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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

REG-146459-05

RIN 1545-BF04

Designated Roth Accounts Under Section 402A

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under sections 402(g), 402A, 403(b), and 408A of the Internal Revenue Code (Code) relating to designated Roth accounts. These regulations will affect administrators of, employers maintaining, participants in, and beneficiaries of section 401(k) and section 403(b) plans, as well as owners and beneficiaries of Roth IRAs and trustees of Roth IRAs.

DATES: Written or electronic comments and requests for a public hearing must be received by April 26, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-146459-05), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-146459-05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington D.C. Alternatively, taxpayers may submit comments electronically

directly to the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs), or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS-REG-146459-05).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, R. Lisa Mojiri-Azad, 202-622-6060 or Cathy A. Vohs, 202-622-6090; Concerning the submission of comments or to request a public hearing, Richard Hurst at Richard.A.Hurst@irscounsel.treas.gov or (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Paperwork Reduction Act**

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP; Washington, DC 20224. Comments on the collection of information should be received by March 27, 2006. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in 26 CFR §1.402A-2. This information is required to comply with the separate accounting and recordkeeping requirements of section 402A. This information will be used by the IRS and employers maintaining designated Roth accounts to insure compliance with the requirements of section 402A. The collection of information is required to obtain a benefit. The likely recordkeepers are state or local governments, business or other for-profit institutions, nonprofit institutions, and small businesses or organizations.

Estimated total annual recordkeeping burden: 828,000 hours.

Estimated average annual burden hours per recordkeeper: 2.3 hours.

Estimated number of recordkeepers: 357,000

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal

revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

## **Background**

This document contains proposed regulations under sections 402(g), 402A, 403(b), and 408A of the Internal Revenue Code. Section 402A, which sets forth rules for designated Roth contributions, was added to the Code by section 617(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (115 Stat. 103) (EGTRRA), effective for taxable years beginning after December 31, 2005.

Section 401(k) sets forth rules for qualified cash or deferred arrangements under which an employee may make an election between cash and an employer contribution to a plan qualified under section 401(a) and section 403(b) permits a similar salary reduction agreement under which payments are made to a section 403(b) plan. Section 402(e)(3) provides that an amount is not includible in an employee's income merely because the employee has an election whether these contributions will be made to the trust or annuity or received by the employee in cash.

Amounts contributed pursuant to these qualified cash or deferred arrangements and salary reduction agreements are defined in section 402(g)(3) as elective deferrals and section 402(g)(1) provides a limit on the amount of elective deferrals that may be excluded from an employee's income for a taxable year. Section 402(g)(2) provides for the distribution of elective deferrals that exceed the annual limit on elective deferrals (an excess deferral).

A designated Roth contribution is an elective deferral, as described in section 402(g)(3)(A) or (C), to a section 401(k) or 403(b) plan that has been designated by an employee, pursuant to section 402A, as not excludable from the employee's gross income. Under section 402A(b)(2), designated Roth contributions must be maintained by the plan in a separate account (a designated Roth account).

Under section 402(a), a distribution from a plan qualified under section 401(a) is taxable under section 72 to the distributee in the taxable year distributed. However, pursuant to section 402A(d)(1), a qualified distribution from a designated Roth account is excludable from gross income. A qualified distribution is defined in section 402A(d)(2) as a distribution that is made after completion of a specified 5-year period and the satisfaction of other specified requirements.

If the distribution is not a qualified distribution, pursuant to section 72, the distribution is included in the distributee's gross income to the extent allocable to income on the contract and excluded from gross income to the extent allocable to investment in the contract (basis). The amount of a distribution allocated to investment in the contract is determined by applying to the distribution the ratio of the investment in the contract to the account balance.

Section 402(c) provides rules under which certain distributions from a plan qualified under section 401(a) may be rolled over into another eligible retirement plan. In such a case, the distribution is not currently includible in the distributee's gross income. Under section 402(c)(2), to the extent some or all of the

distribution from a plan qualified under section 401(a) would not have been includible in gross income if it were not rolled over, that portion of the distribution can only be rolled over into an individual retirement plan, or through a direct rollover to another plan qualified under section 401(a) which agrees to separately account for such rolled over amounts. Section 403(b)(8)(B) provides that the rules of section 402(c)(2) also apply for purposes of the rollover rules under section 403(b)(8).

Under section 402(c)(8) and 402A(c)(3), a distribution from a designated Roth account can be rolled over only to another designated Roth account or to a Roth IRA. Under section 408A, a Roth IRA is a type of individual retirement plan (IRA) under which contributions to the account are never deductible and qualified distributions from the account are excludable from gross income. Section 408A(d)(4) sets forth special ordering rules for the return of basis in the case of a distribution from a Roth IRA. Under these ordering rules, in the case of nonqualified distribution from the account, basis is recovered before income is taxed.

Section 617(d) of EGTRRA amended section 6051(a)(8) to require the reporting of designated Roth contributions on Form W-2, "Wage and Tax Statement," and added a new subsection (f) to section 6047 to require plan administrators or other responsible persons of section 401(k) or 403(b) plans to make such returns and reports regarding designated Roth contributions to the Secretary of the Treasury and such other persons the Secretary may prescribe.

Final regulations under section 401(k) were issued on December 29, 2004 (69 FR 78144). Those final regulations reserved §1.401(k)-1(f) for special rules for designated Roth contributions. On March 2, 2005, proposed regulations to fill in that reserved paragraph and provide additional rules applicable to designated Roth contributions were issued (70 FR 10062). Final regulations adopting those proposed regulations, with certain modifications, were issued on January 3, 2006 (71 FR 6). The provisions of the final section 401(k) regulations regarding designated Roth contributions do not address the taxability of distributions from designated Roth accounts or the reporting requirements that apply to contributions of designated Roth contributions or distributions from the accounts.<sup>1</sup>

These proposed regulations under section 402A are intended to provide comprehensive guidance on the taxation of distributions from designated Roth accounts under section 401(k) and section 403(b) plans. The proposed regulations also provide guidance on the reporting requirements with respect to these accounts. In addition, these proposed regulations provide guidance with respect to designated Roth contributions under section 403(b) plans by amending the proposed section 403(b) regulations issued in 2004 (2004 proposed section 403(b) regulations), which were published in the **Federal Register** on November 16, 2004 (69 FR 67075), to reflect the provisions of section 402A.

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<sup>1</sup> The preamble to the proposed regulations under section 401(k) regarding designated Roth contributions, which were issued on March 2, 2005, requested comments on the issues for which guidance is needed with respect to the taxation of distributions from designated Roth accounts and any other issues under section 402A on which guidance is needed. A number of comments were received in response to that solicitation and those comments have been taken into account in developing these proposed regulations.

Finally, these proposed regulations include amendments to the regulations under section 402(g) issued in 1991 in order to reflect the enactment of section 402A (as well as other statutory changes since those regulations were issued) and to make changes to conform the regulations under section 402(g) to the final section 401(k) regulations. These proposed regulations also add a new §1.408A-10 to the existing regulations under section 408A for Roth IRAs (§1.408A-1 through 9) issued in 1999 to reflect the interaction between section 408A and section 402A.

## **Explanation of Provisions**

### Overview

These proposed regulations provide guidance on the taxation of distributions from designated Roth accounts and other related issues. A designated Roth account is a separate account under a section 401(k) plan or section 403(b) plan to which designated Roth contributions are made, and for which separate accounting of contributions, gains, and losses are maintained. These proposed regulations clarify that any transaction or accounting methodology involving an employee's designated Roth account and any other accounts under the plan or plans of an employer that has the effect of directly or indirectly transferring value from another account into the designated Roth account violates the separate accounting requirement under section 402A.

