

REPTECH

Customized Employee Benefits Administration

The Roth 401(k)

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On March 2, 2005 the Internal Revenue Service (“IRS”) issued proposed regulations for Roth 401(k) plans. Beginning January 1, 2006, the IRS will allow employers to offer a Roth 401(k), which has been described as a cross between the Roth IRA and a traditional 401(k).

The Basics of the Roth 401(k). The Roth 401(k) is designed to allow 401(k) plan participants to make their contributions to the plan on an after-tax basis. These contributions grow with tax-free earnings and may be distributed at retirement without triggering any future income tax liability.

Designation of Elective Deferrals as Roth 401(k) Contributions. In creating the Roth 401(k), Congress established a basic rule that a Roth 401(k) contribution will, for most purposes, be treated the same as an elective deferral. A participant must designate his or her 401(k) contributions as Roth 401(k)

contributions prior to the date they are contributed to a plan.

Because Roth 401(k) contributions are treated as elective deferrals, Roth 401(k) contributions are subject to the \$15,000 maximum deferral limit (in 2006 when Roth 401(k)s will first be permitted). Furthermore, if a participant makes both Roth 401(k) contributions and pre-tax elective deferral contributions, the two contributions may not exceed the maximum deferral limit.

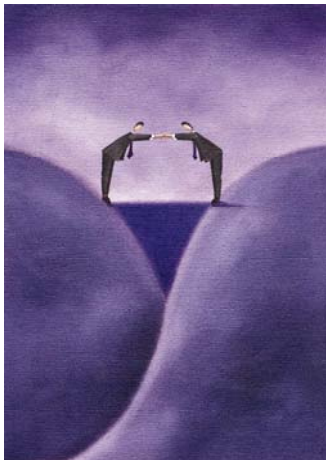
Matching Contributions. The Roth 401(k) rules do not provide for employer after-tax matching contributions. Employer matching contributions on Roth 401(k) contributions will continue to be treated as pre-tax contributions subject to taxation when distributed to a participant.

Rollover Contributions. If a Roth 401(k) plan permits, a

participant may make rollover contributions of his or her Roth 401(k) distributions from other tax-qualified plans and Roth IRAs. Notably, the availability of Roth 401(k) rollover contributions may also allow Roth IRA holders to cloak their Roth IRA account balances in the qualified plan creditor protections not provided to IRAs.

Nondiscrimination Rules. Roth 401(k) contributions are aggregated with and treated as elective deferrals for purposes of the actual deferral percentage (“ADP”) test under Code section 401(k). If corrective distributions are required to correct a failed ADP test, the plan may authorize the participant to decide whether Roth 401(k)s or pre-tax elective deferrals are to be returned to them.

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DOL Issues Guidance About Locating Missing Participants

The Department of Labor (“DOL”) has issued guidance to fiduciaries about missing participants in terminated defined contribution plans. Once the decision is made to terminate a plan, a fiduciary is faced with the task of implementing

the termination. As such, the plan fiduciary is responsible for locating plan participants and distributing plan benefits.

Locating Plan Participants. According to DOL guidance, a plan fiduciary must, at minimum, take the following steps

before determining that the plan participant cannot be found:

1. Attempt to contact the participant via certified mail;
2. Check other related employer records, such as a

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Participant Direction of Investments— Safe or Sorry?

Participant investing—are you, the fiduciary, following ERISA’s requirements?

When a participant fails to direct his investments, many plans provide for a “default” account, where his money is placed automatically in a predetermined investment. That raises four questions. The first is whether fiduciaries are protected under 404(c) if a participant does not actually “direct” his investments. The second is whether, and to what extent, the fiduciaries are required to manage participant investments. Third, may fiduciaries automatically use default accounts and, fourth, must participants be informed that the plan fiduciaries will manage their accounts if the participants do not direct their investments?

In response to the first question, the Department of Labor’s (“DOL”) Preamble to the 404(c) Regulation explains that fiduciaries are not entitled to 404(c) protection for participants who do not actually direct their investments.

