Bouncing around the idea of a **Roth deferral?**

Commonly asked questions about
Roth 401(k) Deferrals.

Table of Contents

Introduction 1

What is the difference between a regular 401(k) deferral (pre-tax) and a Roth 401(k) deferral? 2

Who is eligible to make a Roth 401(k) deferral? 3

Roth IRAs have income restrictions; are there income restrictions for making Roth 401(k) deferrals? 3

How do I make a Roth 401(k) deferral contribution? 3

May I contribute a Roth 401(k) deferral out of my own savings? 4

Is there a limit on how much I may defer? 4

May I convert my existing regular 401(k) account balance to a Roth 401(k) account? 4

Under our plan, are Roth 401(k) deferrals treated differently than regular 401(k) deferrals? 5

How do I get a tax-free distribution of Roth 401(k) earnings? 5

If a distribution from my Roth 401(k) deferral account does not meet the conditions for tax-free treatment, what are my income tax consequences? 7

If a distribution from my Roth 401(k) deferral account does not qualify for tax-free treatment, is the distribution subject to any penalty taxes? 7

Sample

May I roll over my Roth 401(k) deferral account? 8

If my beneficiary receives a distribution from my Roth 401(k) deferral account, will the death benefit qualify for tax-free treatment? 9

If I make Roth 401(k) deferrals, may I also contribute to my regular IRA or Roth IRA? 9

What factors should I consider in deciding whether to make a Roth 401(k) deferral or a regular 401(k) deferral? 10

Sample

Introduction

You will now have a new way to save money in our 401(k) plan – savings that will generally not be taxed when you take a plan distribution. This new way to contribute money into our plan is called a "Roth 401(k) deferral." Normally, your contributions to our plan are made as "regular 401(k) deferrals (pre-tax)." However, due to a change in the law, you are now able to make Roth 401(k) deferrals in our plan. Before you decide whether to make Roth 401(k) deferrals, you should review this pamphlet to determine if this option is best for you.

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What is the difference between a regular 401(k) deferral (pre-tax) and a Roth 401(k) deferral?

Under either a regular 401(k) deferral or a Roth 401(k) deferral, you make a deferral contribution by electing to set aside part of your pay (by either a certain percentage or a certain dollar amount). For a regular 401(k) deferral, the taxable wages on your W-2 are reduced by the deferral contribution; therefore, you pay less current income tax. However, you will eventually pay tax on these contributions and earnings when the plan distributes the regular 401(k) deferrals and earnings to you. The result is that the tax on the regular 401(k) deferrals and earnings is only postponed.

A Roth 401(k) deferral is an after-tax contribution, which means you must pay current income tax on the deferral. Since you have already paid tax on the deferral, you won't pay tax on it again when you receive a distribution of your Roth 401(k) deferral. In addition, if you satisfy certain distribution conditions, then you won't have to pay tax on the earnings either. This means that the distribution of the Roth 401(k) earnings can be *tax-free,* not just *tax-postponed*.

Example: Jim's annual salary is $40,000 and he elects to contribute 5% ($2,000) of his pay to the 401(k) plan as a regular 401(k) deferral. Jim's employer will report taxable income of $38,000 on his W-2. When the plan distributes the regular 401(k) deferral, Jim pays tax on the regular 401(k) deferral and earnings.

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However, using the new Roth 401(k) option, Jim designates his deferral as a Roth 401(k) deferral. Jim's W-2 will reflect taxable income of $40,000. Jim doesn't pay tax on the $2,000 when distributed from the plan (because he already paid tax on this deferral), and if he satisfies certain conditions, Jim will not be taxed on the earnings.

Who is eligible to make a Roth 401(k) deferral?

If you are eligible to make a regular 401(k) deferral under our 401(k) plan, then you will be eligible under the Roth 401(k) deferral option.

Roth IRAs have income restrictions; are there income restrictions for making Roth 401(k) deferrals?