The taxation of a distribution from a designated Roth account depends on whether or not the distribution is a qualified distribution. A qualified distribution from a designated Roth account is not includible in the employee's gross income.



A qualified distribution is generally a distribution that is made after a 5-taxable-year period of participation and that either (1) is made on or after the date the employee attains age 59½, (2) is made after the employee's death, or (3) is attributable to the employee's being disabled within the meaning of section 72(m)(7).

#### Determination of 5-year Rule for Qualified Distributions

In order for a distribution from a designated Roth account to be a qualified distribution and thus not includible in gross income, a 5-taxable-year requirement must be satisfied. These proposed regulations would reflect the rule in section 402A that the 5-taxable-year period during which a distribution is not a qualified distribution begins on the first day of the employee's taxable year for which the employee first had designated Roth contributions made to the plan and ends when 5 consecutive taxable years have been completed. However, if a direct rollover is made from a designated Roth account under another plan, the 5-taxable-year period for the recipient plan begins on the first day of the employee's taxable year for which the employee first had designated Roth contributions made to the other plan, if earlier.

#### Taxation of Nonqualified Distributions

Some commentators requested that the special ordering rules in section 408A(d), providing that the first distributions from a Roth IRA are a return of contributions (and thus not includible in gross income) until all contributions have been returned as basis, be applied to distributions from a designated Roth account. Although designated Roth contributions to a designated Roth account

bear some similarity to contributions to a Roth IRA (e.g., contributions to either type of account are after-tax contributions and qualified distributions from either type of account are excludable from gross income), there are many differences between these types of arrangements.

Section 402A does not provide that the special ordering rules of section 408A(d) apply to distributions from designated Roth accounts and, thus, these proposed regulations do not apply those special ordering rules. The only special rule under section 402A for nonqualified distributions from a designated Roth account is that the account is treated as a separate contract for purposes of section 72. Thus, these proposed regulations provide that a distribution from a designated Roth account that is not a qualified distribution is taxable to the distributee under section 402 (or section 403(b)(1)), treating the designated Roth account as a separate contract under section 72. In applying that treatment, the portion of any distribution that is includible in gross income as an amount allocable to income on the contract and the portion not includible in income as an amount allocable to investment in the contract is generally determined under section 72(e)(8). For example, if a nonqualified distribution of \$5,000 is made from an employee's designated Roth account when the account consists of \$9,400 of designated Roth contributions and \$600 of earnings, the distribution consists of \$4,700 of designated Roth contributions (that are not includible in the employee's gross income) and \$300 of earnings (that are includible in the employee's gross income).

#### Rollover of Designated Roth Contributions

As described above in the Background section of this preamble, section 402(c)(2) provides that, if a portion of the distribution from a plan qualified under section 401(a) is not includible in income (determined without regard to the rollover), that portion of the distribution can only be rolled over by a direct rollover of the distribution to another plan qualified under section 401(a) that agrees to separately account for the amount not includible in income. (Alternatively the distribution can be rolled over to an IRA in either a 60-day rollover or direct rollover.) The rule under section 402(c)(2) requiring direct rollover is designed to insure that the portion of the rolled over distribution that is investment in the contract is properly accounted for in the recipient plan.

Section 402A(c)(3) provides that a rollover contribution of a distribution from a designated Roth account may only be made to the extent it is otherwise allowable. Section 402(c)(2) provides rules regarding when a rollover contribution of amounts not includable in gross income are allowable. The IRS and Treasury Department believe that the rules in section 402(c)(2) relating to the distribution of an amount not includable in gross income apply to a distribution from a designated Roth account.<sup>2</sup> Thus, these regulations would provide that if the portion of a distribution from a designated Roth account under a plan qualified under section 401(a) that is not includible in income is to be rolled over into a designated Roth account under another plan, the rollover of the distribution must be accomplished through a direct rollover (i.e., a rollover to another designated

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<sup>2</sup> For distributions from designated Roth accounts, there is the same need for proper accounting of investment in the contract as for distributions from other accounts that include after-tax contributions. In addition, it is necessary to track whether the employee has satisfied the 5-year rule for qualified distributions.

Roth account is not available for the portion of the distribution not includible in gross income if the distribution is made directly to the employee) and can only be made to a plan qualified under section 401(a) which agrees to separately account for the amount not includible in income (i.e., it cannot be rolled over into a section 403(b) plan). To insure that there is proper accounting in the recipient plan, as described under Reporting and recordkeeping the distributing plan is required to report the amount of the investment in the contract and the first year of the 5-year period to the recipient plan so that the recipient plan will not need to rely on information from the distributee.

If a distribution from a designated Roth account is made to the employee, the employee would still be able to roll over the entire amount (or any portion thereof) into a Roth IRA within a 60-day period. Under section 402(c)(2), if only a portion of the distribution is rolled over, the portion that is not rolled over is treated as consisting first of the amount of the distribution that is includible in gross income. These regulations would provide that the income limits for contributions for Roth IRAs do not apply for this purpose.

Alternatively, the employee is permitted to roll over the taxable portion of the distribution to a designated Roth account under either a section 401(a) or 403(b) plan within a 60-day period. In such a case, additional reporting is required from the recipient plan, as described below under the heading Reporting and recordkeeping. In addition, the employee's period of participation under the distributing plan is not carried over to the recipient plan for purposes of determining whether the employee satisfies the 5-taxable-year requirement

under the recipient plan.

#### Determination of 5-Taxable-year Period after a Rollover to a Roth IRA

Section 402A and section 408A each provide for a 5-taxable-year period that must be completed in order for a distribution from a designated Roth account or a Roth IRA to be a qualified distribution. However, each of these sections contains different rules for determining when the 5-taxable-year requirement is satisfied. Generally, under section 402A, satisfaction of the 5-taxable-year requirement with respect to a designated Roth account under a plan is based on the years since a designated Roth contribution was first made by the employee under that plan. In contrast, the 5-year period under section 408A begins with the first taxable year for which a contribution is made to any Roth IRA.

Commentators suggested that, if a distribution from a designated Roth account to an individual is rolled into a Roth IRA, the individual receive credit under the 5-year rule in section 408A for the years since the individual first made a contribution to a designated Roth account. The IRS and Treasury Department do not believe that the Code permits this interaction between the two 5-year rules. Instead, these proposed regulations would provide that the 5-taxable-year period described in section 402A and the 5-taxable-year period described in section 408A(d)(2)(B) are determined independently. Thus, in the case of a rollover of a distribution from a designated Roth account maintained under a section 401(k) or 403(b) plan to a Roth IRA, the period that the rolled-over funds were in the designated Roth account does not count towards the 5-taxable-year period for determining qualified distributions from the Roth IRA. However, if an

individual had established a Roth IRA in a prior year, the 5-year period for determining qualified distributions from a Roth IRA that began as a result of that earlier Roth IRA contribution applies to any distributions from the Roth IRA (including a distribution of an amount attributable to a rollover contribution from a designated Roth account).

