

UPDATE!

ROTH 401(K)'S ARE COMING!!!

One of the key pieces of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) was to allow Roth 401(k) or 403(b) contributions effective with tax years beginning on or after January 1, 2006. The popularity of Roth IRAs and the desire of the Bush Administration to allow workers to avoid capital gains taxes led to this landmark change in workplace retirement savings.

Tax Free Earnings:

Roth 401(k) contributions are like Roth IRAs in that both allow for after-tax contributions with tax-free earnings. The Roth contributions must be allowed by the provisions of the Plan. Currently, employee deferrals are tax-deferred with taxes due on the entire balance once withdrawn. Roth contributions are taxed up-front, but no earnings are taxed in any way – not as ordinary income or as capital gains.

An additional benefit of Roth contributions applies to Required Minimum Distributions (RMDs). RMDs must be taken by all retired participants in the year after reaching age 70½. This is true of IRAs, tax-deferred contributions and Roth contributions in 401(k) plans. However, these distributions do not apply to Roth IRAs. Therefore, a participant nearing age 70½ may rollover the Roth contributions and earnings from a 401(k) plan to an IRA. At this point the participant does not have to receive these distributions and may leave the balance to his or her heirs.

What's Required:

In order for a plan to allow Roth contributions the plan's document must allow for them. The participants must then choose between

- Tax-deferred contributions or
- Roth contributions

If the plan allows for it, the participant may elect tax-deferred contributions, Roth contributions or both.

Limitations and Reporting:

Amount: Roth contributions have a shared limitation with tax-deferred contributions. **Combined** they are limited to \$15,000 per year (\$20,000 if age 50). For example, a participant may elect to defer \$15,000 or make Roth contributions of \$15,000 or do a combination of both that does not exceed \$15,000; for instance, \$7,500 each.

Distributions: Participants eligible to receive a distribution of Roth contributions will not be taxed on any portion of Roth contributions. However, in order to receive the special tax treatment, Roth contributions must remain in a Roth plan or IRA for at least five years from the time the contribution was made. Roth contributions may not be withdrawn by active participants before age 59½, except for reasons of financial hardship. This is the same treatment of tax-deferred contributions. The plan may place even greater restrictions on the withdrawal of Roth contributions. Rollovers of Roth contributions will be allowed to Roth IRAs and, if allowed by another plan sponsor, Roth 401(k) or Roth 403(b) plans. Minimum Required Distributions apply to Roth contributions as well.

Matching: Roth contributions may be matched at the discretion of the employer. However, it is still unclear whether Safe Harbor matching contributions that apply to Roth

contributions will automatically satisfy non-discrimination requirements. It is our opinion that they will.

Tax Reporting: Roth contributions will be included with tax-deferred contributions in box 12 of participants' W-2s. Upon distribution, 1099-Rs will be issued.

Roth IRAs: A participant eligible to make Roth contributions to a 401(k) Plan is **still eligible** to make contributions to a Roth IRA.

We look forward to hearing your thoughts. MVP Plan Administrators, Inc. believes that, if you want to add a Roth feature, you should discuss it with your financial advisor before committing. We will continue to communicate new developments as they take place.

If we can help you in any way or answer any of your questions, please contact us at 1-866-687-6877 or at mvp@mvplanadmin.com.