

Roth Contributions: Case Studies

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Basic Requirements

- Effective January 1, 2006, participants can elect to make voluntary salary reduction contributions to 401(k) and 403(b) plans on a “Roth” basis (but only if plan so permits).
- Roth contributions are taxable when made.
- Roth contributions and their earnings are not taxable if distributed in a “qualified distribution.”

Note: Pension Protection Act has now made Roth provisions permanent

Basic Requirements

Designated Roth contributions must be:

- Designated irrevocably as Roth contributions by the employee at the time of the deferral election;
- Treated by the employer as includible in the employee's income at the time the employee would have otherwise received the contribution amounts in cash; and
- Maintained by the plan in a separate account.

Separate Roth Account Requirements

- Must maintain separate Roth account until all amounts contributed to the Roth account have been distributed;
- Only Roth contributions can be allocated to the Roth account;
- Gains and losses must be allocated separately “on a reasonable and consistent basis” to the Roth account and other accounts under the plan; and
- Forfeitures may not be allocated to the Roth accounts.

Taxation of Roth Distributions

Proposed Regulations on Taxation of Roth Distributions:

- Issued January 26, 2006.
- Definition of “qualified distribution” –
 - Made after a five-year participation period; and
 - Made on account of:
 - Attainment of age 59½;
 - Death; or
 - Disability.

Qualified Roth Distributions

Proposed Regulations (cont'd)

- The following distributions are not qualified distributions:
 - Distributions of elective deferrals in excess of the contribution limits;
 - Distributions necessary to pass nondiscrimination testing;
 - Deemed distributions of plan loans; and
 - Cost of current life insurance protection provided through Roth account.

Five-Year Participation Period

Proposed Regulations (cont'd)

- Calculation of 5-year participation period:
 - Begins on the first day of the employee's tax year during which the employee first made designated Roth contributions to "the plan."
 - 5-year period is calculated separately for each "plan" in which the employee participates.

Question: What is the "plan" in case of a denominational, multiple employer church plan?

Roth vs Pre-Tax Contributions

Which type of contribution is best?

Answer depends on many factors, including:

- Participant's age
- Planned retirement age
- Participant's current marginal tax rate
- Participant's likely blended tax rate at retirement
- Amount available for contributions
- Projected earnings rate on retirement plan contributions
- State taxes
- Whether participant is eligible for housing allowance
- Estate planning concerns