If a nonqualified distribution from a designated Roth account is rolled over into a Roth IRA, the portion of the distribution that constitutes a nontaxable return of investment in the contract is treated as basis in the Roth IRA. However, the proposed regulations would provide that, if a qualified distribution from a designated Roth account is rolled over into a Roth IRA, the entire amount of the distribution will be treated as basis in the Roth IRA. As a result, a subsequent distribution from the Roth IRA in the amount of the rollover would be treated as a tax-free return of basis regardless of whether the individual had maintained a Roth IRA for 5 years (although the investment return on that amount earned in the Roth IRA would not be excluded from income when distributed unless the distribution satisfied the requirements for a qualified distribution from a Roth IRA).

Under section 402A(c)(3)(B), only an amount rolled over from a designated Roth account is not taken into account for purposes of section 402A(c). Thus, these proposed regulations provide that a distribution from a Roth IRA cannot be rolled over into a designated Roth account.

#### Certain Amounts not Qualified Distributions

Section 1.402(c)-2, A-4, provides a list of amounts that are not treated as eligible rollover distributions and are instead currently includible in income. These proposed regulations would provide that these same amounts also cannot be qualified distributions. Distributions described in A-4(a) (distribution of elective deferrals in excess of the section 415 limits), (b) (corrective distribution of excess deferrals), and (c) (corrective distribution of excess contributions or excess aggregate contributions), have statutorily specified tax treatments. In the case of a deemed distribution under section 72(p) or the cost of current life insurance protection, an actual amount has not in fact been distributed. In the case of distributions of dividends deductible under section 404(k), section 72(e)(5)(D) and §1.404k-1(t) provide that these amounts are treated as paid under a separate contract providing only for payment of deductible dividends. However, if a dividend described in section 404(k) has been reinvested in accordance with section 404(k)(2)(iii)(II), then a distribution of the reinvested amount can be a qualified distribution.

#### Distribution of Employer Securities

The proposed regulations would also provide rules relating to the distribution of employer securities and the application of the net unrealized appreciation election of section 402(e)(4). If a qualified distribution includes employer securities, the distribution is not includible in gross income and the basis of each security in the hands of the distributee is the fair market value of the security on the date of the distribution. In such a case, the distributee will receive capital gains treatment at the time of any future disposition of the

security, to the extent of any post-distribution appreciation. If a distribution with respect to employer securities is not a qualified distribution, the rules of section 402(e)(4) apply in the same manner as to any other distribution except that the designated Roth account is treated as a separate contract.

#### Designated Roth Accounts under Section 403(b) Plans

These proposed regulations amend the 2004 proposed section 403(b) regulations to reflect the provisions of section 402A. Generally, these proposed regulations merely incorporate basic and definitional rules for a designated Roth program in §1.401(k)-1(f) under a section 401(k) plan into the 2004 proposed section 403(b) proposed regulations under section 403(b). Further, these proposed regulations also incorporate the taxation rules in section 402A into the 2004 proposed regulations under section 403(b) and clarify the taxation rules of section 402(c)(2) as they would apply to distributions from a section 403(b) plan. Thus, these proposed regulations provide that to the extent some or all of the distribution from a section 403(b) plan (including a distribution of an amount from a designated Roth account) would not have been includible in gross income if it were not rolled over, that portion of the distribution can only be rolled over into an individual retirement plan, or through a direct rollover to another section 403(b) plan which agrees to separately account for such rolled over amounts.

However, there is one issue that is unique to section 403(b) plans: the interaction between the right to make designated Roth contributions and the universal availability requirement in section 403(b)(12)(A)(ii). These proposed regulations provide that the universal availability requirement of section



403(b)(12) includes the right to make designated Roth contributions. Thus, if any employee is given the opportunity to designate section 403(b) elective deferrals as designated Roth contributions, then all employees must be given that right. These proposed regulations do not address what other rights with respect to section 403(b) elective deferrals under a section 403(b) plan may also be subject to the universal availability requirement.

#### Reporting and Recordkeeping

Under these proposed regulations, the plan administrator or other responsible party with respect to a plan with a designated Roth account would be responsible for keeping track of the 5-taxable-year period for each employee and the amount of designated Roth contributions made on behalf of such employee. In addition, the plan administrator or other responsible party of a plan directly rolling over a distribution would be required to provide the plan administrator of the recipient plan (i.e., the plan accepting the eligible rollover distribution) with a statement indicating either the first year of the 5-taxable-year period for the employee and the portion of such distribution attributable to basis or that the distribution is a qualified distribution. If the distribution is not a direct rollover to a designated Roth account under another eligible plan, the plan administrator or responsible party must provide to the employee, upon request, this same information, except the statement need not indicate the first year of the 5-taxable-year period. The statement would be required to be provided within a reasonable period following the direct rollover (or employee request), but in no event later than 30 days following the direct rollover (or employee request), and the plan

administrator or other responsible party for the recipient plan would be permitted to rely on these statements.

In order to give plans sufficient time to develop systems to comply with these reporting requirements, these reporting and record keeping requirements are proposed to be effective beginning with the 2007 taxable year. However, plan administrators are cautioned that it will not be possible for a plan to comply with the separate accounting requirement under section 402A and the recently published final regulations with respect to Roth 401(k) plans without keeping track of each employee's investment in the contract under the designated Roth account. Further, for any plan accepting a rollover from another designated Roth account, the proposed regulations only permit reliance for purposes of the record keeping requirement in future years on a statement from the plan administrator (or other responsible party) for the other plan. Consequently, we would anticipate that plans accepting a rollover contribution to a designated Roth account during 2006 would request representations from the other plan administrator (or responsible party) that the distribution being rolled over is from a designated Roth account and stating what portion of the distribution is investment in the contract.

As noted above, to the extent that a portion of a distribution is includible in income (determined without regard to the rollover), if any portion of that distribution is rolled over to a designated Roth account by the distributee rather than by direct rollover, the plan administrator of the recipient plan must notify the IRS of its acceptance of the rollover contribution. The notification is required to

be sent to an address to be specified by the Commissioner and must include: 1) the employee's name and social security number; 2) the amount rolled over; 3) the year in which the rollover contribution was made; and 4) such other information as the Commissioner may require in future published guidance in order to determine that the amount rolled over is a valid rollover contribution.

With respect to other reporting, generally, the same reporting requirements apply to plans with designated Roth accounts as apply to other plans. A contribution to and a distribution from a designated Roth account must be reported on Form W-2 and Form 1099-R, "Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA, Insurance Contracts," respectively, in accordance with the instructions thereto. It is expected that the instructions to Form 1099-R will be changed to require that a separate Form 1099-R be used to report the amount of a distribution from a designated Roth account, the taxable amount with respect to the distribution, and the first year of the 5-taxable year period. An employee has no reporting obligation with respect to designated Roth contributions under a section 401(k) or 403(b) plan. However, an employee rolling over a distribution from a designated Roth account to a Roth IRA should keep track of the amount rolled over in accordance with the instructions to Form 8606, "Nondeductible IRA's."

#### Designated Roth Contributions as Excess Deferrals

Even though designated Roth contributions are not excluded from income when contributed, they are treated as elective deferrals for purposes of section 402(g). Thus, to the extent total elective deferrals for the year exceed the section

402(g) limit for the year, the excess amount can be distributed by April 15<sup>th</sup> of the year following the year of the excess without adverse tax consequences.

However, if such excess deferrals are not distributed by April 15<sup>th</sup> of the year following the year of the excess, these proposed regulations would provide that any distribution attributable to an excess deferral that is a designated Roth contribution is includible in gross income (with no exclusion from income for amounts attributable to basis under section 72) and is not eligible for rollover.

