

# Notice of Proposed Rulemaking

## Designated Roth Contributions to Cash or Deferred Arrangements Under Section 401(k)

### REG-152354-04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the regulations under section 401(k) and (m) of the Internal Revenue Code. These proposed regulations would provide guidance concerning the requirements for designated Roth contributions to qualified cash or deferred arrangements under section 401(k). These proposed regulations would affect section 401(k) plans that provide for designated Roth contributions and participants eligible to make elective contributions under these plans.

DATES: Written or electronic comments and requests for a public hearing must be received by May 31, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-152354-04), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-152354-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs) or the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG-152354-04).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, R. Lisa Mojiri-Azad or Cathy A. Vohs, 202-622-6060; concerning submissions and requests for a public hearing, contact Treena Garrett, 202-622-7180 (not toll-free numbers).

### SUPPLEMENTARY INFORMATION:

#### Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP; Washington, DC 20224. Comments on the collection of information should be received by May 2, 2005. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in 26 CFR §1.401(k)-1(f)(1) & (2). This information is required to comply with the separate accounting and recordkeeping requirements of section 402A. This information will be used by the IRS and employers maintaining section 401(k) plans to insure compliance with the requirements of section 402A. The collection of information is required to obtain a benefit. The likely recordkeepers are state or local governments, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

Estimated total annual recordkeeping burden: 157,500 hours.

Estimated average annual burden hours per recordkeeper: 1 hour.

Estimated number of respondents recordkeepers: 157,500.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

#### Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 401(k) and (m) of the Internal Revenue Code of 1986 (Code). The amendments would provide guidance on designated Roth contributions under section 402A of the Code, added by section 617(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16, 115 Stat. 38) (EGTRRA).

Section 401(k) provides that a profit-sharing, stock bonus, pre-ERISA money purchase or rural cooperative plan will not fail to qualify under section 401(a) merely because it contains a cash or deferred arrangement. Contributions made at the election of an employee under a qualified cash or deferred arrangement are known as elective contributions. Generally, such elective contributions are not includible in income at the time contributed and are sometimes referred to as pre-tax elective contributions.

Under section 402A, beginning in 2006, a plan may permit an employee who makes elective contributions under a qualified cash or deferred arrangement to designate some or all of those contributions as Roth contributions. Although designated Roth contributions are elective contributions under a qualified cash or deferred arrangement, unlike pre-tax elective contributions, they are currently includible in gross income. However, a qualified distribution of designated Roth

contributions is excludable from gross income.

On December 29, 2004, final regulations under section 401(k) were issued (T.D. 9169, 2005-5 I.R.B. 381 [69 FR 78144]). Those regulations apply to plan years beginning on or after January 1, 2006. Under those final regulations, §1.401(k)-1(f) was reserved for special rules for designated Roth contributions. These proposed regulations would amend those final regulations to fill in that reserved paragraph and provide additional rules applicable to designated Roth contributions.

## Explanation of Provisions

### *Rules Relating to Designated Roth Contributions*

The proposed regulations provide special rules relating to designated Roth contributions under a section 401(k) plan. The proposed regulations would amend §1.401(k)-1(f) to provide a definition of designated Roth contributions and special rules with respect to such contributions. Under these proposed regulations, designated Roth contributions are defined as elective contributions under a qualified cash or deferred arrangement that are: (1) designated irrevocably by the employee at the time of the cash or deferred election as designated Roth contributions; (2) treated by the employer as includible in the employee's income at the time the employee would have received the contribution amounts in cash if the employee had not made the cash or deferred election (*e.g.*, by treating the contributions as wages subject to applicable withholding requirements); and (3) maintained by the plan in a separate account. The proposed regulations provide that contributions may only be treated as designated Roth contributions to the extent permitted under the plan.

The proposed regulations provide that, under the separate accounting requirement, contributions and withdrawals of designated Roth contributions must be credited and debited to a designated Roth contribution account maintained for the employee who made the designation and the plan must maintain a record of the employee's investment in the contract (*i.e.*, designated Roth contributions that have

not been distributed) with respect to the employee's designated Roth contribution account. In addition, gains, losses, and other credits or charges must be separately allocated on a reasonable and consistent basis to the designated Roth contribution account and other accounts under the plan. However, forfeitures may not be allocated to the designated Roth contribution account. The separate accounting requirement applies at the time the designated Roth contribution is contributed to the plan and must continue to apply until the designated Roth contribution account is completely distributed.

### *Other Rules*

A designated Roth contribution must satisfy the requirements applicable to elective contributions made under a qualified cash or deferred arrangement. Thus, designated Roth contributions are subject to the nonforfeitability and distribution restrictions applicable to elective contributions and are taken into account under the ADP test of section 401(k) in the same manner as pre-tax elective contributions. Similarly, designated Roth contributions are subject to the rules of section 401(a)(9)(A) and (B) in the same manner as pre-tax elective contributions.