The second question—whether fiduciaries must manage the investments for participants who do not direct—is also answered in the Preamble to the 404(c) regulation: “In this regard, it should be noted that, as in any other type of ERISA-covered plan, fiduciaries of ERISA section 404(c) plans have a duty to provide for the investment of idle plan assets, and lack of participant direction will not absolve a fiduciary from such duties.” In other words, if a default account is suitable for retirement investing for a participant, it may be used; however, it may

not be a suitable retirement investment for the next participant. Fiduciaries also must monitor the prudence of the default investments on an ongoing basis.

The answer to the third question is that fiduciaries may use the default investment, so long as it is a prudent investment for the participant.

The fourth issue is not answered specifically in ERISA or DOL guidance. However, in explaining the statute, the regulations say that the plan fiduciaries “shall exercise considered judgment and discretion by taking into account such factors as the level of comprehension and education of typical participants in the plan and the complexity of the terms of the plan.”

If conservative fiduciaries decide to conduct themselves in a manner that minimizes their risk and that maximizes the odds of participants being well-invested, what should they do? One option is to “default” participants into lifestyle funds—and particularly into lifestyle funds (or asset allocation models) that grow more conservative as participants age. Another option is to work with investment advisors to provide individually managed accounts as participant defaults.

However, the issue is not whether or how to use individually managed accounts, lifestyle funds, or asset allocation models. Instead, it is whether fiduciaries have a responsibility to manage participant accounts prudently when the participants do not direct their own investments. The answer to that question is an emphatic YES.



Roth 401(k)

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Separate Accounting. A Roth 401(k) must maintain separate accounts for participant Roth 401(k) contributions and must separately recordkeep each Roth 401(k) account.

Distributions. Because a participant's Roth 401(k) account will be treated as an elective deferral it will only be eligible for distribution on a participant's termination of employment, death, disability, attainment of age 59 1/2 (if permitted under the terms of the plan), or hardship.

However, a participant's reaching one of these distribution events will not necessarily ensure tax-free distribution of his or her Roth 401(k) account. In order to be treated as a tax-free distribution, a distribution from a Roth 401(k) account must be a "qualified distribution." In order to be treated as a "qualified distribution," the distribution must meet two requirements: (1) be made after a participant's reaching age 59 1/2, a participant's death, or a participant becoming disabled; and, (2) may not be made within five years of the first Roth 401(k) contribution to the plan or a predecessor Roth 401(k) plan.

Rollover Distributions. A participant may roll over his or her Roth 401(k) account to another Roth 401(k) plan or to a Roth IRA.

The Benefits of a Roth 401(k). Employees at many income levels will benefit from Roth 401(k) accounts. Lower income employees are currently eligible to contribute to Roth IRAs. However, the maximum amount that these employees can contribute is very limited (\$4,000 (\$4,500 for employees over age 50) in 2005). In addition, many Roth IRA service providers impose account fees on small Roth IRAs that can chip away a Roth IRA's value. In a Roth 401(k) plan, plan administration fees may be paid by a plan or plan sponsor, thus allowing participant contributions to grow without reduction for administrative overhead costs.

Higher income employees have not had the ability to use Roth IRAs because of the Roth IRA income limits. Although some plans already permit employees to make after-tax contributions to 401(k) plans, earnings on these after-tax contributions are subject to federal income taxation when they are distributed. By adopting Roth 401(k)s these highly compensated employees will be able to save up to \$15,000 per year (in 2006, subject to an inflation adjustment in future years) without future income tax liability on the earnings on these Roth 401(k) contributions.

Further, there is one significant benefit to all employees—contributions to a Roth 401(k), unlike Roth IRAs, may be matched by a participant's employer on a pre-tax basis.

What To Do Next. Plan sponsors will have to take several steps to implement Roth 401(k) programs in their defined contribution plans.

First, a plan sponsor should determine what and when Roth 401(k) features will be implemented in its defined contribution plan.

Second, a plan sponsor should communicate with its service providers regarding their ability to separately account for Roth 401(k) contributions. The sponsor may also need to modify its own recordkeeping and payroll systems.