These regulations would provide that if there are any excess deferrals that are designated Roth contributions that are not corrected prior to April 15<sup>th</sup> of the year following the excess, the first amounts distributed from the designated Roth account are treated as distributions of excess deferrals and earnings until the full amount of the those excess deferrals (and attributable earnings) are distributed.

#### Gap Period Income

In addition, these proposed regulations conform the gap period income rules for a distribution of excess deferrals under section 402(g) to the gap period income rules in the 2004 final section 401(k) and 401(m) regulations by providing that gap period income (i.e., income for the period after the taxable year) needs to be included in the distribution to the extent the employee is or would be credited with allocable gain or loss on those excess deferrals for that period, if the total account were to be distributed. This gap period income rule applies to both pre-tax excess deferrals and designated Roth contributions.

#### **Effective Date**

Section 402A applies to employees' taxable years beginning on or after January 1, 2006. The proposed regulations under section 402A are generally proposed to be applicable for taxable years beginning on or after January 1, 2007. However, certain provisions in the proposed regulations under section 402A are proposed to be applicable at the same time as section 402A. These include the clarification that the separate accounting requirement does not permit any transaction or accounting methodology that transfers value between designated Roth accounts and other accounts under a plan and the rules relating to rollovers to designated Roth accounts and Roth IRAs. Similarly, the proposed regulations under section 408A would be applicable at the same time as section 402A. These proposed regulations also address the treatment of rollover contributions to Roth IRAs and designated Roth accounts.

The proposed amendments to the regulations under section 402(g) relating to designated Roth contributions also are proposed to be applicable at the same time as section 402A. Thus, those proposed amendments would be applicable for excess deferrals for taxable years beginning on or after January 1, 2006. The rule requiring distribution of gap period income on excess deferrals applies to distributions in taxable years beginning on or after January 1, 2007, and thus will generally also apply for excess deferrals for taxable years beginning on or after January 1, 2006. As a result, this requirement generally would become applicable when the corresponding requirement under the 2004 final 401(k) and (m) regulations that distributions to correct excess contributions and excess aggregate contributions include gap period income becomes applicable.

The proposed amendments to the 2004 proposed section 403(b) regulations will not be applicable earlier than the applicability date of those regulations when they are finalized. The IRS and Treasury Department expect that the 2004 proposed section 403(b) regulations when finalized will be applicable for taxable years on or after January 1, 2007.

For the period after section 402A is applicable and before these proposed regulations are made final, taxpayers may rely on these proposed regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

These regulations do not provide rules for the application of the EGTRRA sunset provision (section 901 of EGTRRA), under which the provisions of EGTRRA do not apply to taxable, plan, or limitation years beginning after December 31, 2010. Unless the EGTRRA sunset provision is repealed before it becomes effective, additional guidance will be needed to clarify its application.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that 5 U.S.C. 553(b) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that most small entities that will maintain a designated Roth account

already use a third party provider to administer the plan and the collection of information in these regulations, which is required to comply with the separate accounting and recordkeeping requirements of section 402A(b), will only minimally increase the third party provider's administrative burden with respect to the plan. Therefore, an analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

### **Drafting Information**

The principal authors of these regulations are Cathy Vohs and R. Lisa Mojiri-Azad, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in the development of these regulations.

## List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

## Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

### PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended to read, in part, as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.402A-1 is also issued under 26 U.S.C. 402A \* \* \*

Par. 2. Section 1.402(g)-1 is amended as follows:

1. Revise the second sentence and add a third sentence to paragraph (a).
2. Add new paragraphs (b)(5) and (b)(6).
3. Revise paragraph (d).
4. Revise paragraph (e)(2) introductory text.
5. Revise paragraph (e)(2)(i).
6. Revise the second sentence and add a new third sentence in paragraph (e)(3)(i)(A).
7. Revise paragraph (e)(5)(i).
8. Add a sentence after the last sentence in paragraph (e)(5)(ii).
9. Revise paragraph (e)(5)(iii).
10. Add paragraph (e)(5)(v).
11. Add paragraph (e)(8)(iv).

The additions and revisions to §1.402(g)-1 read as follows:



§1.402(g)-1 Limitation on exclusion for elective deferrals.

(a) In general. \* \* \* , except to the extent the excess deferrals are comprised of designated Roth contributions, and thus, are already includible in gross income. A designated Roth contribution is treated as an excess deferral only to the extent that the total amount of designated Roth contributions for an individual exceeds the applicable limit for the taxable year or the designated Roth contributions are identified as excess deferrals and the individual receives a distribution of the excess deferrals and allocable income under paragraph (e)(2) or (e)(3) of this section.

(b) \* \* \*

(5) Any designated Roth contributions described in section 402A (before applying the limits of section 402(g) or this section).

(6) Any elective employer contributions to a SIMPLE retirement account, on behalf of an employee pursuant to a qualified salary reduction arrangement as described in section 408(p)(2) (before applying the limits of section 402(g) or this section).

\* \* \* \* \*

(d) Applicable limit--(1) In general. Except as provided under paragraph (d)(2) of this section, the applicable limit for an individual's taxable year is the applicable dollar amount set forth in section 402(g)(1)(B). This applicable dollar amount is increased for the taxable year beginning in 2007 and later years in the same manner as the dollar amount under section 415(b)(1)(A) is adjusted

pursuant to section 415(d). See §1.402(g)-2 for the treatment of catch-up contributions described in section 414(v).

(2) Special adjustment for elective deferrals with respect to section 403(b) annuity contracts for certain long-term employees. The applicable limit for an individual who is a qualified employee (as defined in section 402(g)(7)(C)) and has elective deferrals described in paragraph (b)(3) or (5) of this section for a taxable year is adjusted by increasing the applicable limit otherwise determined under paragraph (d)(1) of this section in accordance with section 402(g)(7).

(e) \* \* \*

(2) Correction of excess deferrals after the taxable year. A plan may provide that if any amount is an excess deferral under paragraph (a) of this section:

(i) Not later than the first April 15 (or such earlier date specified in the plan) following the close of the individual's taxable year, the individual may notify each plan under which deferrals were made of the amount of the excess deferrals received by the plan. If any designated Roth contributions were made to a plan, the notification must also identify the extent to which, if any, the excess deferrals are comprised of designated Roth contributions. A plan may provide that an individual is deemed to have notified the plan of excess deferrals (including the portion of excess deferrals that are comprised of designated Roth contributions) to the extent the individual has excess deferrals for the taxable year calculated by taking into account only elective deferrals under the plan and other plans of the same employer and the plan may provide the extent to which

such excess deferrals are comprised of designated Roth contributions. A plan may instead provide that the employer may notify the plan on behalf of the individual under these circumstances.

\* \* \* \* \*

(3) \* \* \*

(i) \* \* \*

(A) \* \* \* If any designated Roth contributions were made to a plan, the notification must identify the extent to which, if any, the excess deferrals are comprised of designated Roth contributions. A plan may provide that an individual is deemed to have notified the plan of excess deferrals (including the portion of excess deferrals that are comprised of designated Roth contributions) for the taxable year calculated by taking into account only elective deferrals under the plan and other plans of the same employer and the plan may provide the extent to which such excess deferrals are comprised of designated Roth contributions. \* \* \*

\* \* \* \* \*

(5) Income allocable to excess deferrals--(i) General rule. The income allocable to excess deferrals is equal to the sum of the allocable gain or loss for the taxable year of the individual and, in the case of a distribution in a taxable year beginning on or after January 1, 2007, made to correct an excess deferral, to the extent the excess deferrals are or will be credited with gain or loss for the gap period (i.e., the period after the close of the taxable year and prior to the

distribution) if the total account were to be distributed, the allocable gain or loss during that period.