No. In order to be able to make Roth IRA contributions, your income must be below a certain dollar amount. However, you may make Roth 401(k) deferrals regardless of your income.

How do I make a Roth 401(k) deferral contribution?

You make a Roth 401(k) deferral contribution the same way that you make a regular 401(k) deferral contribution (*i.e.,* from your pay via payroll withholding). You elect to contribute a certain percentage or dollar amount of your pay. When you elect how much you want to contribute, you must also specify whether the contribution is

Sample

either a Roth 401(k) deferral or a regular 401(k) deferral.

May I contribute a Roth 401(k) deferral out of my own savings?

No. You may not make any 401(k) deferrals by contributing money out of your own savings directly to the plan (*i.e.*, writing a check directly to the plan).

Is there a limit on how much I may defer?

For 2007, the Roth 401(k) deferral limit is $15,500 ($20,500 if you are allowed to make catch-up contributions), the same limit as the regular 401(k) deferral limit. However, if you make both regular 401(k) deferrals and Roth 401(k) deferrals in the same calendar year, a single limit applies to the sum of both types of deferrals. After 2007, the limit is subject to cost-of-living adjustments. In addition, see our Summary Plan Description for other limits that may apply to Roth 401(k) deferrals.

May I convert my existing regular 401(k) account balance to a Roth 401(k) account?

No. You may not change an existing regular 401(k) account balance to a Roth 401(k) account (or vice versa).

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Under our plan, are Roth 401(k) deferrals treated differently than regular 401(k) deferrals?

Other than the different tax treatment, Roth 401(k) deferrals are generally treated the same as regular 401(k) deferrals. For example, Roth 401(k) deferrals are subject to the same distribution restrictions that apply to regular 401(k) deferrals. Our Summary Plan Description describes the rules that apply, such as when you will be able to receive a distribution of your deferrals.

How do I get a tax-free distribution of Roth 401(k) earnings?

If the distribution of your Roth 401(k) deferral account is made when you are at least age 59½, or upon your death or disability, then you may be entitled to a tax-free distribution of earnings. However, you must also satisfy the "5-year participation requirement." The "5-year participation requirement" is satisfied once you have had funds in your Roth 401(k) account for 5 years. However, you do not have to make Roth 401(k) deferrals in each of the 5 years.

Example: David terminates employment on his birthday on May 1, 2014 at age 55. David made his first Roth 401(k) deferral contribution in 2006. Although David may receive a distribution from the plan because he terminated employment, the distribution of the Roth 401(k)

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earnings would not qualify for tax-free treatment because he is not 59½.

Now, assume the same facts as in the previous example except David waits until November 1, 2018 (the date he attains age 59½), to take his distribution. The entire distribution (including Roth 401(k) earnings) would qualify for tax-free treatment because he has satisfied both conditions (5-year participation requirement and attainment of age 59½).

Example: Ann (age 60 on March 10, 2009) terminates employment in 2009. Ann made her first Roth 401(k) deferral contribution in 2006. Although Ann may receive a distribution because she terminated employment (she also has attained age 59½), the distribution of the Roth 401(k) earnings does not qualify for tax-free treatment because the distribution occurs before she satisfied the 5-year participation requirement. Since Ann made her first Roth 401(k) deferral contribution in 2006, the 5-year participation requirement begins January 1, 2006, and ends December 31, 2010. If she waits until January 1, 2011, she will have satisfied the 5-year participation requirement and the distribution of the Roth 401(k) earnings would qualify for tax-free treatment.

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If a distribution from my Roth 401(k) deferral account does not meet the conditions for tax-free treatment, what are my income tax consequences?

If a distribution from your Roth 401(k) deferral account does not satisfy the conditions to be tax-free, then you will pay income tax on your distributed Roth 401(k) earnings but you won't be taxed again on the distributed Roth 401(k) deferrals. However, you may avoid the tax on the Roth 401(k) earnings by rolling over (*i.e.,* transferring) the Roth 401(k) deferral account to a Roth IRA or other retirement plan that includes Roth deferral provisions (See the Question in this pamphlet entitled "May I roll over my Roth 401(k) account?").

