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TCRS 2006-01: Roth 401(k) Final Regulations

On December 30, 2005, the Internal Revenue Service (IRS) issued final regulations on designated Roth 401(k) accounts. For more information on designated Roth contributions, refer to TCRS 2005-02.

Below is a brief summary of the highlights of the final regulations. These final regulations generally retain the guidance in the proposed regulations and provide clarification/confirmation relating to some, but not all, of the issues raised after the issuance of the proposed regulations. For example, the final regulations do not include guidance on any of the tax issues relating to designated Roth accounts. In addition, the final regulations do not address the sunset provision of The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), which provides that for years beginning after December 31, 2010, designated Roth accounts and other provisions of EGTRRA will expire.

Clarifications/confirmations in the following areas are provided in the final regulations:

- It is not permissible for a plan sponsor to maintain a designated Roth-only 401(k). It is permissible, however, to allow employees to designate up to 100% of their deferrals as Roth contributions.
- It is not permissible to convert a traditional pre-tax 401(k) account to a designated Roth account.
- Designated Roth contributions may be treated as catch-up contributions (if they exceed plan and legal limits). Such Roth contributions may then be used to calculate the maximum permissible loan amount.
- The final regulations confirm that designated Roth contributions are subject to the required minimum distribution rules.
- The rules relating to the frequency of elections to make, change or suspend pre-tax contributions also apply to designated Roth contributions.
- Automatic enrollment may be used in conjunction with designated Roth contributions. The plan document must state the extent to which default contributions are irrevocably designated as Roth contributions or pre-tax contributions.
- Direct rollovers of amounts from a designated Roth account may only be made to another designated Roth account or to a Roth IRA, and the plan must permit such a rollover.
- For purposes of the special rollover rule concerning direct rollovers of amounts under \$200, a plan is permitted to treat designated Roth accounts as held under a plan separate from the plan that holds the other accounts (the traditional 401(k) accounts). For example, if a participant's balance in his/her designated Roth account is under \$200, the plan is not required to offer a direct rollover for this account even though the aggregate balance of the other accounts may exceed \$200. In this case, the automatic rollover rules also would not apply.
- The final regulations make clear that the extent to which a plan would permit an employee to elect the character of a distribution (whether the distribution will come from the designated Roth account or the other accounts under the plan) must be set forth in the plan document.
- The separate accounting requirement for designated Roth contributions is merely a recordkeeping requirement rather than a requirement that the designated Roth account be physically held in a separate account.
- Assets from a Roth IRA may not be rolled over to a designated Roth 401(k) account.
- Income on corrective contributions (excess ADP/ACP) attributable to designated Roth contributions is includible in the employee's gross income in the same manner as pre-tax contributions.

These final regulations apply to plan years beginning on and after January 1, 2006. Plan sponsors wishing to add a designated Roth feature in 2006 generally have until the last day of their 2006 plan year to adopt an amendment. Off-calendar plans can be amended to add designated Roth contributions before the first day of the 2006 plan year, provided the amendment is effective on and after January 1, 2006 and it is adopted before the first day of the 2006 plan year. The IRS plans to issue additional proposed regulations in the near future to address tax and distribution issues and possibly a model amendment.

A handwritten signature in cursive script, reading "Emily Urban". The signature is written in black ink and is positioned in the upper left quadrant of the page.

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