(ii) Method of allocating income. \* \* \* A plan will not fail to use a reasonable method for computing the income allocable to excess deferrals merely because the income allocable to excess deferrals is determined on a date that is no more than 7 days before the distribution.

(iii) Alternative method of allocating taxable year income. A plan may determine the income allocable to excess deferrals for the taxable year by multiplying the income for the taxable year allocable to elective deferrals by a fraction. The numerator of the fraction is the excess deferrals by the employee for the taxable year. The denominator of the fraction is equal to the sum of:

(A) The total account balance of the employee attributable to elective deferrals as of the beginning of the taxable year, plus

(B) The employee's elective deferrals for the taxable year.

\* \* \* \* \*

(v) Alternative method for allocating plan year and gap period income. A plan may determine the allocable gain or loss for the aggregate of the taxable year and the gap period by applying the alternative method provided by paragraph (e)(5)(iii) of this section to this aggregate period. This is accomplished by substituting the income for the taxable year and the gap period for the income for the taxable year and by substituting the elective deferrals for the taxable year and the gap period for the elective deferrals for the taxable year in determining the fraction that is multiplied by that income.

\* \* \* \* \*

(8) \* \* \*

(iv) Distributions of excess deferrals from a designated Roth account. The rules of paragraph (e)(8)(iii) of this section generally apply to distributions of excess deferrals that are designated Roth contributions and the attributable income. Thus, if a designated Roth account described in section 402A includes any excess deferrals, any distribution of amounts attributable to those excess deferrals are includible in gross income (without adjustment for any return of investment in the contract under section 72(e)(8)). In addition, such distributions cannot be qualified distributions described in section 402A(d)(2) and are not eligible rollover distributions within the meaning of section 402(c)(4). For this purpose, if a designated Roth account includes any excess deferrals, any distributions from the account are treated as attributable to those excess deferrals until the total amount distributed from the designated Roth account equals the total of such deferrals and attributable income.

\* \* \* \* \*

Par. 3. Sections 1.402A-1 and 1.402A-2 are added to read as follows:

§1.402A-1 Designated Roth Accounts

Q-1: What is a designated Roth account?

A-1: A designated Roth account is a separate account under a qualified cash or deferred arrangement under a section 401(a) plan, or under a section 403(b) plan, to which designated Roth contributions are made that satisfies the

requirements of §1.401(k)-1(f) (in the case of a section 401(a) plan) or §1.403(b)-3(c) (in the case of a section 403(b) plan).

Q-2. How is a distribution from a designated Roth account taxed?

A-2. (a) The taxation of a distribution from a designated Roth account depends on whether or not the distribution is a qualified distribution. A qualified distribution from a designated Roth account is not includible in the distributee's gross income.

(b) Except as otherwise provided in paragraph (c) of this A-2, a qualified distribution is a distribution that is both--

(1) Made after the 5-taxable-year period of participation defined in A-4 of this section has been completed; and

(2) Made on or after the date the employee attains age 59½, made to a beneficiary or the estate of the employee on or after the employee's death, or attributable to the employee's being disabled within the meaning of section 72(m)(7).

(c) A distribution from a designated Roth account is not a qualified distribution to the extent it consists of a distribution of excess deferrals and attributable income described in §1.402(g)-1(e). See A-11 of this section for other amounts that are not treated as qualified distributions, including excess contributions described in section 401(k)(8), or excess aggregate contributions described in section 401(m)(8), and income on any of these excess amounts.

Q-3. How is a distribution from a designated Roth account taxed if it is not a qualified distribution?

A-3. Except as provided in A-11 of this section, a distribution from a designated Roth account that is not a qualified distribution is taxable to the distributee under section 402 in the case of a plan qualified under section 401(a) and under section 403(b)(1) in the case of a section 403(b) plan. For this purpose, a designated Roth account is treated as a separate contract under section 72. Thus, except as otherwise provided in A-5 of this section for a rollover, if a distribution is before the annuity starting date, the portion of any distribution that is includible in gross income as an amount allocable to income on the contract and the portion not includible in gross income as an amount allocable to investment in the contract is determined under section 72(e)(8), treating the designated Roth account as a separate contract. Similarly, if a distribution is on or after the annuity starting date, the portion of any annuity payment that is includible in gross income as an amount allocable to income on the contract and the portion not includible in gross income as an amount allocable to investment in the contract is determined under section 72(b), treating the designated Roth account as a separate contract. For purposes of section 72, designated Roth contributions are employer contributions described in section 72(f)(1) (contributions that are includible in gross income).

Q-4. What is the 5-taxable-year period of participation described in A-2 of this section?

A-4. (a) The 5-taxable-year period of participation described in A-2 of this section for a plan is the period of 5 consecutive taxable years that begins with the first day of the first taxable year in which the employee makes a designated Roth

contribution to any designated Roth account established for the employee under the same plan and ends when 5 consecutive taxable years have been completed. For this purpose, the first taxable year in which an employee makes a designated Roth contribution is the year in which the amount is includible in the employee's gross income.

(b) Generally, an employee's 5-taxable-year period of participation is determined separately for each plan (within the meaning of section 414(l)) in which the employee participates. Thus, if an employee has elective deferrals made to designated Roth accounts under two or more plans, the employee may have two or more different 5-taxable-year periods of participation, depending on when the employee first had contributions made to a designated Roth account under each plan. However, if a direct rollover contribution of a distribution from a designated Roth account under another plan is made by the employee to the plan, the 5-taxable-year period of participation begins on the first day of the employee's taxable year in which the employee first had designated Roth contributions made to such other designated Roth account, if earlier.

(c) The beginning of the 5-taxable-year period of participation is not redetermined for any portion of an employee's designated Roth account. This is true even if the employee dies or the account is divided pursuant to a qualified domestic relations order, and thus, a portion of the account is not payable to the employee and is payable to the employee's beneficiary or an alternate payee. The same rule applies if the entire designated Roth account is distributed during



the 5-taxable-year period of participation and the employee subsequently makes additional designated Roth contributions under the plan.

Q-5. How do the taxation rules apply to a distribution from a designated Roth account that is rolled over?

A-5. (a) An eligible rollover distribution from a designated Roth account is permitted to be rolled over into another designated Roth account or a Roth IRA, and the amount rolled over is not currently includable in gross income. In accordance with section 402(c)(2), to the extent that a portion of a distribution from a plan qualified under section 401(a) is not includible in income (determined without regard to the rollover), if that portion of the distribution is to be rolled over into a designated Roth account, the rollover must be accomplished through a direct rollover of the entire distribution (i.e., a 60 day rollover to another designated Roth account is not available for this portion of the distribution) and can only be made to another plan qualified under section 401(a) which agrees to separately account for the amount not includible in income (i.e., it cannot be rolled over into a section 403(b) plan). See § 1.403(b)-7(a) for the corresponding rule applicable to section 403(b) plans. If a distribution from a designated Roth account is instead made to the employee, the employee would still be able to roll over the entire amount (or any portion thereof) into a Roth IRA within the 60-day period described in section 402(c)(3).

(b) In the case of an eligible rollover distribution from a designated Roth account that is not a qualified distribution, if the entire amount of the distribution

is not rolled over, the part that is rolled over is deemed to consist first of the portion of the distribution that is attributable to income under section 72(e)(8).

