Introducing the Supercharged Roth!

Now Every American Can Enjoy Roth Benefits

New Roth 401(k) Allows Contributions Up to $20,000 with NO Income Limits

Two of the most popular types of retirement savings plans available today are the Roth IRA and the 401(k) plan. In 2001, Congress married these two types of plans with the passing of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA), which included a provision allowing 401(k)s (regular and solo/individual) the opportunity to make Roth 401(k) contributions after the 2005 tax year.

Once available, this new program will afford plan participants the ability to put some of their wages into a 401(k)/Solo(k) plan as Roth contributions that, upon distribution, will result in tax treatment similar to distributions from Roth IRAs. This new plan will be available to anyone with a 401(k) or Solo(k), and is a boon to higher-paid employees and self-employed individuals (e.g. real estate investors) who may be excluded from having a Roth IRA account because of income limitations.

In preparation for the January 1, 2006 launch date, the IRS recently released proposed regulations concerning the Roth 401(k), or as the IRS refers to it, a "designated Roth contribution program." With 2006 almost upon us, now is the time to begin looking into the advantages of the Roth 401(k) to ensure that you are ready to act when regulations are final.

So, you may be wondering, what exactly ARE the advantages of the Roth 401(k)? Why all the hype? To better understand the appeal of the Roth 401(k), let's first review the regular 401(k)/Solo(k) and the Roth IRA.

BACKGROUND: THE TAX-DEFERRED 401(k)/SOLO(k)

You receive a deduction going in, and pay taxes when withdrawing funds.

The 401(k) or Solo(k) (a 401(k) for self-employed people, like real estate investors) is generally thought to be a good choice for those wanting to contribute more to a retirement account than an IRA will permit. Employees may contribute up to $15,000 for 2006 through salary deferral, although this may not exceed 100% of pay. Under a “catch up” provision, individuals age 50+ may contribute an additional $5,000 in salary deferrals beyond the $15,000. These contributions are tax-deferred, meaning that you can take a deduction on those funds for the tax year in which they were contributed.

In addition to this amount, the employer (or business owner, in the case of a Solo(k)) may also match these contributions, with a total combined contribution limit of $43,000 in 2006. Your own contributions are immediately "vested," meaning they are yours to keep under any circumstance. Employer contributions can vest immediately or over a period as long as six years.

No withdrawals, with the exception of hardship withdrawals, are allowed before age 59½ while you are employed. If you leave the company before age 55, withdrawals may be taxed and hit with a 10% penalty unless they are rolled over into an IRA or another 401(k).

You must begin to take distributions from your 401(k) or Solo(k) by April 1 of the year after you turn 70½ or when you retire, whichever is later. These distributions are taxed, as your contributions to the plan were tax-deferred going in.

BACKGROUND: THE ROTH IRA

No deductions going in, but… all profits are TAX-FREE going out.

Contributions made to a Roth are not deductible, but distributions are tax-free upon retirement. This is especially appealing to investors who expect to earn above-average rates on investments within their IRA, as this means that the earnings on these investments are tax-free.

Not all Americans qualify for a Roth IRA. The downside to the Roth IRA is that not all Americans are qualified to have one. If you currently make more than $110,000 as a single tax payer or $160,000 filing jointly, you do not qualify to open this type of account. Not so with the Roth 401(k)! Anyone can contribute, regardless of income.

In addition to qualifying restrictions, the contributions limits of the Roth IRA are low compared to the 401(k) – only $4,000 in 2006, with a $1,000 additional catch-up contribution for those age 50 or older.

There are no age restrictions with the Roth IRA. The account owner may continue to make contributions to, and need not take distributions from, the account when they reach age 70½.

When the account owner is ready to take distributions, they may do so, tax-free, as long as the account has been open for five years, and they are age 59½ or older.

NEW ROTH 401(k)

Allows greater "Roth" type contributions for EVERYONE, with no income limits.

Beginning in 2006, 401(k) and Solo(k) plans will be capable of allowing employees to make their contributions as Roth contributions. These Roth contributions are tax-free upon distribution, and any investment earnings in the account compound tax-free as well. Also, unlike the Roth IRA, Roth 401(k) contributions are allowable regardless of income level, permitting many taxpayers, who would not otherwise be eligible, to participate in a Roth account.

Contribute up to $43,000 to your 401(k) or Solo(k), with up to $20,000 as Roth contributions!

Like the regular 401(k) or Solo(k), the maximum employee contribution to a Roth 401(k) is $15,000 for 2006, plus another $5,000 in catch-up contributions if the participant reaches age 50 or older in that year.

Please consider that when an employer (or, in the case of the Solo(k), the business owner) makes a matching contribution to the employee's plan, those funds cannot be contributed to the Roth portion of the account. Only the employee's after-tax contributions and the related earnings on those contributions are permitted in the Roth 401(k). Any employer matching must be contributed to the participant's standard 401(k) account. Employer matches will still be made with pre-tax dollars, and the match will accumulate in a separate account that will be taxed as ordinary income at withdrawal. And, like the regular 401(k) or Solo(k), the total maximum contribution from both sources is $43,000 in 2006.

EXAMPLE: John is self-employed real estate investor and has a Solo(k) plan that he contributes to each year. This year, he set up his plan to allow Roth contributions, in addition to his regular Solo(k) contributions, beginning in January of 2006. John's compensation as an "employee" of his company will be $100,000 is 2006. When making his deferral elections, John wants to make the most of his opportunity to make Roth contributions, and decides to defer 1% of his pay ($1,000) as standard Solo(k) contributions, with an additional 14% ($14,000) as a designated Roth contribution. He may do this, because his combined contributions do not exceed the IRS limit of $15,000 for the 2006 tax year.

