

# Retirement PLAN news

WINTER 2018

## Considering a Roth 401(k)?

The Roth 401(k) option is becoming increasingly popular with plan sponsors. According to the 58th Annual Survey of Profit Sharing and 401(k) Plans from the Plan Sponsor Council of America, 57.9% of 401(k) plans offered Roth 401(k) deferrals in 2014 — a substantial increase from 51.6% in 2013 and 49.8% in 2012. What general rules and requirements should sponsors know about when considering to add this feature?

### Benefits of a Roth 401(k)

Although traditional 401(k)s and Roth 401(k)s have many similarities, they have many important differences. With a traditional 401(k), participants make retirement plan contributions with pretax dollars. For 2018, participants may contribute up to \$18,500 (\$24,500 if age 50 or older). Taxes on contributions and earnings are deferred until participants take distributions. At that point, withdrawals are included in income, and participants pay taxes based on their tax rate at that time.

for which the participant made a designated Roth contribution under the same plan. Additionally, the participant must have reached age 59½ or the distribution must be made after the participant's death or because of disability. Unlike Roth IRAs, Roth 401(k)s do not allow a qualified distribution for a first-time home purchase.

The maximum annual contribution to a Roth IRA for 2018 is \$5,500 (\$6,500 if age 50 or older), and eligibility for Roth IRA contributions is phased out as income rises. No such income limits apply to a designated Roth 401(k) account — a feature that might appeal to highly compensated employees. Moreover, plans may allow eligible participants to make designated Roth contributions up to the limits set for traditional 401(k) plans. These limits will apply to pretax and after-tax Roth contributions combined. Employers may make matching contributions on designated Roth contributions, but they must allocate any matching contributions to a pretax account.

A plan may not consist solely of designated Roth accounts — if offering a Roth 401(k) option, the sponsor must also offer a traditional 401(k) plan. Participants may then be allowed to designate some or all of their elective deferrals as Roth 401(k) contributions.

### Implementing a Roth 401(k)

When considering a Roth 401(k) option, sponsors should be aware of the need to comply with additional administrative requirements. To implement a Roth 401(k), the sponsor must adopt an appropriate plan amendment by the end of the plan year for which the amendment is effective. Participants must receive amended plan notifications, including an updated summary plan description and election forms. Educational materials may need to be updated as well.

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In contrast, a Roth 401(k) combines certain features of a traditional 401(k) and a Roth individual retirement account (IRA). As with a Roth IRA, contributions to a Roth 401(k) are made with after-tax dollars. Qualified distributions of contributions — as well as any earnings — from a Roth 401(k) account are income tax free. To qualify for tax-free treatment, a Roth 401(k) distribution must be made after a five-tax-year period beginning with the first tax year



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## Considering a Roth 401(k)? (continued)

Plans must keep separate accounts for each participant's Roth 401(k) and traditional 401(k) accounts, and employers will need to change their payroll systems to accommodate Roth contributions. If recordkeeping is outsourced, service providers will need to properly account for Roth 401(k) contributions and any earnings.

### In-plan Rollovers

Sponsors may also want to amend their plans to allow participants to make "in-plan Roth rollovers" from their traditional 401(k) accounts to their Roth 401(k)s. Participants who choose to make in-plan

Roth rollovers will be subject to income tax on any previously untaxed amounts that are rolled over. However, the 20% withholding requirement that generally applies to eligible rollover distributions does not apply to direct in-plan rollovers. Also, in-plan Roth rollovers are generally not subject to the 10% additional tax on early distributions.

Plans may choose to allow in-plan Roth rollovers even where the amounts are not otherwise distributable under the plan's terms. However, once the rollover is completed, any distribution restrictions that applied before the rollover will again apply

to both the rolled over amount and any earnings thereon.

### Nondiscrimination Testing

Plans may not discriminate in favor of highly compensated employees when offering a Roth 401(k). Additionally, designated Roth 401(k) contributions are treated as elective contributions for purposes of the actual deferral percentage test.

The foregoing is a broad overview of the relevant rules. If you are considering adding a designated Roth contribution option to your plan, please contact us.



## Tax Relief for Hurricane Victims

Recent legislation\* affords various tax-related and other forms of relief to victims of Hurricanes Harvey, Irma, or Maria. Included in the legislation are provisions designed to provide affected plan participants with both greater access to their retirement funds and potential tax relief for distributions taken.

**Tax-favored withdrawals.** The new rules permit plans to allow "qualified hurricane distributions" of up to \$100,000, provided certain requirements are met. Distributions must be made on or after a relevant storm-specific date and before January 1, 2019, to qualifying individuals whose principal place of abode is in one of the three designated storm areas and who have sustained an "economic loss."