(c) If an employee receives a distribution from a designated Roth account, the portion of the distribution that would be includible in gross income is permitted to be rolled over into a designated Roth account under another plan. In such a case, §1.402A-2, A-3, provides for additional reporting by the recipient plan. In addition, the employee's period of participation under the distributing plan is not carried over to the recipient plan for purposes of satisfying the 5-taxable-year period of participation requirement under the recipient plan.

(d) The following example illustrates the application of this A-5:

Example. Employee B receives a \$14,000 eligible rollover distribution that is not a qualified distribution from B's designated Roth account, consisting of \$11,000 of investment in the contract and \$3,000 of income. Within 60 days of receipt, Employee B rolls over \$7,000 of the distribution into a Roth IRA. The \$7,000 is deemed to consist of \$3,000 of income and \$4,000 of investment in the contract. Because the only portion of the distribution that could be includible in gross income (the income) is rolled over, none of the distribution is includible in Employee B's gross income.

(e) This A-5 applies for taxable years beginning on or after January 1, 2006.

Q-6. In the case of a rollover contribution to a designated Roth account, how is the amount that is treated as investment in the contract under section 72 determined?

A-6. If the entire amount of a distribution from a designated Roth account is rolled over to another designated Roth account, the amount of the rollover contribution allocated to investment in the contract in the recipient designated Roth account is the amount that would not have been includible in gross income

(determined without regard to section 402(e)(4)) if the distribution had not been rolled over. Thus, if an amount that is a qualified distribution is rolled over, the entire amount of the rollover contribution is allocated to investment in the contract. If less than the entire amount of a distribution is rolled over, A-5(b) of this section provides a rule for determining the portion of the rollover contribution treated as investment in the contract.

Q-7. After a qualified distribution from a designated Roth account has been made, how is the remaining investment in the contract of the designated Roth account determined under section 72?

A-7. (a) The portion of any qualified distribution that is treated as a recovery of investment in the contract is determined in the same manner as if the distribution were not a qualified distribution. (See A 3 of this section) Thus, the remaining investment in the contract in a designated Roth account after a qualified distribution is determined in the same manner after a qualified distribution as it would be determined if the distribution were not a qualified distribution.

(b) The following example illustrates the application of this A-7:

Example. Employee C receives a \$12,000 distribution, which is a qualified distribution that is attributable to the employee being disabled within the meaning of section 72(m)(7), from C's designated Roth account. Immediately prior to the distribution, the account consisted of \$21,850 of investment in the contract (i.e., designated Roth contributions) and \$1,150 of income. For purposes of determining recovery of investment in the contract under section 72, the distribution is deemed to consist of \$11,400 of investment in the contract [ $\$12,000 \times 21,850 / (1,150 + 21,850)$ ], and \$600 of income [ $\$12,000 \times 1,150 / (1,150 + 21,850)$ ]. Immediately after the distribution, C's designated Roth account consists of \$10,450 of investment in the contract and \$550 of income. This determination of the remaining investment in the contract will be needed if C

subsequently is no longer disabled and takes a nonqualified distribution from the designated Roth account.

Q-8. What is the relationship between the accounting for designated Roth contributions as investment in the contract for purposes of section 72 and their treatment as elective deferrals available for a hardship distribution under section 401(k)(2)(B)?

A-8. (a) There is no relationship between the accounting for designated Roth contributions as investment in the contract for purposes of section 72 and their treatment as elective deferrals available for a hardship distribution under section 401(k)(2)(B). A plan that makes a hardship distribution under section 401(k)(2)(B) from elective deferrals that includes designated Roth contributions must separately determine the amount of elective deferrals available for hardship and the amount of investment in the contract attributable to designated Roth contributions for purposes of section 72. Thus, the entire amount of a hardship distribution is treated as reducing the otherwise maximum distributable amount for purposes of applying the rule in section 401(k)(2)(B) and §1.401(k)-1(d)(3)(ii) that generally limits hardship distributions to the principal amount of elective deferrals made less the amount of elective deferrals previously distributed from the plan, even if a portion of the distribution is treated as income under section 72(e)(8).

(b) The following example illustrates the application of this A-8:

Example. Assume the same facts as in the Example in A-7 of this section, except that Employee C is not disabled, the distribution is a hardship distribution, and Employee C has received no previous distributions of elective deferrals from the plan. The adjustment to the investment in the contract is the same as in A-7 of this section, but for purposes of determining the amount of elective deferrals

available for future hardship distribution, the entire amount of the distribution is subtracted from the maximum distributable amount. Thus, Employee C has only \$9,850 (\$21,850 - \$12,000) available for hardship distribution from C's designated Roth account.

Q-9. Can an employee have more than one separate contract for designated Roth contributions under a plan qualified under section 401(a) or a section 403(b) plan?

A-9. (a) Except as otherwise provided in paragraph (b) of this A-9, for purposes of section 72, there is only one separate contract for an employee with respect to the designated Roth contributions under a plan. Thus, if a plan maintains one separate account for designated Roth contributions made under the plan and another separate account for rollover contributions received from a designated Roth account under another plan (so that the rollover account is not required to be subject to the distribution restrictions otherwise applicable to the account consisting of designated Roth contributions made under the plan), both separate accounts are considered to be one contract for purposes of applying section 72 to the distributions from either account.

(b) If a separate account with respect to an employee's accrued benefit consisting of designated Roth contributions is established and maintained for an alternate payee pursuant to a qualified domestic relations order and another designated Roth account is maintained for the employee, each account is treated as a separate contract for purposes of section 72. The alternate payee's designated Roth account is also a separate contract for purposes of section 72 with respect to any other account maintained for that alternate payee. Similarly, if separate accounts are established and maintained for different beneficiaries

after the death of an employee, the separate account for each beneficiary is treated as a separate contract under section 72 and is also a separate contract with respect to any other account maintained for that beneficiary under the plan that is not a designated Roth account. When the separate account is established for an alternate payee or for a beneficiary (after an employee's death), each separate account must receive a proportionate amount attributable to investment in the contract.

Q-10. What is the tax treatment of employer securities distributed from a designated Roth account?

A-10. (a) If a distribution of employer securities from a designated Roth account is not a qualified distribution, section 402(e)(4)(B) applies. Thus, in the case of a lump-sum distribution that includes employer securities, unless the taxpayer elects otherwise, net unrealized appreciation attributable to the employer securities is not includible in gross income; and such net unrealized appreciation is not included in the basis of the distributed securities and is capital gain to the extent such appreciation is realized in a subsequent taxable transaction.

(b) In the case of a qualified distribution of employer securities from a designated Roth account, the distributee's basis in the distributed securities for purposes of subsequent disposition is their fair market value at the time of distribution.

Q-11. Can an amount described in A-4 of §1.402(c)-2 with respect to a designated Roth account be a qualified distribution?

A-11. No. An amount described in A-4 of §1.402(c)-2 with respect to a designated Roth account cannot be a qualified distribution. Such an amount is taxable under the rules of §§ 1.72-16(b), 1.72(p)-1, A-11 through A-13, 1.402(g)-1(e)(8), 1.401(k)-2(b)(2)(vi), 1.401(m)-2(b)(2)(vi), or 1.404(k)-1T. Thus, for example, loans that are treated as deemed distributions pursuant to section 72(p), or dividends paid on employer securities as described in section 404(k) are not qualified distributions even if the deemed distributions occur or the dividends are paid after the employee attains age 59 ½ and the 5-taxable-year period of participation defined in A-4 of this section has been satisfied. However, if a dividend is reinvested in accordance with section 404(k)(2)(A)(iii)(II), the amount of such a dividend is not precluded from being a qualified distribution if later distributed.