Example: Mary (age 54) has a $50,000 Roth 401(k) deferral account ($40,000 of Roth 401(k) deferrals and $10,000 of Roth 401(k) earnings). Mary receives a distribution before she attains age 59½. She is taxed on the $10,000 Roth 401(k) earnings, but not on the $40,000 Roth 401(k) deferrals. However, she could avoid the taxation by rolling over the total distribution to a Roth IRA or a retirement plan that includes a Roth feature.

If a distribution from my Roth 401(k) deferral account does not qualify for tax-free treatment, is the distribution subject to any penalty taxes?

The Roth 401(k) earnings portion of your account would be subject to a 10% penalty tax unless one of

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the penalty exceptions applies. The distribution of the Roth 401(k) deferral portion is not subject to the 10% penalty tax. In general, the 10% penalty tax does not apply to the taxable portion of a distribution if the distribution is made (1) after attainment of age 59½, (2) after termination of employment after attaining age 55, (3) upon death or disability, (4) after termination of employment and payable in substantially equal installments over your lifetime, or (5) to pay for deductible medical expenses.

Example: Mary (age 54) receives a lump-sum distribution of her Roth 401(k) deferral account ($40,000 of Roth 401(k) deferrals and $10,000 of Roth 401(k) earnings). She has not attained age 59½ so the distribution of the Roth 401(k) earnings is not tax-free. The Roth 401(k) earnings will be subject to income tax plus an additional 10% penalty tax of $1,000 (10% x $10,000 = $1,000).

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May I roll over my Roth 401(k) deferral account?

Yes, subject to certain rules. If you roll over the account by a direct transfer (referred to as a direct rollover), then the account can be rolled over to a Roth IRA or to another qualified plan or 403(b) plan that includes a Roth deferral feature. If, instead of a direct rollover, you receive a distribution from the plan and then decide within

60 days to make a rollover, then the entire amount can be rolled over to a Roth IRA. If you want to use the 60-day rollover option to make a rollover to another qualified plan or 403(b) plan, then you can only rollover the portion of the distribution that would otherwise be taxable (*i.e.,* the earnings). An explanation of the rollover rules will be provided to you when you are entitled to receive a distribution from the plan.

If my beneficiary receives a distribution from my Roth 401(k) deferral account, will the death benefit qualify for tax-free treatment?

A distribution to the beneficiary of your Roth 401(k) account may qualify for tax-free treatment. Death is one of the three qualifying distribution events. However, death is not an exception to the 5-year participation requirement. In other words, if you have not satisfied the 5-year participation requirement before your death, then the beneficiary would need to wait until the end of the 5-year participation period before a distribution of your Roth 401(k) earnings would qualify for tax-free treatment.

If I make Roth 401(k) deferrals, may I also contribute to my regular IRA or Roth IRA?

Yes. Your Roth 401(k) deferrals do not affect your ability to make Roth IRA contributions. Similarly, your Roth IRA contributions do not affect your

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ability to make Roth 401(k) deferrals. However, there is an income limitation that restricts who can contribute to a Roth IRA.

Your Roth 401(k) deferrals also do not affect your ability to make regular IRA contributions. However, because you are an active participant in our plan, if you want the regular IRA contribution to be deductible, then your income must be below certain income limitations.

What factors should I consider in deciding whether to make a Roth 401(k) deferral or a regular 401(k) deferral?

Your decision to make Roth 401(k) deferrals or regular 401(k) deferrals involves a number of factors that are discussed below. In general, the longer Roth 401(k) deferrals remain in the plan, the more favorable they are (*i.e.*, the Roth deferrals may result in more tax savings than regular 401(k) deferrals). However, this is not always the case so you must think about several things before making your decision.

