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## Inside this issue

*Get Ready for the Roth 401(k)* . 1  
*2006 Plan Limits Announced* ... 1  
*Calendar Year Plans*..... 2

## Get Ready for the Roth 401(k)

*by Lori Mayer*

Effective January 1, 2006, 401(k) plan sponsors may allow participants to designate some or all of their traditional 401(k) contributions as Roth 401(k) contributions. This is increasingly generating interest and questions. We're ready to help by providing insightful information about the Roth 401(k) contribution in this article.

### ***What is a Roth 401(k) contribution and how is it different from the traditional 401(k) contribution?***

The traditional 401(k) contribution is made with pre-tax dollars. The account's gains are also tax-deferred. However, you owe taxes on all money that is withdrawn. A Roth 401(k)

contribution will be made with after-tax dollars and the money grows tax-free. Therefore, no tax is paid when the funds are taken out.

In a nutshell, with the traditional 401(k) option, money withdrawn from the plan is taxed. With the Roth option, the contributions are taxed.

### ***What are some of the advantages to offering the Roth 401(k) to plan participants?***

- **Younger Employees** – Participants who are currently in a lower tax bracket and expect their income to increase may want to consider paying taxes now rather than later.
- **Highly Compensated Employees** - Single employees that made over \$110,000 and

*continued on page 2*

## 2006 Plan Limits Announced

*by Larry Shippee*

On October 14, 2005 the IRS announced cost of living adjustments to the various dollar limits that are applicable to qualified plans. The 401(k) limit was raised to \$15,000 (\$20,000 with catch up), the defined contribution limit - \$44,000 and the compensation limit - \$220,000. On page 4 is a complete list of the limits with a comparison to prior years.

*list on page 4*



“Rolling the Roth 401(k) to a Roth IRA is a way of avoiding the minimum distribution requirement”

## Get Ready for the Roth 401(k) (continued from page 1)

married couples that had a combined income of over \$160,000 are ineligible to contribute to a Roth IRA. However, they may contribute Roth 401(k) contributions because there are no income limits on the 401(k) Plan.

- **Plan limits** – For 2006, the Roth IRA limit is \$4,000 (\$5,000 if age 50 or over). The Roth 401(k) limit is the same as the traditional 401(k) limit which is nearly four times as much. For 2006, the 401(k) limit is \$15,000 (\$20,000 if age 50 or over).
- **Flexibility in tax planning** – Participants will have the flexibility to split their contributions between a traditional 401(k) and a Roth 401(k). During years when the income tax rate is high, retired participants can withdraw from their Roth 401(k). When the tax rates are low, participants can withdraw from their traditional 401(k) account.
- **Avoid Required Minimum Distributions** – Since Roth IRA's are not subject to Required Minimum Distributions at age 70 ½, rolling the

Roth 401(k) to a Roth IRA is a way of avoiding the minimum distribution requirement.

### What are the disadvantages?

- **Separate Accounting** – A little more work is involved on the record keeping side to make sure Roth 401(k) contributions are not commingled with any pre-tax money in a participant's account.
- **Payroll** – The payroll system must be able to correctly tax the Roth 401(k) contributions, but not the traditional 401(k) contributions.
- **5 Year Wait** – If a participant with a Roth 401(k) account takes a distribution during the initial 5 year period, the participant's earnings will be taxed.

*list on page 3*

## Calendar Year Plans

*By Matthew Puetz*

Employers sponsoring calendar year plans will be receiving the 2005 anniversary notice data request during the second half of December 2005. The purpose of the anniversary notice is to collect the relevant data that we will use to complete the 2005 compliance testing, contribution allocation and preparation of Form 5500. This year we are encouraging all employers to submit the employee census data in electronic format, such as a

Microsoft Excel spreadsheet. This will enable us to complete the contribution calculations and compliance testing in a timelier manner. Details of the electronic submission method will be outlined in the anniversary notice. We ask that the requested information be returned to us as soon as possible. Please contact us if you need assistance in completing the anniversary notice.

**Get Ready for the Roth 401(k) (continued from page 2)**

If you now offer a 401(k) for yourself and your employees, adopting the Roth 401(k) option may be a tremendous chance for you and your employees to add to retirement savings.

Here is a summary of the Roth 401(k) and traditional 401(k):

	<b>Traditional 401(k)</b>	<b>Roth 401(k)</b>
Funding	Funded with pre-tax dollars	Funded by after-tax dollars
Matching Contributions	Allowed	Employer matching of Roth 401(k) contributions is allowed but not as an after tax contribution. The employer match is treated the same as it is for pre-tax contributions
Contribution Limits	\$15,000 (\$20,000 if age 50 or older)	\$15,000 (\$20,000 if age 50 or older); if participant makes a combination of Roth 401(k) and pre-tax elective deferrals, total cannot exceed (\$15,000/\$20,000)
Investment Earnings	Tax-deferred earnings	Tax-free earnings
Taxes	Pay taxes later	Pay taxes now
Access to Money	Can get access to money when leaving a job, disabled, die or (if plan provides) reach age 59 ½	Subject of the same restrictions as traditional 401(k)
Tax-Free Distribution	Not Applicable	2 conditions must be met: 1) Distribution must be a "qualified distribution"- attainment of 59 ½, death or disabled AND 2) Special 5-year-rule – contributions must remain in the plan for 5 years of the first Roth 401(k) contribution to receive the tax-free advantage
Rollovers	Can be rolled over into a traditional IRA	Can be rolled over into a Roth IRA

**“Adopting the Roth 401(k) option may be a tremendous chance for you and your employees to add to retirement savings”**



**2006 Plan Limits Announced (continued from page 1)**

<b>401(k) Plan Limits for Plan Year</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>
401(k) Elective Deferrals	\$ 15,000	\$ 14,000	\$ 13,000
Annual Defined Contribution Limit	\$ 44,000	\$ 42,000	\$ 41,000
Annual Compensation Limit	\$220,000	\$210,000	\$205,000
Catch-Up Contribution Limit	\$ 5,000	\$ 4,000	\$ 3,000
Highly Compensated Employees	\$100,000	\$ 95,000	\$ 90,000
<b>Non 401(k) Related Limits</b>			
403(b) / 457 Elective Deferrals	\$ 15,000	\$ 14,000	\$ 13,000
SIMPLE Employee Deferrals	\$ 10,000	\$ 10,000	\$ 9,500
SIMPLE Catch-Up Deferral	\$ 2,500	\$ 2,000	\$ 1,500
SEP Minimum Compensation	\$ 450	\$ 450	\$ 450
SEP Annual Compensation Limit	\$220,000	\$210,000	\$205,000
Social Security Wage Base	\$ 94,200	\$ 90,000	\$ 87,900
Defined Benefit Limit	\$175,000	\$170,000	\$165,000

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