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Comments on Proposed Regulations Relating to Designated Roth Contributions

Comments on Proposed Regulations Relating to Designated Roth Contributions to Cash or Deferred Arrangements under Section 401(k)

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Department of Treasury
Internal Revenue Service

REG-152354-04

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on the proposed amendments to the regulations under Internal Revenue Code (IRC) §§401(k) and 401(m) that provide guidance regarding designated Roth contributions to qualified cash or deferred arrangements under IRC §401(k) (Proposed Regulations).

ASPPA is a national society of retirement plan professionals. ASPPA's mission is to educate pension professionals and to preserve and enhance the private pension system. Its membership consists of approximately 5,500 actuaries, plan administrators, attorneys, CPAs, and other retirement plan experts who design, implement and maintain qualified retirement plans, especially for small to mid-size employers.

The Proposed Regulations are welcome first steps for practitioners who must advise IRC §401(k) plan sponsors who wish to include a qualified Roth contribution program in their plans. ASPPA requests clarification of several issues addressed in the Proposed Regulations as well as guidance on distribution issues not covered in the Proposed Regulations. Issuing timely and comprehensive guidance on all aspects of qualified Roth contribution programs will allow plan sponsors to appropriately implement this new plan feature and achieve compliance in both form and operation. It is important to note that the implementation of a qualified Roth contribution program may be contingent on underlying payroll and recordkeeping systems. Thus, advance guidance, particularly with respect to the rules relating to distributions, is necessary to ensure that these systems can be updated on a timely basis.

Summary of Recommendations

The following is a summary of ASPPA's recommendations. These are described in greater detail in the Discussion of Issues section.

- A. Treasury should issue guidance clarifying that the determination of the five-taxable-year holding period (Nonexclusion Period) is based on a calendar year (rather than the plan year).
- B. With respect to eligible rollovers of designated Roth contributions into a 401(k) plan, participants should be responsible for tracking both the basis in the rollover account and the time at which a designated Roth contribution was first made. Requiring the plan administrator of the receiving plan to be responsible for tracking both of these items would be a deterrent to accepting rollovers of designated Roth contributions and would effectively restrict the portability of these amounts.
- C. Sponsors of plans that permit designated Roth contributions should have the autonomous ability to include plan provisions that set forth ordering rules with respect to the account sources for all types of plan distributions.
- D. The Service should clarify that pursuant to IRS Notice 2001-42, a 401(k) plan sponsor that wants to permit designated Roth contributions during the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) remedial

amendment period is only required to amend its plan by the end of the plan year in which such contributions are first accepted (rather than being required to amend the plan prior to its acceptance of contributions). Furthermore, the Service should issue sample or good-faith amendments that plan sponsors may use without affecting reliance on prior determination letters, notification letters or opinion letters as to the qualification of the terms of their plans.

E. Sponsors of 401(k) plans that permit designated Roth contributions and who want to implement an automatic enrollment (negative election) feature should be able to choose whether pre-tax or Roth elective contributions will be the default election for participants.

F. Sponsors of 401(k) plans that permit designated Roth contribution programs should be permitted to impose limitations on the ability of plan participants to opt between designated Roth and pre-tax elective contributions in a given calendar year without violating IRC §401(a)(4).

G. ASPPA recommends that the Service issue a new model IRC §402(f) notice to take into account distributions of both pre-tax and designated Roth elective contributions.

H. ASPPA recommends that guidance be issued to clarify whether a plan sponsor would be permitted to maintain a plan that only permits designated Roth contributions (*i.e.*, no pre-tax elective contributions).

Discussion of Issues

A. Calculation of Five-Taxable-Year Holding Period

A distribution from a designated Roth account is not a qualified distribution if it is made within the five-taxable-year holding period. However, it is not clear whether this five-taxable-year holding period refers to a plan year or a participant's calendar tax year. IRC §402(d)(2)(B) provides:

DISTRIBUTIONS WITHIN NONEXCLUSION PERIOD—A payment or distribution from a designated Roth account shall not be treated as a qualified distribution if such payment or distribution is made within the 5-taxable-year period beginning with the earlier of-

(i) the first taxable year for which the individual made a designated Roth contribution to any designated Roth account established for such individual under the same applicable retirement plan, or

(ii) if a rollover contribution was made to such designated Roth account from a designated Roth account previously established for such individual under another applicable retirement plan, the first taxable year for which the individual made a designated Roth contribution to such previously established account.

ASPPA recommends that the final Regulations clarify that the five-taxable-year holding period is based on the calendar year and not on the plan's fiscal year. This appears to be the statutory intent and would be consistent with any notion of portability of designated Roth contributions (*i.e.*, attempting to track periods other than calendar years would be an administratively burdensome and discourage portability).

B. Responsibility for Determination of Basis and Five-Taxable-Year Holding Period for Rollovers

The Proposed Regulations do not indicate which party is responsible for tracking both the five-taxable-year holding period and the basis for eligible rollovers of designated Roth contributions. Requiring the plan administrator to be the responsible party for such rollovers presents various obstacles. For example, in order to be held accountable for tracking these items, the plan administrator would need information regarding the designated proposed rollover that is both timely (*i.e.*, available at the time the rollover is accepted) and reliable. This will be particularly problematic when there is a rollover into a 401(k) plan from a conduit Roth IRA account [*i.e.*, where designated Roth contributions are rolled over into a Roth IRA and then rolled into another 401(k) plan]. Under current Roth IRA rules, individual account owners are responsible for tracking both the basis of the account as well as whether any distribution is a qualified distribution (IRS Form

8606 is used for such purpose).

