

Time to Add a Roth Feature to Your 401(k) Plan?

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Here's what you should know.

What is a Roth 401(k) Feature? 401(k) plans with Roth features allow participants to choose between making their contributions to the plan as a before-tax or Roth 401(k) contribution. The Roth 401(k) contributions are subject to current income tax, but the entire distribution from the Roth 401(k) account, including earnings, is tax-free.

Are Other Companies Offering Roth Features? A recent Hewitt study found that 29% of mid to large sized employers are currently offering a Roth 401(k) feature, another 12% are very likely to add the feature during 2010, and yet another 13% are somewhat likely to add the feature in 2010.

But Do Participants Actually Use the Roth 401(k) Feature? The Hewitt study reported that usage ranges between 4% to 22% of participants, with younger participants more likely to utilize the feature. Over half of the participants utilizing the feature made a combination of before-tax and Roth 401(k) contributions to the plan.

Why All of the Sudden Interest in Roth Accounts? Higher income participants are now eligible to convert their traditional IRAs into Roth IRAs regardless of their income. Further, new legislation allows 401(k) plans to provide for a conversion of retirement plan funds into a Roth account without the money ever needing to leave the 401(k) plan. This means more of your participants may be hearing about Roth features and whether it would be advantageous for them to utilize such a feature. In order to allow for a Roth conversion, a 401(k) plan must allow participants to make Roth contributions to the 401(k) plan.

Are There Any Limitations on In-Plan Roth Account Conversions? Yes. Only funds that are eligible for distribution to the participant are eligible for conversion to a Roth account. However, the legislative history indicates that plan sponsors may be able to provide for special in-service distributions that would be limited to participants who elect an in-plan Roth conversion for those funds. Formal guidance confirming this option would likely increase the number of plans allowing in-plan Roth conversions.

Anything Else to Consider? Yes. The new legislation approving in-plan Roth conversions raises a number of administrative questions that have yet to be answered, including withholding and tax reporting questions. Pending guidance on these issues, plan sponsors may wish to wait to implement the Roth in-plan conversion option.



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Nevertheless, companies that believe participants will be interested in the in-plan conversion option may wish to amend their plans to allow Roth 401(k) contributions with the future enhancement of in-plan Roth conversions once the needed guidance is issued.



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