Regulations Touching 401(k) Plans Just Keep Coming

Final regulations issued under Section 415, which are effective for plan limitation years beginning July 1, 2007, allow employees to defer certain payments they receive after they've terminated into their old 401(k) accounts. In addition, the IRS released final regulations governing Roth 401(k) distributions. The Roth 401(k) regulations are generally effective for tax years beginning after January 1, 2007.

Post-Termination Deferrals

Under these final regulations, employees who terminate employment can pile more money into their former employers' 401(k) plans. *Catch:* Employees must receive payments by the later of 2½ months after their termination, or the end of the plan limitation year that includes the date they terminated. The following payments are included:

- regular pay, overtime pay, bonuses, commissions, shift differentials, and similar compensation (i.e., payments that would have continued had employment continued);
- payments for accrued bona fide sick pay, vacation pay, or other leave, provided employees would have been able to use the leave if employment had continued;
- payments under an unfunded non-qualified deferred compensation plan, provided payments are included in employees' gross income and payments would have been made if employment had continued;
- military continuation payments made to employees who have been called to active military service; and
- salary continuation payments made to employees who are disabled.

Plans will need to be amended to allow for these contributions. To read the regs in their entirety, surf to: http://edocket.access.gpo.gov/2007/pdf/E7-5750.pdf

Roth 401(k)s

Roth 401(k) plans are a good deal for employees. Provided they don't raid their Roth accounts for five years, and don't take distributions until after they turn 59½, die, or become disabled, distributions are 100% tax-free, qualified distributions. Like its older sibling, the Roth IRA, employees' contributions must be after-tax. *Twist:* Employees' contributions are considered elective — that is, they cut into the amounts they could otherwise contribute on a pre-tax basis.

Final regulations set three rules for counting that all-important five-year period. The regs specify that tracking

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employees' time in the Roth 401(k) plan is a plan responsibility. Plans must also track the amount of employees' contributions and earnings. *Rule #1 (the general rule):* The five years start with the first calendar year employees make a Roth 401(k) contribution. *Rule #2:* A Roth 401(k) plan that accepts a direct rollover from another Roth 401(k) plan (i.e., a recipient plan) counts the employee's time in the distributing plan toward the five-year requirement. *Rule #3:* A recipient plan that accepts an indirect rollover from an employee starts counting the five-year period with the date the rollover is made.

Not every contribution starts the five-year clock, however. The clock doesn't start if the only contributions consist of excess deferrals, excess contributions that are distributed to prevent an ADP failure, or contributions that are returned to employees who opt out of a negative-option plan.

To read the regs in their entirety, surf to: http://edocket.access.gpo.gov/2007/pdf/E7-8125.pdf

While the rewards to employees can be great, Roth 401(k) plans do require a bit more effort on the part of plan sponsors. In addition to tracking employees' time in the plan and contributions, Roth 401(k) plans must be entirely separate from regular 401(k) plans. Separate accounting applies to contributions and withdrawals; and to gains, losses, and other credits. *Key:* Because of these separation rules, employers may not make matching contributions, and forfeitures may not be credited to employees' Roth 401(k) accounts.

Plan amendments are also required. To download a copy of the IRS's sample Roth 401(k) plan amendments, point your browser to: http://www.irs.gov/pub/irs-drop/n-06-44.pdf

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