

## IRS Releases Guidance on In-Plan Roth Conversions

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### Background

On Friday, November 26th, the IRS issued Notice 2010-84, which provides guidance on in-plan Roth conversions (<http://www.irs.gov/pub/irs-drop/n-10-84.pdf>). This option, available to 401(k) and 403(b) plans as of September 27th, 2010, and for governmental 457(b) plans starting January 1, 2011, enables plans to permit participants to convert existing pre-tax funds in a plan to an after-tax Roth account. More information on the background can be found in *asap* 10-12.

### Questions Answered

The guidance answers twenty questions, ranging in topic from definition to taxation issues.

The guidance provides clarity on which types of accounts are available for the in-plan Roth conversion. Any vested amount eligible for a rollover distribution is available to convert. Pre-tax elective deferrals are not available as an eligible rollover source for a participant who has not had a severance from employment unless they are over 59 ½, have died or become disabled, or have received the qualified reservist distribution.

### Distribution Issues

In-plan Roth direct rollovers are not treated as distributions for all purposes. Any loan amount rolled over will not be treated as a new loan, spousal consent is not required, the special notice to defer receipt of distribution is not triggered for amounts

over \$5,000, and any optional forms of distribution must be preserved.

A beneficiary or alternate payee may elect an in-plan Roth direct rollover only if the beneficiary is a surviving spouse and if the alternate payee is a spouse or former spouse.

Plans may be amended to allow a direct rollover option solely for the in-plan Roth direct rollover. Also, distribution options for the Roth conversion may be more liberal than distribution options for other events, with the exception that pre-tax deferrals may not be distributable until the participant has obtained age 59 ½.

One issue that differentiates the in-plan Roth direct rollover from the traditional IRA-to-Roth IRA rollover is that a direct rollover conversion cannot be undone. With IRA conversions, the amounts can be recharacterized back to a pre-tax IRA.

### Special Notices

Plans which offer the in-plan Roth direct rollover option must include information about this feature with the 402(f) notice provided to participants qualified for an eligible rollover distribution. Language to be included is detailed in the IRS guidance under Q&A-5.

### Taxation Issues

The guidance addressed several tax issues (Q&A-7 through Q&A-13). The taxable amount that must be included in the participant's gross income is the fair

market value of the rollover amount reduced by any basis the participant has in the distribution. This is the same amount that is taxable should the amount be rolled over to a Roth IRA.

In-plan Roth direct rollovers are not subject to mandatory 20% Federal withholding. Accordingly, participants may need to increase their personal income tax withholdings in order to avoid an underpayment penalty. The taxable amount of the in-plan Roth direct rollover is includable as income in the taxable year in which the distribution occurs, with an exception for direct rollovers in the 2010 plan year. Taxpayers taking advantage of the in-plan Roth direct rollover in 2010 may elect to include the entire taxable amount as gross income on their 2010 return, otherwise half of the taxable amount will be taxable in 2011 and half in 2012 (special income acceleration rules also apply and are detailed in Q&A-11). The participant's election to include the income in 2010, or to defer the income until 2011 and 2012 may not be changed past the due date (including extensions) for filing their 2010 income tax return.

### **Administrative Issues**

Plan documents for 401(k) do not need to be amended by the end of the 2010 plan year in order to provide the in-plan Roth conversion option to participants in the 2010 plan year. The IRS is extending the deadline for 401(k) plans to adopt the plan amendment(s) to the later of the last day of the plan year in which the amendment is effective or December 31, 2011.

For 403(b) plans, a plan amendment providing for the in-plan Roth conversion will be required by the later of the remedial amendment period (retroactive to January 1, 2010 for certain plans) or the last day of the first plan year in which the amendment is effective. See Q&A-16.

These extensions apply to amendments that permit Roth contributions to be made to the plan, provide for acceptance of rollover contributions, and permit

in-plan Roth rollovers. The extensions do not apply to a plan amendment that adds a 401(k) CODA to the plan.

The plan must allow for qualified Roth contributions prior to allowing a rollover contribution to be designated as an in-plan Roth direct rollover. As stated in Q&A-15 and Q&A-16, the plan may be amended retroactively to designate the qualified Roth program. The Roth program is considered to be in place as of the date that eligible employees are given the opportunity to designate Roth contributions made to the plan.



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