Q-12. If any amount from a designated Roth account is included in a loan to an employee, do the plan aggregation rules of section 72(p)(2)(D) apply for purposes of determining the total amount an employee is permitted to borrow from the plan, even though the designated Roth account generally is treated as a separate contract under section 72?

A-12. Yes. If any amount from a designated Roth account is included in a loan to an employee, notwithstanding the general rule that the designated Roth account is treated as a separate contract under section 72, the plan aggregation rules of section 72(p)(2)(D) apply for purposes of determining the maximum amount the employee is permitted to borrow from the plan and such amount is based on the total of the designated Roth contributions amounts and the other

amounts under the plan, regardless of whether the loan is from the designated Roth account or other accounts under the plan. However, to the extent a loan is from a designated Roth account, the repayment requirement of section 72(p)(2)(C) must be satisfied separately with respect to that portion of the loan and with respect to the portion of the loan from other accounts under the plan.

Q-13. Does a transaction or accounting methodology involving an employee's designated Roth account and any other accounts under the plan or plans of an employer that has the effect of transferring value from the other accounts into the designated Roth account violate the separate accounting requirement of section 402A?

A-13. Yes. Any transaction or accounting methodology involving an employee's designated Roth account and any other accounts under the plan or plans of an employer that has the effect of directly or indirectly transferring value from another account into the designated Roth account violates the separate accounting requirement under section 402A. However, any transaction that merely exchanges investments between accounts at fair market value will not violate the separate accounting requirement. This A-13 applies to designated Roth accounts for taxable years beginning on or after January 1, 2006.

Q-14. When is section 402A and this §1.402A-1 applicable?

A-14. Section 402A is applicable for taxable years beginning on or after January 1, 2006. Except as otherwise provided in A-5 and A-13 of this section, the rules of this §1.402A-1 apply for taxable years beginning on or after January 1, 2007.



§1.402A-2 Reporting and recordkeeping requirements with respect to designated Roth accounts.

Q-1. Who is responsible for keeping track of the 5-taxable-year period of participation and the investment in the contract, i.e., the amount of unrecovered designated Roth contributions for the employee?

A-1. The plan administrator or other responsible party with respect to a plan with a designated Roth account is responsible for keeping track of the 5-taxable-year period of participation for each employee and the amount of investment in the contract (unrecovered designated Roth contributions) on behalf of such employee. For purposes of the preceding sentence, in the absence of actual knowledge to the contrary, the plan administrator or other responsible party is permitted to assume that an employee's taxable year is the calendar year. In the case of a direct rollover from another designated Roth account, the plan administrator or other responsible party of the recipient plan can rely on reasonable representations made by the plan administrator or responsible party with respect to the plan with the other designated Roth account. See A-2 of this section for statements required in the case of rollovers.

Q-2. In the case of an eligible rollover distribution from a designated Roth account, what additional information must be provided with respect to such distribution?

A-2. (a) Pursuant to section 6047(f), if an amount is distributed from a designated Roth account, the plan administrator or other responsible party with

respect to the plan must provide a statement as described below in the following situations--

(1) In the case of a direct rollover of a distribution from a designated Roth account under a plan to a designated Roth account under another plan, the plan administrator or other responsible party must provide to the plan administrator or responsible party of the recipient plan either a statement indicating the first year of the 5-taxable-year period described in A-1 of this section and the portion of the distribution that is attributable to investment in the contract under section 72, or a statement that the distribution is a qualified distribution.

(2) If the distribution is not a direct rollover to a designated Roth account under another plan, the plan administrator or responsible party must provide to the employee, upon request, the same information described in paragraph (a)(1) of this A-2, except the statement need not indicate the first year of the 5-taxable-year period described in A-1 of the section.

(b) The statement described in paragraph (a) of this A-2 must be provided within a reasonable period following the direct rollover or distributee request but in no event later than 30 days following the direct rollover or distributee request.

Q-3. If a plan qualified under section 401(a) or a section 403(b) plan accepts a 60-day rollover of earnings from a designated Roth account, what report to the IRS must be provided with respect to such rollover contribution?

A-3. A plan qualified under section 401(a), or a section 403(b) plan, accepting a rollover contribution (other than a direct rollover contribution) under section 402(c)(2), or section 403(b)(8)(B), of the portion of a distribution from a

designated Roth account that would have been includable in gross income must notify the Commissioner of its acceptance of the rollover contribution no later than the due date for filing Form 1099-R, "Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRA, Insurance Contracts." The notification is required to be sent to an address to be specified by the Commissioner and must include the employee's name and social security number, the amount rolled over, the year in which the rollover contribution was made, and such other information as the Commissioner, in revenue rulings, notices, or other published guidance in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter) may require in order to determine that the amount rolled over is a valid rollover contribution.

Q-4. When is this §1.402A-2 applicable?

A-4. The rules of this §1.402A-2 are applicable for taxable years beginning on or after January 1, 2007.

Par. 4. Section 1.403(b)-2 as set forth in Paragraph 5 of the 2004 section 403(b) proposed regulations (69 FR 67075) is amended by revising paragraph (a)(17) to read as follows:

§1.403(b)-2 Definitions.

(a) \* \* \*

(17) Section 403(b) elective deferral; designated Roth contribution--(i)  
Section 403(b) elective deferral means an elective deferral that is an employer contribution to a section 403(b) plan for an employee. See §1.403(b)-5(b) for additional rules with respect to a section 403(b) elective deferral.

(ii) Designated Roth contribution under a section 403(b) plan means a section 403(b) elective deferral that satisfies §1.403(b)-3(c).

\* \* \* \* \*

Par. 5. Section 1.403(b)-3, as set forth in paragraph 5 of the 2004 section 403(b) proposed regulations (69 FR 67075) is amended to read as follows:

1. A sentence is added to the end of paragraph (a) introductory text.
2. Paragraph (c) is redesignated as paragraph (d) and a new paragraph (c) is added.

§1.403(b)-3 Exclusion for contributions to purchase section 403(b) contracts.

(a) Exclusion for section 403(b) contracts. \* \* \* However, the preceding two sentences do not apply to designated Roth contributions; see paragraph (c) of this section and §1.403(b)-7(e) for special taxation rules that apply with respect to designated Roth contributions under a section 403(b) plan.

\* \* \* \* \*

(c) Special rules for designated Roth contributions. (1) The rules of §1.401(k)-1(f)(1) and (2) for designated Roth contributions under a qualified cash or deferred arrangement apply to designated Roth contributions under a section 403(b) plan. Thus, a designated Roth contribution under a section 403(b) plan is a section 403(b) elective deferral that is designated irrevocably by the employee at the time of the cash or deferred election as a designated Roth contribution that is being made in lieu of all or a portion of the section 403(b) elective deferrals the employee is otherwise eligible to make under the plan; that is treated by the employer as includible in the employee's gross income at the time the employee

would have received the amount in cash if the employee had not made the cash or deferred election (e.g., by treating the contributions as wages subject to applicable withholding requirements); and that is maintained in a separate account (within the meaning of §1.401(k)-1(f)(2)).