Section 1.401(k)-2 of the final section 401(k) regulations contains correction methods that a plan may use if it fails to satisfy the ADP test for a year. The proposed regulations would amend the rules relating to these correction methods to permit an HCE with elective contributions for a year that includes both pre-tax elective contributions and designated Roth contributions to elect whether excess contributions are to be attributed to pre-tax elective contributions or designated Roth contributions.

The proposed regulations provide that a distribution of excess contributions is not includible in income to the extent it represents a distribution of designated Roth contributions. However, the income allocable to a corrective distribution of excess contributions that are designated Roth contributions is includible in gross income in the same manner as income allocable to a corrective distribution of excess contributions that are pre-tax elective contributions. The proposed regulations also provide a similar rule under the correction

methods that a plan may use if it fails to satisfy the ACP test in §1.401(m)-2.

### *Additional Required Plan Terms*

In addition to the rules relating to section 401(k) and (m) discussed above, there are other aspects of designated Roth contributions that must be reflected in plan terms and are not addressed in these proposed regulations. For example, while a plan is permitted to allow an employee to elect the character of a distribution (*i.e.*, whether the distribution will be made from the designated Roth contribution account or other accounts), the extent to which a plan so permits must be set forth in the terms of the plan. In addition, the plan must provide that, for purposes of section 401(a)(31), designated Roth contributions may be rolled over only to another plan maintaining a designated Roth contribution account or to a Roth IRA.

### *Certain Issues not Addressed*

These proposed regulations do not provide guidance with respect to the taxation of the distribution of designated Roth contributions. For example, the proposed regulations do not provide guidance with respect to the recovery of an employee's investment in the contract associated with his or her designated Roth contributions. The IRS and Treasury request comments on the issues on which guidance is needed with respect to the taxation of such distributions. Comments are also requested on any other issues arising under section 402A on which guidance is needed.

### **Effective Date**

Section 402A is effective for taxable years beginning after December 31, 2005. These regulations are proposed to apply to plan years beginning on or after January 1, 2006.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial

number of small entities. This certification is based on the fact that most small entities that maintain a section 401(k) plan use a third party provider to administer the plan. Therefore, an analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

## Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

## Drafting Information

The principal authors of these proposed regulations are R. Lisa Mojiri-Azad and Cathy A. Vohs of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in the development of these regulations.

## Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

### PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:  
Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.401(k)–0 is amended by:

1. The entry for §1.401(k)–1(f) is amended by removing “[Reserved]” and adding entries for §1.401(k)–1(f)(1), (2) and (3).

2. Adding an entry for §1.401(k)–2(b)(2)(vi)(C).

The additions read as follows:

#### *§1.401(k)–0 Table of contents.*

\* \* \* \* \*

#### *§1.401(k)–1 Certain cash or deferred arrangements.*

\* \* \* \* \*

(f) \* \* \*

(1) In general.

(2) Separate accounting required.

(3) Designated Roth contributions must satisfy rules applicable to elective contributions.

\* \* \* \* \*

#### *§1.401(k)–2 ADP test.*

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(vi) \* \* \*

(C) Corrective distributions attributable to designated Roth contributions.

\* \* \* \* \*

Par. 3. Section 1.401(k)–1(f) is revised as follows:

#### *§1.401(k)–1 Certain cash or deferred arrangements.*

\* \* \* \* \*

(f) *Special rules for designated Roth contributions*—(1) *In general*. The term *designated Roth contribution* means an elective contribution under a qualified cash or deferred arrangement that, to the extent permitted under the plan, is—

(i) Designated irrevocably by the employee at the time of the cash or deferred election as a designated Roth contribution;

(ii) Treated by the employer as includible in the employee’s income at the time the employee would have received the amount in cash if the employee had not made the cash or deferred election (*e.g.*, by treating the contributions as wages subject to applicable withholding requirements); and

(iii) Maintained by the plan in a separate account (in accordance with paragraph (f)(2) of this section).

(2) *Separate accounting required*. Under the separate accounting requirement of this paragraph (f)(2), contributions and withdrawals of designated Roth contributions must be credited and debited to a designated Roth contribution account maintained for the employee who made the designation and the plan must maintain a record of the employee’s investment in the contract (*i.e.*, designated Roth contributions that have not been distributed) with respect to the employee’s designated Roth contribution account. In addition, gains, losses, and other credits or charges must be separately allocated on a reasonable and consistent basis to the designated Roth contribution account and other accounts under the plan. However, forfeitures may not be allocated to the designated Roth contribution account. The separate accounting requirement applies at the time the designated Roth contribution is contributed to the plan and must continue to apply until the designated Roth contribution account is completely distributed.

