

The distribution rules that apply to Roth 401(k) and Roth IRAs are not the same. Roth 401(k) distributions will always be represented by principal (contributions) and earnings. Roth IRA distributions are processed according to ordering rules that allow for return of contributions first. The feature allows for tax-free distribution for any reason and is not available to Roth 401(k) distributions.

#### What about rollovers?

Terminated employees have the option of rolling over their Roth 401(k) balance to either a Roth IRA or another retirement program that includes a Roth 401(k), or Roth 403(b) feature.

## Administrative & Testing Questions

### What affect will the Roth 401(k) have on testing?

*Actual Deferral Percentage “ADP” Test:* Roth 401(k) contributions can be aggregated with, and treated as, elective deferrals for purposes of the ADP test. If a failed ADP test is corrected by distributions, a plan may provide that contributions be returned to the “highly-compensated” employees\*, and can be made from either pre-tax or “Roth” contributions.

\* *Highly compensated employees(HCE) are defined as employees who are more than five percent owners in a current or preceding plan year, a direct relative of the owner or generally any employee who has earned \$110,000 or more in the preceding year (in 2011).*

### Does adding this feature require a plan amendment? Will there be a cost?

Yes. Plan sponsors have until the end of the plan year in which the plan “adopts” the Roth 401(k) feature to amend the plan. Plan sponsors looking to add a Roth 401(k) feature to their retirement program should contact our office for a quote, and additional information.

### What kind of administration changes should I keep in mind?

Roth 401(k) contributions require a separate account source. As your TPA, we will be required to track all of the following items in that separate source:

- ◆ Roth 401(k) contributions
- ◆ Roth 401(k) gains & losses
- ◆ Roth 401(k) distributions

## Determining if Roth 401(k) feature makes business sense

Integrating a Roth 401(k) feature might be the right fit for some companies, and not for others. To help you decide, ask yourself the questions that follow:

### Tax Considerations

- ◆ Do you or your employees believe your/their personal tax rate will rise in the future?
- ◆ Do you believe income tax rates will rise in the future?
- ◆ Is your employee base predominantly lower-paid and younger in age?
- ◆ Are you and your employees looking to reduce taxes on Social Security benefits?

### Estate Planning

- ◆ Do you have employees looking to help preserve assets for heirs by rolling over their Roth 401(k) assets to a Roth IRA, thereby avoiding required minimum distributions?

### Contribution Impact

- ◆ Do you have employees looking to pay their tax liability during their working years?

- ◆ Do you have employees looking to “gross-up” their salary deferrals by the tax deduction they would have received in a traditional 401(k) retirement program?
- ◆ Do you have employees who are aggressive investors seeking to take advantage of tax-free earnings at retirement?

### Flexibility

- ◆ Would your employees benefit from the choice of investing on both a pre-tax and/or after-tax basis?
- ◆ Do you have higher income employees who previously were excluded from contributing to a Roth IRA due to income limitations\* and who are looking for the added flexibility of a Roth 401(k)?

\* *Generally, income limitations for Roth IRA are modified adjusted gross income of \$122,000 for single individuals and \$183,000 for married couples filing jointly in 2012.*

### What are the potential disadvantages to offering a Roth 401(k) feature in the company’s retirement plan?

**Operations:** Plan sponsors need to know that the following items, if applicable, will require changes prior to establishing a Roth 401(k) feature:

- ◆ Internal systems to separately account for Roth contributions
- ◆ Various plan specific documents including: (1) plan document amendment, (2) summary plan description modifications
- ◆ Enrollment and distribution material(s) update

**Education:** Helping educate plan participants on the Roth 401(k) feature will be necessary so they can decide if it makes sense for them

## Here is a quick checklist to test your company’s readiness for a Roth 401(k):

### Items to Consider

- ◆ Decide when you wish to adopt the Roth 401(k) feature for your plan  **Completed**
- ◆ If applicable, verify that your outside payroll company is ready to accommodate Roth 401(k) contributions  **Completed**
- ◆ Ensure that your internal payroll system is ready to segregate traditional and Roth 401(k) contributions  **Completed**
- ◆ Decide if you wish to establish guidelines around changing from traditional contributions to Roth contributions and vice-versa  **Completed**
- ◆ Determine the contribution source to which excess contributions are to be returned  **Completed**
- ◆ Work with your plan provider and financial professional to determine what enrollment support and materials will be used  **Completed**
- ◆ For post-educational sessions, contact your plan provider and financial professional for timely “Roth” updates and educational presentations  **Completed**