ASPPA recommends that participant taxpayers be responsible for tracking both the basis and the five-taxable-year holding period for any amounts attributable to designated Roth contributions that are rolled over into a 401(k) plan. The plan administrator should only be responsible for tracking and reporting designated Roth contributions made to the plan. It should also be noted that the committee report to IRC §402A requires Form W-2 be changed to report designated Roth contributions. This would be consistent with the position that the participant is in the best position to track the basis and holding period with respect to designated Roth contributions that are made to one plan and rolled into another plan.

C. Ordering Rules for Distributions from Designated Roth Accounts

The committee report to IRC §402A indicates that plan sponsors should be permitted to provide ordering rules for the sources of any plan distributions from plans that include designated Roth accounts. There do not appear to be any limitations on the flexibility plan sponsors may have as to the ordering or types of distributions that may occur.

ASPPA recommends that sponsors of plans that include qualified Roth contribution programs have the ability, by plan design, to provide specific ordering rules and procedures for all types of plan distributions, including qualified domestic relations orders (QDROs), defaulted plan loans, distributions upon severance of employment or retirement, in-service distributions (e.g., hardship distributions), and corrective distributions such as distributions to correct excess contributions under IRC §401(k), excess deferrals under IRC §402(g) or excess annual additions under IRC §415.

ASPPA also recommends that guidance be issued clarifying that there is no impermissible IRC §411(d)(6) cutback solely because a plan sponsor modifies the ordering rules with respect to a particular distribution source.

D. Timing of Plan Document Amendments for Adding Designated Roth Contributions

IRC §401(k) regulations provide that pre-tax elective contributions may not be made to a plan prior to the date the plan sponsor adopts provisions permitting such contributions. IRS Notice 2001-42 provides that an amendment to implement an optional provision of EGTRRA is not required to be adopted by a plan sponsor until the end of the plan year in which such optional provision is implemented.

ASPPA recommends that the Service clarify that a plan sponsor of an existing 401(k) plan may permit designated Roth contributions during the EGTRRA remedial amendment period and amend its plan by the end of the plan year in which such contributions are first permitted. To ensure that such a provision is implemented without violating IRC §401(a)(4), all eligible participants must be notified and be given the ability to make designated Roth contributions prior to accepting any such contributions.

Furthermore, ASPPA recommends that the Service issue model or sample amendments that 401(k) plan sponsors may use to add qualified Roth contribution programs to their plans.

E. Treatment of Plans with Automatic Enrollment Features

Revenue Ruling 2000-8 and Treas. Reg. §1.401(k)-1(a)(3)(ii) permit 401(k) plan sponsors to include automatic enrollment (negative elections) features in their plans. Under an automatic enrollment feature, a participant who does not make an affirmative deferral election is deemed to have made a "default" deferral election. It is not clear whether a plan permitting both designated Roth and pre-tax elective contributions may make designated Roth contributions the "default" contribution type.

ASPPA recommends that a plan sponsor be allowed to determine whether the default contribution type for an automatic enrollment feature will be either a pre-tax elective contribution or a designated Roth contribution. Under this type of plan design, a participant would still have the ability to make an affirmative election and override the default.

F. Benefits, Rights, and Features

Some practitioners and plan sponsors have expressed concerns about payroll system problems they may encounter by permitting Roth contributions. In an effort to alleviate these concerns, they may wish to impose limits on the timing of participant deferral elections. For example, participants in a plan may only be permitted to designate whether their contributions are designated Roth contributions or pre-tax elective contributions at the beginning of a calendar or plan year. While the plan sponsor may permit adjustments to the amount of the contribution during the year, the type of contribution would be determined based on the election made at the beginning of such year. Presumably the IRC §401(a)(4) regulations would not be violated solely by the inclusion of such a provision.

ASPPA recommends that the Service affirm that there would be no IRC §401(a)(4) benefits, rights or features violation solely because a plan limits a participant to choosing the type of elective contribution (designated Roth or pre-tax) once each calendar year or plan year.

G. Revised IRC §402(f) Notice

The current model IRC §402(f) notice set forth in IRS Notice 2002-3 does not take designated Roth distributions into account. By providing a new model IRC §402(f) notice in light of the potential issues regarding distributions of Roth deferral contributions given the five-taxable-year holding period, the Service can facilitate the implementation of this new plan feature and would reduce the potential for defects in form and operation.

ASPPA recommends that the Service issue a new IRC §402(f) notice that takes into account the tax treatment of distributions of designated Roth accounts.

H. Including Only Designated Roth Contributions in a Plan

The implementation of a qualified Roth contribution program may create payroll concerns. Another potentially popular plan design that would alleviate these concerns would be to maintain a plan that only permits designated Roth contributions (*i.e.*, no pre-tax elective contributions). However, it is not clear whether such a plan design is permissible pursuant to IRC §402A(b)(1) that provides (emphasis added):

(1) IN GENERAL—The term "qualified Roth contribution program" means a program under which an employee may elect to make designated Roth contributions in lieu of all or a portion of elective deferrals the employee is otherwise eligible to make under the applicable retirement plan.

ASPPA recommends that the final regulations clarify whether a plan may be designed so that the only elective deferrals permitted under the plan are designated Roth contributions.

These comments were prepared by ASPPA's 401(k) subcommittee of the Government Affairs Committee, Virginia Krieger Sutton, Chair and primary author. Please contact us if you have any comments or questions regarding the matters discussed above. Thank you for your consideration.

Sincerely,

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