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## Roth 403(b) Contributions: What You Should Know

By: 403(b) "Gatekeeper" Services<sup>SM</sup>

A Division of Citizens Bank & Trust

800-399-3023    [cbt403b@cbcfamily.com](mailto:cbt403b@cbcfamily.com)    [www.cbt403b.com](http://www.cbt403b.com)

The Roth 403(b) was signed into law as part of the Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA). Employers will have the opportunity to amend their plan document to include the Roth(b) for the availability of participants beginning January 1, 2006. Amended 401(k) regulations were issued on March 28, 2005 to provide rules for Roth(k). Regulations for the Roth(b) will be issued separately and should follow 401(k) regulations for good faith compliance. When the proposed 403(b) regulations are finalized (expected in 2006), the regulations should address Roth(b) directly.

The Roth(b) is an optional feature that a 403(b) plan MAY offer to its participants. Unlike a Roth IRA, it is available to both low and high income employees and higher wage earners. Amendments to the employer/plan policies and procedures will be required before implementation can begin.

How the Plans Differ	
Traditional(b)	Roth(b)
Pre-tax Contributions	After-tax Contributions
Tax-deferred Earnings	Tax-free Earnings*
Taxable Withdrawals	Tax-free Withdrawals
<i>*If withdrawn after 5 years and past age 59 1/2</i>	

There are many questions to ask regarding the Roth(b), such as, “which option is best for you and your employees?” The Traditional(b) is the better option if your tax rate will be lower in retirement because taxes will be paid later on. If your tax rate will be higher in retirement, the Roth(b) may be your best option because taxes will be paid now on the contributions. If your tax rate is the same now as in retirement the Traditional(b) and Roth(b) will produce the same results. The argument for which is more beneficial often boils down to whether or not you can predict the future!

Some of the advantages of the Traditional(b) are participants will have a lower taxable income level today, some tax breaks that “phase out” at higher income levels may be available, and the Roth(b) may also be suited to those participants who have questions about what is on the horizon for income taxes. Advantages the Roth(b) provides are for tax-free income at retirement, avoiding tax on Social Security, a higher “effective” contribution limit, and it also helps to maximize estate taxes.

The Roth(b) and Traditional(b) deferrals have a combined limit and have to be tested together (limit for 2006 is \$15,000 plus catch-ups). They also have to be accounted for separately on payroll and reported separately on W-2, therefore new salary reduction agreement forms will be required. They also may both be eligible for matching contributions and they require separate accounting with investment providers. Combining Traditional(b) and Roth(b) accounts is not allowed and neither is allocating Employer contributions to Roth(b) accounts. Contribution in-lieu-of other benefits and administrators and post-retirement contributions must only be credited to Traditional(b) accounts. Roth(b) accounts cannot be converted to Traditional(b) accounts and visa versa. The same vesting rules apply to both the Traditional and Roth deferrals; employees are 100% immediately vested. Both plans have the same minimum distribution requirements and there are distribution restrictions that no payments are allowed until severance, hardship, death, disability, age 59 ½, or plan termination (as proposed).

A Roth(b) may only be rolled over to another Roth(b) account or a Roth IRA. Plans that permit Roth contributions must be amended by the end of the first plan year in which Roth money is allowed. Plan documents are proposed as part of the new regulations; these contributions will have to be written into this document. Contributions always come out of the Roth(b) tax-free, however earnings only come out of the account tax-free if the participant is age 59 ½, disability, or death, and 5 years after starting the Roth(b) account.

The employees that will be interested in the Roth(b) account are young and in low tax brackets, are well-off but view tax hikes as inevitable, hope to avoid taxes on Social Security (if applicable), want to max out their contributions, do not want to be forced to take distributions at age 70 ½, and/or want to maximize assets left to heirs.

Some of the issues Employers need to consider before adding a Roth(b) are the current Employer's policies and procedures will need to be amended to include "pre-tax" contributions to the Tax-Sheltered Annuity Plan. Employees will need additional education on the plan and the employer will have to re-enroll current participants. Employees will have to be given an opportunity to elect their contribution types on a new Salary Reduction Agreement. New accounts will also need to be opened with providers who offer the Roth(b) accounts. There are also operational concerns and costs such as payroll and reporting issues for remittances. The scheduled expiration date of the Roth 403(b) is scheduled after the year 2010 unless by an Act of Congress it is ruled to continue the Roth(b). Another item to consider is that a proposal to repeal the Roth 403(b) was introduced on April 28, 2005. There are also proposed tax revisions in place such as a lower capital gains tax, introduced November 1<sup>st</sup>, 2005.

Each Employer will have to weigh the benefits and capabilities of their own organization against the interest they have from their employees to see if the Roth(b) will be beneficial to make available to employees.

**Questions?** Please feel free to call Citizens Bank & Trust for further information at 800-399-3023 or by email at [cbt403b@cbcfamily.com](mailto:cbt403b@cbcfamily.com). You may also visit our website at [www.cbt403b.com](http://www.cbt403b.com).

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