

# REPTECH

Customized Employee Benefits Administration

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Happy Holidays  
From the Staff  
at  
REPTECH

## NEW BENEFIT PLAN LIMITS ANNOUNCED FOR 2006

Each year the U.S. government adjusts the limits for private pension plans, Social Security, Medicare, and other benefit programs to reflect price and wage inflation, and changes in the law.

Many of the pension plan limitations changed for 2006 as noted below.

	2005	2006
<b>Annual Compensation Limit</b>	\$210,000	\$220,000
<b>Elective deferral limit for 401(k), 403(b), and 457(b) plans</b>	\$ 14,000	\$ 15,000
<b>Catch-up contribution limit for 401(k), 403(b) and governmental 457(b) plans</b>	\$ 4,000	\$ 5,000
<b>SIMPLE Plans</b>		
Elective deferral limit	\$ 10,000	\$ 10,000
Catch-up contribution limit	\$ 2,000	\$ 2,500
<b>Annual additions limit for defined contribution plans</b>	\$ 42,000	\$ 44,000
The maximum annual addition is the lesser of 100% of compensation or \$44,000.		
<b>Annual benefit limit for defined benefit plans</b>	\$170,000	\$175,000
The maximum annual benefit allowed between ages 62—65 is the lesser of 100% of compensation or \$175,000.		
<b>Highly compensated employee compensation threshold</b>	\$ 95,000	\$100,000
A highly compensated employee is any person who either owns more than 5% of the employer or earned more than \$100,000 in the prior plan year.		
<b>Key employee compensation threshold</b>	\$135,000	\$140,000
A key employee for top-heavy plan purposes is any person who is a more than 5% owner, a 1% owner earning more than \$150,000, or an officer who earned more than \$140,000 in the current plan year.		
<b>Social Security taxable wage base</b>	\$ 90,000	\$ 94,200

# To “Roth” or Not To “Roth”?



As previously reported, beginning January 1, 2006, the IRS will allow employers to add a Roth 401(k) option to their 401(k) plan.

The following is a reprint of our April, 2005 article to help you decide whether “To Roth or Not To Roth.”

If you decide to add a Roth 401(k) provision to your plan, please contact us.

**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 sub-

ject 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 defer-

als 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.

**Separate Accounting.** A Roth 401(k) must maintain separate accounts for participant Roth 401(k) contributions and must separately record-keep 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

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# Roth 401(k)

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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, earn-

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. This is a decision best made with the help of your tax advisor.

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

ings 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.





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## QUESTIONS?

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## Say "Goodbye" to the "Use It or Lose It" Flexible Spending Account Rule

The Internal Revenue Service ("IRS") has announced in Notice 2005-42 that it will allow employers to modify their Flexible Spending Accounts ("FSAs") within their cafeteria plans to reduce the impact of the longstanding "Use It or Lose It" rule. Up until now, a participant was required to incur qualified expenses within the 12-month plan year. If the participant did not incur expenses at least equal to the amount they set aside in their FSA during this period, their balance was forfeited. Under this new ruling, all employees who participate in an FSA can be given more time, up to 2 1/2 months after the end of the plan year, to spend the money that is in their FSA account.

### Grace Period Requirements. The grace period must:

- Be offered to all participants in the cafeteria plan.

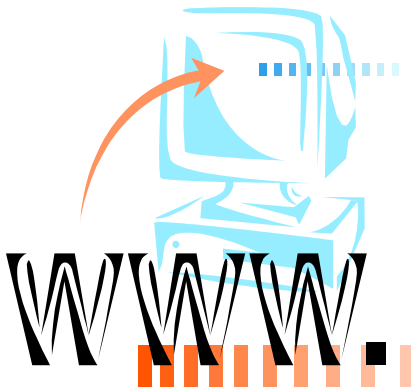


- Be applied immediately after the end of the plan year.
- Be applied towards qualified expenses incurred during the immediately preceding plan year or the grace period for contributions which remain unused at the end of the immediately preceding plan year.
- Be concluded by the 15th day of the 3rd calendar month after the end of the plan year (i.e., for a calendar year plan, the grace period cannot extend be-

yond March 15).

- In addition, those participants who do not use the remaining contributions or benefits before the end of the grace period must forfeit the funds at the end of the grace period.

Plan sponsors who decide to implement this grace period must amend their cafeteria plan documents no later than the end of the plan year for which the grace period applies. For example, to add the grace period for the 2005 calendar year, plan documents must be amended no later than December 31, 2005. If you are currently a REPTECH cafeteria plan document client, additional information will be mailed to you directly. If you currently have a cafeteria plan and are interested in taking advantage of this new grace period, or if you are interested in establishing a cafeteria plan, please contact us.



## NEW CAFETERIA ADMINISTRATION SYSTEM

In keeping with our goal to offer the best service possible to our clients, REPTECH is proud to announce the acquisition of a new cafeteria plan processing system. This new system offers on-line participant enrollment for flexible spending accounts and on-going website access to their account balances. Plan sponsors will have on-line access to reports showing participants' current flexible spending account balances, claims paid, contributions made, and amounts available for reimbursement. Access to the new system will be through a special link on the REPTECH website.

We have also installed a dedicated fax line to accept participant flexible spending account claims. Beginning immediately, claim forms and supporting documentation can be faxed to 303.217.5797.

If you are an existing cafeteria plan client, more detailed information regarding this new system will be sent to you directly. If you are interested in obtaining our services, please contact us.