(2) A designated Roth contribution under a section 403(b) plan must satisfy the requirements applicable to section 403(b) elective deferrals. Thus, for example, designated Roth contributions under a section 403(b) plan must satisfy the requirements of §1.403(b)-6(d). Similarly, a designated Roth account under a section 403(b) plan is subject to the rules of section 401(a)(9)(A) and (B) and §1.403(b)-6(e).

\* \* \* \* \*

Par. 6. Section 1.403(b)-5, as set forth in paragraph 5 of the 2004 section 403(b) proposed regulations (69 FR 67075), is amended by adding a sentence to the end of paragraph (b)(1) to read as follows:

§1.403(b)-5 Nondiscrimination rules

(a) \* \* \*

(b) \* \* \* (1) \* \* \* Further, the employee's right to make elective deferrals also includes the right to designate section 403(b) elective deferrals as designated Roth contributions.

\* \* \* \* \*

Par. 7. Section 1.403(b)-7, as set forth in paragraph 5 of the 2004 section 403(b) proposed regulations (69 FR 67075), is amended as follows:

1. A sentence is added before the last sentence in paragraph (b)(1).

2. A sentence is added before the last sentence in paragraph (b)(2)
3. A paragraph (e) is added.

The additions are to read as follows:

§1.403(b)-7 Taxation of distributions and benefits

\* \* \* \* \*

(b) \* \* \* (1) \* \* \* Thus, to the extent that a portion of a distribution (including a distribution from a designated Roth account) would be excluded from gross income if it were not rolled over, if that portion of the distribution is to be rolled over into an eligible retirement plan that is not an IRA, the rollover must be accomplished through a direct rollover of the entire distribution (i.e., a 60-day rollover to another section 403(b) plan is not available for this portion of the distribution) to a section 403(b) plan that agrees to separately account for the amount not includible in income (i.e., it cannot be rolled over into a plan qualified under section 401(a)). \* \* \*

(2) \* \* \* Thus, the special rule in §1.401(k)-1(f)(3)(ii) with respect to distributions from a designated Roth account that are expected to total less than \$200 during a year applies to designated Roth accounts under a section 403(b) plan. \* \* \*

\* \* \* \* \*

(e) Special rules relating to distributions from a designated Roth account.

If an amount is distributed from a designated Roth account under a section 403(b) plan, the amount, if any, that is includible in gross income and the amount, if any, that may be rolled over to another section 403(b) plan is

determined under §1.402A-1. Thus, the designated Roth account is treated as a separate contract for purposes of section 72. For example, the rules of section 72(b) must be applied separately to annuity payments with respect to a designated Roth account under a section 403(b) plan and separately to annuity payments with respect to amounts attributable to any other contributions to the section 403(b) plan.

Par. 8. Section 1.408A-10 is added to read as follows:

§1.408A-10 Coordination between designated Roth accounts and Roth IRAs

Q-1. Can an eligible rollover distribution, within the meaning of section 402(c)(4), from a designated Roth account as defined in A-1 of §1.402A-1, be rolled over to a Roth IRA?

A-1. Yes. An eligible rollover distribution, within the meaning of section 402(c)(4), from a designated Roth account may be rolled over to a Roth IRA. For purposes of this section, designated Roth account means a designated Roth account as defined in A-1 of §1.402A-1.

Q-2. Can an eligible rollover distribution from a designated Roth account be rolled over to a Roth IRA even if the distributee is not otherwise eligible to make regular or conversion contributions to a Roth IRA?

A-2. Yes. An individual may establish a Roth IRA and rollover an eligible rollover distribution from a designated Roth account to that Roth IRA even if such individual is not eligible to make regular contributions or conversion contributions (as described in section 408A(c)(2) and (d)(3), respectively) because of the modified adjusted gross income limits in section 408A(b)(3).

Q-3. For purposes of the ordering rules on distributions from Roth IRAs, what portion of a distribution from a rollover contribution from a designated Roth account is treated as contributions?

A-3. Under section 408A(d)(4), distributions from Roth IRAs are deemed to consist first of regular contributions, then of conversion contributions, and finally, of earnings. For purposes of section 408A(d)(4), the amount of a rollover contribution that is treated as a regular contribution is the portion of the distribution that is treated as investment in the contract under A-6 of §1.402A-1, and the remainder of the rollover contribution is treated as earnings. Thus, the entire amount of any qualified distribution from a designated Roth account that is rolled over into a Roth IRA is treated as a regular contribution to the Roth IRA. Accordingly, a subsequent distribution from the Roth IRA in the amount of that rollover contribution is not includible in gross income under the rules of A-8 of §1.408A-6.

Q-4. In the case of a rollover from a designated Roth account to a Roth IRA, when does the 5-taxable-year period (described in section 408A(d)(2)(B) and A-1 of §1.408A-6) for determining qualified distributions from a Roth IRA begin?

A-4. (a) The 5-taxable-year period for determining a qualified distribution from a Roth IRA (described in section 408A(d)(2)(B) and A-1 of §1.408A-6) begins with the earlier of the taxable year described in A-2 of §1.408A-6 or the taxable year in which a rollover contribution from a designated Roth account is made to a Roth IRA. The 5-taxable-year period described in this A-4 and the 5-



taxable-year period of participation described in A-4 of §1.402A-1 are determined independently.

(b) The following examples illustrate the application of this A-4:

Example 1. Employee D, who is over age 59½, takes a distribution from D's designated Roth account in 2008, prior to the end of the 5-taxable-year period of participation used to determine qualified distributions from a designated Roth account. The distribution is an eligible rollover distribution and D rolls it over in accordance with sections 402(c) and 402A(c)(3) to D's Roth IRA, which was established in 2003 (i.e., established for more than 5 years). Any subsequent distribution from the Roth IRA of the amount rolled in, plus earnings thereon, would not be includible in gross income (because it would be a qualified distribution within the meaning of section 408A(d)(2)).

Example 2. Assume the facts are the same as in Example 1 except that the Roth IRA is D's first Roth IRA and is established with the rollover in 2008, which is the only contribution made to the Roth IRA. If a distribution is made from the Roth IRA prior to the end of the 5-taxable-year period used to determine qualified distributions from a Roth IRA (which begins in 2008, the year of the rollover which established the Roth IRA) the distribution would not be a qualified distribution within the meaning of section 408A(d)(2), and any amount of the distribution that exceeded the portion of the rollover contribution that consisted of investment in the contract is includible in D's gross income.

Example 3. Assume the facts are the same as in Example 2 except that the distribution from the designated Roth account is after the end of the 5-taxable-year period of participation used to determine qualified distributions from a designated Roth account. If a distribution is made from the Roth IRA prior to the expiration of the 5-taxable-year period used to determine qualified distributions from a Roth IRA, the distribution would not be a qualified distribution within the meaning of section 408A(d)(2), and any amount of the distribution that exceeded the amount rolled in is includible in D's gross income.

Q-5. Can amounts distributed from a Roth IRA be rolled over to a designated Roth account as defined in A-1 of §1.402A-1?

A-5. No. Amounts distributed from a Roth IRA may be rolled over or transferred only to another Roth IRA and are not permitted to be rolled over to a designated Roth account under a section 401(a) or section 403(b) plan. The

same rule applies even if all the amounts in the Roth IRA are attributable to a rollover distribution from a designated Roth account in a plan.

Q-6. When is this §1.408A-10 applicable?

A-6. The rules of §1.408A-10 apply for taxable years beginning on or after January 1, 2006.

Deputy Commissioner for Services and Enforcement.