Ready, Set, Roth

Employers have the option of including a Roth contribution program in their 401(k) plans. Should your plan include this feature? Read on to learn more about the Roth option.

Contributions and Earnings

As is the case with Roth IRAs, participants' "Roth 401(k)" contributions are made with after-tax income and won't be taxed upon distribution. When all requirements are met, distributions of earnings from the Roth program will also be tax free. Unlike Roth IRAs, a Roth contribution program has no income "ceiling" for contributions. Highly compensated employees who cannot contribute to Roth IRAs now because of the income limits* should welcome a Roth 401(k) option.

Roth 401(k) contributions are included in the annual maximum for 401(k) participant contributions — $17,500 in 2014, or $23,000 for those age 50 or older. Within the applicable limit, however, a participant may use a combination of tax-deferred 401(k) contributions and Roth 401(k) contributions. An employer can match Roth 401(k) contributions, but will have to treat any such matching funds as *pretax* contributions. Thus, these matching contributions will be taxable when distributed.

Participating employees irrevocably designate their contributions as Roth contributions when electing them. The employer must include the contributions in the employees' wages subject to withholding. And the plan must maintain all Roth 401(k) contributions in separate accounts.

In addition, a plan must separately allocate investment gains, losses, and other credits and charges, except forfeitures, to the Roth account. If a plan's Roth 401(k) provisions allow rollover contributions, a participant may roll over distributions from other Roth 401(k)s without affecting the annual contribution limit.

Nondiscrimination Testing

Designated Roth contributions will be included in actual deferral percentage (ADP) testing just as pretax deferrals are. However, a highly compensated employee may choose — if the plan allows it — to take a corrective distribution of excess contributions from designated Roth contributions *or* from pretax elective contributions.

Cost Considerations

Offering a Roth option to your 401(k) plan participants will mean taking on additional recordkeeping and compliance costs, plus making some adjustments in your accounting and payroll operations. More specifically, you'll need to:

- Make sure your recordkeeper will be able to keep separate records of Roth 401(k) contributions.

- Adopt plan amendments implementing your Roth program (possibly using model language from the IRS).

- Update your election forms, summary plan description, and communications materials.

- Obtain a determination letter.

If you're considering adding a Roth option to your plan, it's not too soon to begin discussing that option with us.

* In 2014, eligibility to contribute to a Roth IRA is phased out as modified adjusted gross income rises from $114,000 to $129,000 (unmarried), $181,000 to $191,000 (married filing jointly), and $0 to $10,000 (married filing separately).