(3) *Designated Roth contributions must satisfy rules applicable to elective contributions*. A designated Roth contribution must satisfy the requirements applicable to elective contributions made under a qualified cash or deferred arrangement. Thus, for example, a designated Roth contribution must satisfy the requirements of paragraphs (c) and (d) of this section and is treated as an employer contribution for purposes of sections 401(a), 401(k), 402, 404, 409, 411, 412, 415, 416 and 417. In addition, the designated Roth contributions are treated as elective contributions for purposes of the ADP test. Similarly, the designated Roth contribution account is subject to the rules of section 401(a)(9)(A) and (B) in the same manner as an account that contains pre-tax elective contributions.

\* \* \* \* \*

Par. 4. Section 1.401(k)–2 is amended as follows:

1. A new sentence is added after the second sentence in paragraph (b)(1)(ii).

2. The last sentence in paragraph (b)(2)(vi)(B) is amended by removing the period and adding a clause at the end.

3. Paragraph (b)(2)(vi)(C) is added.

The additions read as follows:

§1.401(k)-2 ADP test.

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(ii) \* \* \* Similarly, a plan may permit an HCE with elective contributions for a year that includes both pre-tax elective contributions and designated Roth contributions to elect whether the excess contributions are to be attributed to pre-tax elective contributions or designated Roth contributions. \* \* \*

\* \* \* \* \*

(2) \* \* \*

(vi) \* \* \*

(B) \* \* \*, except to the extent provided in paragraph (b)(2)(vi)(C) of this section.

(C) *Corrective distributions attributable to designated Roth contributions.* Notwithstanding paragraphs (b)(2)(vi)(A) and (B) of this section, a distribution of excess contributions is not includible in gross income to the extent it represents a distribution of designated Roth contributions. However, the income allocable to a corrective distribution of excess contributions that are designated Roth contributions is included in gross income in accordance with paragraph (b)(2)(vi)(A) or (B) of this section (*i.e.*, in the same manner as income allocable to a corrective distribution of excess contributions that are pre-tax elective contributions).

\* \* \* \* \*

Par. 5. Section 1.401(k)-6 is amended as follows:

1. A new definition is added after the definition of *Current year testing method*.

2. A new definition is added after the definition of *Pre-ERISA money purchase pension plan*.

The additions read as follows:

§1.401(k)-6 Definitions.

\* \* \* \* \*

*Designated Roth contributions.* *Designated Roth contributions* means designated Roth contributions as defined in §1.401(k)-1(f)(1).

\* \* \* \* \*

*Pre-tax elective contributions.* *Pre-tax elective contributions* means elective contributions under a qualified cash or deferred arrangement that are not designated Roth contributions.

\* \* \* \* \*

Par. 6. Section 1.401(m)-0 amended by adding an entry for §1.401(m)-2(b)(2)(vi)(C) to read as follows:

§1.401(m)-0 Table of contents.

\* \* \* \* \*

§1.401(m)-2 ACP test.

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \*

(vi) \* \* \*

(C) *Corrective distributions attributable to designated Roth contributions.*

\* \* \* \* \*

Par. 7. Section 1.401(m)-2 is revised as follows:

1. The last sentence in paragraph (b)(2)(vi)(B) is amended by removing the period and adding a clause.

2. Paragraph (b)(2)(vi)(C) is added.

The additions read as follows:

§1.401(m)-2 ACP test.

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(vi) \* \* \*

(B) \* \* \* or as provided in paragraph (b)(2)(vi)(C) of this section.

(C) *Corrective distributions attributable to designated Roth contributions.* Notwithstanding paragraphs (b)(2)(vi)(A) and (B) of this section, a distribution of excess aggregate contributions is not includible in gross income to the extent it represents a distribution of designated Roth contributions. However, the income allocable to a corrective distribution of excess aggregate contributions that are designated Roth contributions is taxed in accordance with paragraph (b)(2)(vi)(A) or (B) of this section (*i.e.*, in the same manner as income allocable to a corrective distribution of excess aggregate contributions that are not designated Roth contributions).

\* \* \* \* \*

Par. 8. Section 1.401(m)-5 is amended by adding a new definition after the definition of *Current year testing method* to read as follows:

The addition reads as follows:

§1.401(m)-5 Definitions.

\* \* \* \* \*

*Designated Roth contributions.* *Designated Roth contributions* means designated Roth contributions as defined in §1.401(k)-1(f)(1).

\* \* \* \* \*

Mark E. Matthews,  
*Deputy Commissioner for  
Services and Enforcement.*