Ability to afford higher contributions

One of the most important items to think about is whether your decision to contribute regular 401(k) deferrals or Roth 401(k) deferrals will affect the amount of salary deferrals that you can afford to

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contribute to the plan. If you can afford to contribute the same dollar amount of salary deferrals, regardless of whether they are regular 401(k) deferrals or Roth 401(k) deferrals, then that means you should think more about making Roth 401(k) deferrals. This is because Roth 401(k) deferrals are generally worth more than regular 401(k) deferrals, since tax has already been paid on the Roth 401(k) deferrals.

Your ability to afford higher contributions becomes more important in two situations: (1) when a plan provides for a matching contribution, or (2) when you want to contribute the maximum amount allowed by our plan or by the law. In the case of matching contributions, it is to your benefit to contribute the maximum amount that will be matched under the plan. If you are not able to contribute enough Roth 401(k) deferrals to receive the maximum matching contribution, then you may be better off making a larger contribution with regular 401(k) deferrals.

Example: Jack earns $50,000 per year. If his plan provides a matching contribution equal to

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100% of his deferrals up to 4% of pay, Jack must contribute $2,000 to receive the full matching contribution. If he contributes $2,000 as regular 401(k) deferrals, then his taxable pay for the year will be $48,000. But, if he contributes the $2,000 as a Roth 401(k) deferral, then his taxable income remains at $50,000. He would owe tax on a larger amount of income, and this tax would result in lower take-home pay. If he cannot afford to lower his take-home pay by the amount of tax on the $2,000 Roth 401(k) deferral and would contribute less than $2,000 as a Roth 401(k) deferral, then he may be better off contributing the $2,000 as a regular 401(k) deferral in order to maximize his matching contribution.

Similarly, if you are trying to contribute the maximum amount permitted by our plan and by the law, then you may be better off making Roth 401(k) deferrals. This is because the Roth 401(k) earnings may be distributed tax-free (if the requirements for a tax-free distribution are met). The larger the amount you are able to contribute, then the larger the amount of earnings.

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Current and future tax rates
Another item to think about is your federal income tax rate at the time of the contribution, compared to your expected tax rate at the time you would receive a distribution. Regular 401(k) deferrals are taxed when distributed. Roth 401(k) deferrals are taxed when these are made to the plan. If you believe that your tax rate will be *lower* in the future when you receive distributions from the plan, then you should consider making regular 401(k) deferrals to the plan. If you believe that your tax rate will be *higher* when you receive distributions from the plan, then you should consider making Roth 401(k) deferrals. Your tax rate when you receive a distribution will depend on your taxable income at that time as well as changes in the tax laws.

When the deferrals will be withdrawn
When you are deciding on the type of contribution to make, you should also think about when you will want, or need, to withdraw the contributions from your account. If you think you will withdraw your contributions before you satisfy the 5-year participation requirement, then you may be

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better off making regular 401(k) deferrals.

Another factor relating to the timing of distributions is whether you want to accumulate funds in a retirement plan for as long as possible. Regardless of whether you make regular 401(k) deferrals or Roth 401(k) deferrals, you must begin receiving distributions from our plan as of the later of your retirement or your attainment of age 70½. However, for estate planning purposes, you may want to delay the receipt of distributions beyond your retirement or your attainment of age 70½. You can delay the distribution of Roth 401(k) deferrals if you roll over the Roth 401(k) deferrals and earnings to a Roth IRA.

The factors to consider when deciding whether to make Roth 401(k) deferrals or regular 401(k) deferrals depend upon many unknown items. Because of this, it is sometimes suggested that you consider making both regular 401(k) deferrals and Roth 401(k) deferrals. This may give you flexibility to control both the timing of distributions as well as your income tax consequences (*e.g.*, if funds are needed prior to satisfaction of the 5-year participation

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requirement, then withdraw from your regular 401(k) deferral account, or if the 5-year participation requirement has been met and your tax bracket is high in a particular year, then withdraw from your Roth 401(k) deferral account). Ultimately, it is a personal decision that requires careful consideration.

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