

IRS ISSUES PROPOSED REGULATIONS ON ROTH 401(k) ACCOUNTS

The IRS has issued guidance on designated Roth contributions to qualified cash or deferred arrangements under Section 401(k). Designated Roth contributions were authorized under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) for taxable years beginning after December 31, 2005.

Important highlights of the guidance follow:

Designated Contributions. The proposed regulations define designated Roth contributions as elective contributions under a qualified cash or deferred arrangement that are –

- designated irrevocably as Roth contributions by the employee at the time of deferral
- treated as includible in the employee's income at the time the employee defers them
- maintained by the plan in a separate account.

Separate Accounts. A separate account must be established at the time the designated Roth contribution is made and must remain in effect until all amounts in this account are distributed. Gains, losses and other credits or charges (but not forfeitures) attributable to designated Roth accounts must be separately allocated on a reasonable and consistent basis to these accounts.

ADP Correction Methods. Designated Roth contributions would be taken into account under the ADP test in the same manner as pre-tax deferrals. A plan would be permitted to allow a highly-compensated employee to designate whether a corrective distribution of excess contributions would be made from pre-tax elective contributions or designated Roth contributions. A distribution of excess contributions would not be includible in gross income to the extent it represents a distribution of designated Roth contributions, however income allocable to such a corrective distribution would be.

Required Minimum Distribution Rules. Designated Roth contributions would be subject to the required minimum distribution rules of Section 401(a)(9) in the same manner as pre-tax elective deferrals.

Rollover Rules. Designated Roth contributions only could be rolled over to another plan maintaining designated Roth contribution accounts or to a Roth IRA.

Effective Date. The proposed regulations would apply to plan years beginning on or after January 1, 2006.

The proposed regulations did not address Roth 403(b) accounts. However, it is expected that similar rules will be promulgated in separate guidance.

This NewsFlash is intended to provide general information. It does not offer legal advice or purport to treat all the issues surrounding any one topic. © 2005 Mellon Financial Corporation.