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Re: Roth 401(k) provision

To our Valued Clients:

We are writing to advise you of a new plan provision that is available starting on January 1, 2006. The "Roth 401(k)" provision can be added to your plan document provisions if the Employer elects to do so. The Roth 401(k) provision is not a required provision; it is an option that can become part of your Plan as of January 1, 2006.

The Roth 401(k) provision is somewhat confusing and there is no direct "yes or no" answer as to whether it should be part of your 401(k) Plan. We would like to highlight some of the provisions as we know them so that you can decide whether you would like the Roth 401(k) provision to be added to your Plan.

Congress allowed for the Roth 401(k) as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) but with an effective date of January 1, 2006. Currently, all employee 401(k) deposits are a "pre tax" deduction from payroll. Effective on January 1, 2006, an employee can elect to have all or part of his or her 401(k) deposit treated as a "post tax" deduction from payroll regardless of the compensation level. The Employer must allow for the Roth 401(k) provision so the first decision is made by the Employer.

If the Roth 401(k) provision becomes part of your Plan, then each individual employee who is eligible for the 401(k) Plan will make a decision as to whether his or her 401(k) contributions will be the traditional "pre tax" deduction from payroll or whether it will be a "post tax" Roth 401(k) deposit.

Why would an employee want a "post tax" Roth 401(k) deduction rather than the traditional "pre tax" 401(k) deduction?

A "pre tax" deduction recognizes the tax savings today and the principal and interest accumulate on a tax deferred basis. Both principal and interest will be fully taxable when the money is distributed at retirement (no earlier than age 59 ½). The taxes that apply at that time will depend on the tax bracket that the employee is in and what those tax brackets will be at that time.

A Roth 401(k) "post tax" deduction does not have any tax benefit at the present time; the deduction from pay is on a "post tax" basis. However, if the Roth 401(k) account remains in the Plan for at least five years and withdrawals are not made before the age of 59 ½, then both principal and earnings can be withdrawn at that time on a tax free basis.

Remember, the Employer must decide whether the provision will even be part of the Plan.

Additional items the Employer should consider when deciding on whether to offer the Roth 401(k)

Your payroll system or payroll provider must be able to identify the traditional “pre tax” portion of the 401(k) deposit separately from the “post tax” Roth 401(k) portion.

Your employee can decide to use both “pre tax” and “post tax” deferrals in the same year, up to the permitted maximum of the lesser of 100% of pay or $15,000 ($20,000 if age 50 or older in 2006). However, the decision by the employee to use “pre tax”, “post tax” or a combination of both **must be put in writing by the employee before any type of 401(k) deductions are made**.

If the Employer has a Matching Contribution provision or a Safe Harbor contribution, the Employer **must** contribute based on both “pre tax” and “post tax” employee contributions up to the limit of the Matching Contribution or Safe Harbor Contribution formula.

All Roth 401(k) contributions will be considered in the normal non-discrimination tests that UB Pensions must perform. There is no testing advantage to a Roth 401(k) contribution as compared to a traditional 401(k) contribution.

If refunds are required due to testing failure, the Employer must decide whether to return money from the “pre tax” traditional contribution or from the “post tax” Roth contribution. This decision can have a big impact on the employee’s tax situation for the year. There will be tax on the interest portion of the refund regardless of which account is used for the refund.

The investment company for the 401(k) Plan must provide a separate account for the traditional “pre tax” 401(k) and for the “post tax” Roth 401(k). The money from the “pre tax” and “post tax” deposits **can not be combined**.

The Roth 401(k) favored tax treatment can only be received if the employee receives a “qualified distribution”. This requires that the distribution be made after age 59 ½, death or disability **and** only if the Roth 401(k) account has been in existence for five years.

The Employer must decide on whether or not to include the Roth 401(k) provision in your Plan. If you decide to offer the Roth 401(k) provision, there will be an immediate charge of $250 from UB Pensions to prepare an Administrative Policy to allow for the provision and to provide a form that the employee will use to elect the Roth 401(k) option.

PLEASE BE AWARE THAT THE IRS WILL REQUIRE A FORMAL AMENDMENT AT THE END OF 2006 (the IRS currently does not have the appropriate language to allow us to prepare the actual amendment) SO THERE WILL BE AN ADDITIONAL $250 CHARGE FOR THAT AMENDMENT BEFORE THE END OF 2006.

You and your employees may want to contact a tax advisor to determine whether a Roth 401(k) is appropriate. If you decide to add the provision, please contact your Account Executive for forms.

Sincerely,

The staff of United Benefit Pensions Inc.