

to contributions in taxable years beginning on or after January 1, 2004.

[T.D. 9072, 68 FR 40515, July 8, 2003]

§ 1.402(g)(3)-1 Employer contributions to purchase a section 403(b) contract under a salary reduction agreement.

(a) *General rule.* With respect to an annuity contract under section 403(b), except as provided in paragraph (b) of this section, an elective deferral means an employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement within the meaning of section 3121(a)(5)(D).

(b) *Special rule.* Notwithstanding paragraph (a) of this section, for purposes of section 403(b), an elective deferral only includes a contribution that is made pursuant to a cash or deferred election (as defined at § 1.401(k)-1(a)(3)). Thus, for purposes of section 402(g)(3)(C), an elective deferral does not include a contribution that is made pursuant to an employee's one-time irrevocable election made on or before the employee's first becoming eligible to participate under the employer's plans or a contribution made as a condition of employment that reduces the employee's compensation.

(c) *Applicable date.* This section is applicable for taxable years beginning after December 31, 2008.

[T.D. 9340, 72 FR 41140, July 26, 2007]

§ 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 permitted to be made in lieu of elective contributions and 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 quali-

fied 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), and 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, in the case of any amount received as an annuity, 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) or (d), as applicable, treating the designated Roth account as a separate contract. For purposes of section 72, designated Roth contributions are described in section 72(f)(1) or 72(f)(2), to the extent applicable.

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. Notwithstanding the preceding, however, a contribution that is returned as an excess deferral or excess contribution does not begin the 5 taxable-year period of participation. Similarly, a contribution returned as a permissible withdrawal under section 414(w) does not begin the 5 taxable-year period of participation.

(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 em-

ployee first had designated Roth contributions made to such other designated Roth account, if earlier than the first taxable year in which a designated Roth contribution is made to the plan. See A-5(c) of this section for additional rules on determining the start of the 5-taxable-year of participation in the case of an indirect rollover.

(c) The beginning of the 5-taxable-year period of participation is not re-determined for any portion of an employee's designated Roth account. This is true even 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.

(d) The rule in paragraph (c) of this section applies if the employee dies or the account is divided pursuant to a qualified domestic relations order (QDRO), 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. In the case of distribution to an alternate payee or beneficiary, generally, the age, death, or disability of the employee is used to determine whether the distribution to an alternate payee or beneficiary is qualified. However, if an alternate payee or a spousal beneficiary rolls the distribution into a designated Roth account in a plan maintained by his or her own employer, such individual's age, disability, or death is used to determine whether a distribution from the recipient plan is qualified. In addition, if the rollover is a direct rollover contribution to the alternate payee's or spousal beneficiary's own designated Roth account, the 5-taxable-year period of participation under the recipient plan begins on the earlier of the date the employee's 5-taxable-year period of participation began under the distributing plan or the date the 5-taxable-year period of participation applicable to the alternate payee's or spousal beneficiary's designated Roth account began under the recipient plan.

(e) If a designated Roth contribution is made by a reemployed veteran for a year of qualified military service pursuant to section 414(u) that is before the year in which the contribution is

actually made, the contribution is treated as having been made in the year of qualified military service to which the contribution relates, as designated by the reemployed veteran. Reemployed veterans may identify the year of qualified military service for which a contribution is made for other purposes, such as for entitlement to a match, and the treatment for the 5-taxable-year period of participation rule follows that identification. In the absence of such designation, for purposes of determining the first year of the five years of participation under section 402A(d)(2)(B), the contribution is treated as relating to the first year of qualified military service for which the reemployed veteran could have made designated Roth contributions under the plan, or if later the first taxable year in which designated Roth contributions could be made 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 includible in gross income. In accordance with section 402(c)(2), to the extent that a portion of a distribution from a designated Roth account 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 (i.e., a 60-day rollover to another designated Roth account is not available for this portion of the distribution). For this purpose, any amount paid in a direct rollover is treated as a separate distribution from any amount paid directly to the employee. 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 and not paid as a direct rollover

contribution, if less than the entire amount of the distribution is 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. Generally, the taxable year in which the recipient plan accepts such rollover contribution is the taxable year that begins the participant's new 5-taxable-year period of participation. However, if the participant is rolling over to a plan in which the participant already has a pre-existing designated Roth account with a longer period of participation, the starting date of the recipient account is used to measure the participant's 5-taxable-year period of participation.

(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. (a) If a distribution from a designated Roth account is rolled over to another designated Roth account in a

direct rollover, 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.

(b) If the entire account balance of a designated Roth account is rolled over to another designated Roth account in a direct rollover, and, at the time of the distribution, the investment in the contract exceeds the balance in the designated Roth account, the investment in the contract in the distributing plan is included in the investment in the contract of the recipient plan.

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. The facts are the same as in the *Example* in A-7 of this section, except that instead of being disabled, Employee C is receiving a hardship distribution. In addition, Employee C has made elective deferrals that are not designated Roth contributions totaling \$20,000 and 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 \$29,850 ($\$41,850 - \$12,000$) 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 59½ 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. Further, an amount is not precluded from being a qualified distribution merely because it is described in section 402(c)(4) as an amount not eligible for rollover. Thus, a hardship distribution is not precluded from being a qualified distribution.

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 contribution amounts and the other amounts under the plan. 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. (a) 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.

(b) In the case of an annuity contract which contains both a designated Roth account and any other accounts, the Commissioner may prescribe additional guidance of general applicability, published in the Internal Revenue Bulletin (see 601.601(d)(2) of this chapter), to provide additional rules for

allocation of income, expenses, gains and losses among the accounts under the contract.

(c) This A-13 applies to designated Roth accounts for taxable years beginning on or after January 1, 2006.

Q-14. How is an annuity contract that is distributed from a designated Roth account treated for purposes of section 402A?

A-14. A qualified plan distributed annuity contract within the meaning of § 1.402(c)-2, A-10(a) that is distributed from a designated Roth account is not treated as a distribution for purposes of section 402 or 402A. Instead, the amounts paid under the annuity contract are treated as distributions for purposes of sections 402 and 402A. Thus, the period after the annuity contract is distributed and before a payment from the annuity contract is made is included in determining whether the five-year period of participation is satisfied. Further, for purposes of determining if a distribution is a qualified distribution, the determination of whether a distribution is 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) is made based on the facts at the time the distribution is made from the annuity contract. Thus for example, if an employee first makes a designated Roth contribution to a designated Roth account in 2006 at age 56, receives a distributed annuity contract within the meaning of § 1.402(c)-2, A-10(a) in 2007 purchased only with assets from the designated Roth account, and then receives a distribution from the contract in 2011 at age 60, the distribution is a qualified distribution.

Q-15. When are section 402A and this § 1.402A-1 applicable?

A-15. 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.

[T.D. 9324, 72 FR 21111, Apr. 30, 2007; 72 FR 30974, June 5, 2007, as amended by T.D. 9340, 72 FR 41140, July 26, 2007]