Third, after IRS guidance is finalized, a plan sponsor will need to amend their plan documents to implement Roth 401(k) features.

Fourth, new election forms and communications (including new summary plan descriptions) will need to be provided to participants.

Fifth, once the determination letter process is open to EGTRRA and Roth 401(k) features, the plan should be submitted for a determination letter.

Missing Participants

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group health plan for updated contact information;

3. Check with a designated plan beneficiary for updated contact information; or
4. Use either the IRS or Social Security Administration letter forwarding service.

If those methods return no results, the DOL suggests that a plan fiduciary should consider using other search methods such as Internet search tools, commercial locator services, and credit reporting agencies in an attempt to reach missing participants. However, since reasonable expenses may be charged to a

participant's account balance, a plan fiduciary must consider the participant's account balance and the expenses involved before engaging in additional search methods.

Distribution Options. There will be times when, despite all reasonable efforts, a fiduciary is unable to locate a participant. Nonetheless, the fiduciary must distribute all participants' benefits to complete the plan termination. In these situations, the fiduciary has several distribution options available; however, the DOL recommends distribution to an IRA. According to the DOL, an IRA is the preferred distribution option as it is more likely to preserve assets for retirement. (Of course, for benefits worth between \$1,000 and \$5,000, fiduciaries must use

the automatic rollover option.)

If a fiduciary is unable to locate a service provider willing to accept a rollover distribution of a missing participant's benefits, the fiduciary may consider establishing an interest-bearing federally insured bank account in the participant's name or transferring the missing participant's account balances to state unclaimed property funds.

In comparing those alternatives to an IRA, the fiduciary should be aware that the funds transferred to either a bank account or state unclaimed property funds will be subject to income taxation, mandatory income tax withholding, and possibly an excise tax for premature distributions. These are factors weighing heavily in favor of the IRA rollover.

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REPTECH WELCOMES NEW STAFF



Don Oldag, Director of Marketing, comes to REPTECH with 25 years of sales and marketing experience. Most recently, he owned his own sales and marketing firm in Atlanta, Georgia. He helped eight manufacturers develop their market in the Southeastern United States. Before that, he was Vice President of Sales and Marketing for a manufacturing firm. Don and his wife pursued a move to Denver for the lifestyle.

Jody Hudson, Accounting Associate, has over 10 years of experience in the accounting field. She will be preparing Trust financial statements including Balance Sheet and Income Statements and Forms 5500.

Scott Ahneman, Associate Pension Analyst, recently moved here from Wisconsin after graduating from the University of Wisconsin La Crosse with a B.S. in Finance and two years in the financial planning arena. Scott is happy to be a new member of the REPTECH team and the Denver community as a whole. Scott says his first weeks have been a tremendous experience and looks forward to meeting and working with many of you in the future.

Leanne Straub, Compliance Associate, is from Ohio where she graduated from the University of Toledo with a degree in Political Science and Business Administration. She relocated to Colorado and received her Juris Doctorate from the University of Denver College of Law. She married Ryan in August of 2004 and together they have a pug named Spartacus and a cat named Rambo. While she is still intimidated by our mountains, she does enjoy hiking, cycling, playing softball, and cooking.

DOL Rule for Military Personnel

Beginning March 10, private and government employers must notify employees who might leave, or be called, for military service of their right to return to their jobs at the same pay, benefits, and status, according to recent DOL guidance.

The notice requirement is intended to foster compliance with the Uniformed Services Employment and Reemployment Rights Act ("USERRA"), which provides employment and reemployment rights for employees who leave their jobs voluntarily or involuntarily to serve in the military.

The notice can be placed along with other employee notices, or can be distributed by hand, mail, or e-mail. The Veterans' Employment and Training Service ("VETS") has developed a poster containing the text of the notice that employers can obtain in electronic or printed form and display in the workplace. A DOL spokesman indicated that the agency will give employers leeway in complying with the deadline, and "will not penalize employers for not having the notice posted by March 10."

A digital copy of the poster is available at www.dol.gov/vets/programs/userra/poster.pdf. Printed copies can be obtained by calling 1.866.487.2365.