Potential tax relief includes:

- Exemption from the 10% early withdrawal penalty that generally applies to distributions taken before age 59½
- Exemption from the 20% withholding tax that generally applies to eligible rollover distributions
- No inclusion in taxable income for qualified distributions repaid at any time within three years of distribution
- The option to spread any income inclusion from a qualified distribution over a three-year period

**Increased plan loan amounts and delayed repayment.** Plans are also permitted to allow greater access and repayment terms for qualified individuals, including:

- An increase in the maximum loan amount from \$50,000 to \$100,000
- Elimination of the restriction limiting plan loans to 50% of the vested account balance
- Longer repayment term for qualifying loans by delaying the due date of the first repayment by one year and adjusting the due dates of subsequent repayments accordingly

Additional requirements apply.

\* The Disaster Tax Relief and Airport and Airway Extension Act of 2017

# Small Plan Audit Waivers

A small plan (generally, one with fewer than 100 plan participants at the beginning of the plan year) may obtain a waiver of the audit requirement generally applicable to qualified plans. Following is an overview of the requirements.

## Qualifying Plan Assets or Bonding

First, at least 95% of the plan's assets must be "qualifying plan assets," or, if more than 5% of the assets are non-qualifying assets, any person handling non-qualifying assets must be bonded for the total amount of non-qualifying plan assets.\*

"Qualifying assets" generally include:

- Assets in individual accounts in which the participant or beneficiary exercises control and receives an annual statement from a regulated financial institution describing the assets
- Loans to plan participants
- Qualifying employer securities
- Assets held by a regulated financial institution such as a bank, an insurance company, a registered broker-dealer, or any organization authorized to act as an individual retirement account trustee
- Shares issued by a registered investment company (e.g., mutual funds)
- Investment and annuity contracts issued by an insurance company

## SAR Disclosure Requirements

Second, specific information must be disclosed to plan participants and beneficiaries. The summary annual report (SAR) must include the name of each regulated financial institution holding or issuing qualifying plan assets and the amount of qualifying plan assets reported by the institutions as of the end of the plan year (not including qualifying employer securities, participant loans, and participant-directed assets in individual account plans). Also, the name of the surety company issuing the fidelity bond must be included in the SAR.

In addition, the SAR must state that participants and beneficiaries may request (free of charge) to examine or receive copies of evidence of the fidelity bond and any statements from the regulated financial institutions describing the qualifying plan assets. The SAR also must let participants and beneficiaries know they should notify the regional office of the Employee Benefits Security Administration if they are unable to view or obtain copies of the regulated financial institution statements or proof of the required fidelity bond.

## Availability of Financial Statement Requirement

A third condition for waiver eligibility is that upon request of a participant or beneficiary, the plan administrator must, free of charge, make available or furnish copies of each regulated

financial institution statement and evidence of any required fidelity bond. Any statements furnished by the administrator must list the name of the institution and the amount of assets held at the end of the plan year.



Although a plan may be exempt from the audit requirement, it must still file Form 5500 and all applicable financial schedules and statements as per the Form 5500 instructions.

### Example

Assume an employer-sponsored plan has fewer than 100 participants and has the following breakdown of assets at the end of the plan year:

Mutual fund assets	\$650,000
Plan participant loans	\$200,000
Limited partnership interests	\$80,000
Annuity contracts	\$70,000
<b>Total:</b>	<b>\$1,000,000</b>

Since limited partnership interests are not qualifying assets, the amount of non-qualifying plan assets is \$80,000, or 8%. Because this exceeds the 5% limit, a fidelity bond of at least \$80,000 must be purchased to qualify for the audit exemption.

\* Generally, ERISA Section 412 requires that officials handling funds or other property be bonded for no less than 10% of the amount handled. As a result, in some situations such a fidelity bond will be adequate for small plan audit waiver purposes.



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## Recent Developments

### Cure Periods for Plan Loans

The IRS recently provided guidance on curing missed plan loan installment payments. Using two examples, the guidance illustrates how a participant may cure prior defaults — and avoid a deemed distribution — by making late payments or refinancing within the plan's cure period. Under IRS regulations, a cure period, if allowed, may not extend past the last day of the calendar quarter following the calendar quarter in which the required installment payment was due.

### Average 401(k) Balances

A recent report from the EBRI/ICI Participant-Directed Retirement Plan

Data Collection Project indicates that the average 401(k) balance tends to increase with the age of the participant and the length of time served with a current employer. For example, at the end of 2015, plan participants in their 40s with more than five to 10 years of tenure had an average 401(k) account balance of \$64,515, as compared to an average of \$280,976 for participants in their 60s with more than 30 years of tenure.

### Effect of Automatic Plan Features

According to a study by the Defined Contribution Institutional Investment Association, middle-income workers in 401(k) plans with both automatic

enrollment and automatic escalation are projected to accumulate more for retirement than middle-income workers in plans without these auto features. According to the study, participants who are eligible to participate in a plan between the ages of 25 and 29 and who have continuous access to a plan with these auto features will eventually accumulate 6.66 times their final earnings by retirement — as compared to 5.02 for comparable participants without such access.

The general information provided in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.

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