Then, putting on his "business owner" hat, John decides to match 100% of his combined contributions, or $15,000. He may do this because the total match is less than 20% of his earnings, which is the maximum amount that may be matched under a Solo(k) plan. According to IRS regulations, all matched funds must be made to John's regular tax-deferred account.

The total amount contributed to John's Solo(k) in 2006 is:

$ 1,000 - "employee" regular tax-deferred contribution to his Solo(k)
$14,000 - "employee" tax-free Roth contributions to his Solo(k)
$15,000 - "employer" match, placed in regular tax-deferred Solo(k) account

$30,000 - TOTAL CONTRIBUTIONS

ROTH 401(k) RULES SIMILAR TO THOSE OF THE ROTH IRA

The proposed rules released by the IRS thus far for the Roth 401(k) are similar to those for the Roth IRA, but there are some important differences. In a Roth 401(k), income taxes are paid at the time of contribution.

5 Years and Age 59½: All you need for tax-free income for life! Earnings and withdrawals are not taxed if withdrawals begin after age 59½, and if five years have elapsed from the date of the first contribution to the plan. Taxes and penalties are waived if a participant dies or is disabled.

Rollover to a Roth IRA to avoid taking distributions at 70½! As in a 401(k), Roth 401(k) participants must take minimum distributions (tax-free, of course) beginning the year after they turn 70½. However, the Roth 401(k) can be rolled into a Roth IRA, relieving the participant from taking these minimum distributions.

TAKE ADVANTAGE OF THE ROTH 401(k) NOW; IT MIGHT NOT LAST…

Roth 401(k) plans are scheduled to expire at the end of 2010. It is possible that after 2010, Roth contributions could remain in the plan, but no new Roth contributions could be made after that time. Congress may, of course, extend these provisions before this occurs. Should the Roth 401(k) become popular, this seems a likely prospect.

ROTH 401(k) HIGHLIGHTS

- **Higher contribution limits.** Roth 401(k) participants may make the maximum contribution allowable under 401(k) rules. The 2006 401(k)/Solo(k) contribution limits allow employees under age 50 to sock away up to $15,000, or $20,000 for employees age 50 or older. For those who want to save after-tax money, this is a much quicker route than saving in the Roth IRA, which has contribution limits of $4,000 for those under age 50 and $5,000 for those age 50 and above in 2006. As an added benefit, Roth 401(k) participants may still have and contribute the maximum allowable amount to a Roth IRA in addition to their Roth 401(k) contributions.
- **Tax benefits.** Roth contributions may be withdrawn tax- and penalty-free as long as the participant is at least 59½ years of age and has held the account for at least five years.
- **Easier participant qualification – Everyone qualifies!** The Roth 401(k) is open to anyone who has a regular 401(k) or Solo(k). This is a boon to higher-paid employees who may be excluded from having a Roth IRA account because of its income limitations.
- **Solo/Individual 401(k) participants can modify their plans to include Roth contributions.** Previously established 401(k) or Solo(k) plans can easily be modified to allow for Roth contributions.
- **Contributions are irrevocable.** Once the money goes into the account, it falls under all of the IRS rules and penalties for 401(k)/Solo(k) accounts. Participants may not later change their minds and move the funds into their regular tax-deferred account.
- **Distribution requirements.** The Roth 401(k) has the same distribution requirements as the 401(k) or Solo(k). Participants must begin taking

minimum distributions by age 70½. This contrasts with the Roth IRA, which has no distribution requirements. Account holders can get around this distribution requirement by rolling over their account into a Roth IRA.

- **Rollover options**. Participants can roll over Roth 401(k) contributions to a Roth IRA upon retirement or termination of employment.

GETTING STARTED

Once the IRS has issued final rules and regulations concerning the Roth 401(k), employers wishing to offer this option to their employees must have their existing 401(k) or Solo(k) plans amended to be able to accept Roth contributions.

Current clients of Equity Trust Company will continue to receive updates on the status of the Roth 401(k) as additional information is made available.

If you are not currently a client of Equity Trust Company, and wish to be notified as new data is released, you may request to be added to our email distribution list by subscribing to our electronic newsletter at www.trustetc.com, or by calling one of our friendly Client Service Team members at 440-323-5491.

About the Author

Richard Desich is the Chairman of the Board and Founder of Equity Trust Company, the nation's leader in self-directed IRAs and small business retirement accounts. Involved in the securities industry for more than 35 years, Mr. Desich has served as chairperson on the Lorain County Community College Board of Directors for over 30 years and for numerous public and private corporations throughout the Lorain County area. Additionally, Richard is President of Equity Oil and Gas Funds, Inc., a company specializing in the production of oil and gas.

Mr. Desich is nationally recognized as a pre-eminent authority on non-traditional investing in IRAs and Qualified Plans. Richard has spoken to thousands of investors throughout the country on using self directed IRAs to invest in real estate, notes, mortgages, etc. In addition, he has published numerous articles on the topic and has helped countless investors create retirement plans for themselves and their families.

Equity Trust Company and affiliates has been a NASD/SIPC member firm for over 31 years. Approved by the Internal Revenue Service to act as an IRA custodian since 1983, Equity Trust Company services tens of thousands of individual retirement accounts and small business retirement plans for clients in all fifty states.