

ROTH 401(k)

FREQUENTLY ASKED QUESTIONS

Have you always wanted to contribute to a Roth IRA but been unable to because of the modified adjusted gross income (MAGI) limits? If so, consider taking advantage of the Roth 401(k) feature.*

Q. What is a Roth 401(k)?

A. A Roth 401(k) is a plan feature that lets participants contribute some of their wages into a 401(k) plan on an after-tax basis. If a Roth 401(k) is offered, participants must also have the option to make traditional pretax salary deferral 401(k) contributions.

Q. How are Roth 401(k) contributions treated under an employer's plan?

A. Roth 401(k) contributions are treated as salary deferrals and must be designated as Roth contributions before the date they are contributed to the plan. A participant's total salary deferral contributions (pretax and after-tax) in 2009 cannot exceed \$16,500. Participants aged 50 or older (before December 31) can also make \$5,500 in catch-up contributions.

Q. If I start making designated Roth 401(k) contributions at the beginning of the year and later change my mind and want them treated as pre-tax contributions, can they be recharacterized and transferred from the designated Roth account to the traditional pretax account?

A. No. Once contributions are designated as Roth 401(k) contributions, they cannot be recharacterized.

Q. Do Roth 401(k) contributions need to be tracked separately from pre-tax 401(k) contributions?

A. Yes. A 401(k) plan must separately account for designated Roth contributions. Roth 401(k) contributions and distributions must be credited and debited to an employee's Roth account, and the plan must maintain a record of the basis (contributions) and earnings within a Roth account. Earnings, losses and other credits or charges applicable to Roth contributions must be separately allocated to an employee's Roth 401(k) account.



Q. What are the tax implications of a Roth 401(k) distribution?

A. A participant must incur a triggering event, as defined by the plan, in order to take a qualified distribution from a retirement plan, including a Roth 401(k). A distribution of Roth assets is considered qualified [based on IRC 402A(d)(2)] only after the assets are held in the account for at least five years and the participant attains age 59 ½ or older dies or becomes disabled. The five-year holding requirement begins with the earlier of either (1) the first taxable year for which the participant makes a Roth 401(k) contribution under the distributing retirement plan or (2) the first taxable year the participant made a Roth 401(k) contribution to a previously held Roth 401(k) that was rolled into the current Roth 401(k).

Q. What happens if I take a distribution from my designated Roth account before the end of the five-year period?

A. A nonqualified distribution will be made pro rata from Roth contributions and earnings and is included in the distributee's gross income. Contributions are not subject to taxation; however, earnings will be subject to ordinary income taxes and premature distribution penalties, if applicable. For example, if a nonqualified distribution of \$5,000 is made from an employee's designated Roth account when the account consists of \$9,400 of designated Roth contributions and \$600 in earnings, the distribution would consist of \$4,700 of designated Roth contributions (which are not eligible to

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*The Roth 401(k) can be offered only as an added feature to a 401(k) plan

be included in the employee's gross income) and \$300 in earnings (which are eligible for inclusion in the employee's gross income).

Q. Can an investor contribute to both a Roth IRA and a Roth 401(k) plan?

- A. Yes. Making Roth 401(k) contributions does not affect an investor's eligibility to contribute to a Roth IRA, and vice versa.



Q. Do plans have to amend their 401(k) documents to include the Roth 401(k) feature?

- A. Yes, plans must be amended.

Q. Because designated Roth contributions are made after tax, can I withdraw from my designated Roth account at any time and without a tax penalty?

- A. No. The plan's restrictions on withdrawals that apply to pre-tax elective contributions also apply to designated Roth contributions. So, if your plan permits distributions from your 401(k) for hardship, you may choose to receive a hardship distribution from your designated Roth account. But such a distribution will consist of a pro rata share of earnings and contributions. Also, the earnings will be included in your gross income unless you have had the designated Roth account for five years and are either disabled or older than age 59 ½.

Q. When does a participant's five-year clock start ticking for a Roth Plan?

- A. The clock starts ticking for calendar-year participants (essentially all participants) on January 2 of the calendar year the participant first makes a salary

deferral in to the Roth account.

Q. Can you roll over a Roth 401(k) distribution? If so, how?

- A. A participant can do a direct plan-to-plan rollover of a Roth 401(k) plan to another 401(k) plan as long as the receiving plan allows. Alternatively a participant can make a plan-to-plan or 60-day rollover of a distribution from a Roth 401(k) into a Roth IRA. During 2008 and 2009, the ability to roll a Roth 401(k) balance into a Roth IRA is limited to individuals with MAGIs of \$100,000 or less. Beginning in 2010, a participant can roll assets into a Roth IRA even if the participant's MAGI was sufficient to bar him or her from making a Roth IRA contribution. Rollovers from a Roth IRA into a Roth 401(k) are not permitted.

Q. How is the five-year clock handled for rollovers?

- A. If the participant rolls a Roth 401(k) distribution from Plan A to Plan B, for example, the five-year clock in Plan B starts ticking on January 1 of the earlier of either the year the participant first made a Roth deferral to Plan B or the year the participant first made a Roth deferral to Plan A. If the participant rolls his or her Roth 401(k) balance into a Roth IRA, the time during which the assets were in the Roth 401(k) does not count toward satisfying the Roth IRA's five-year holding period.

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