



EMPLOYEE BENEFITS PRACTICE

ALERT

IRS COMES THROUGH WITH GUIDANCE ON IN-PLAN ROTH ROLLOVERS

By Susan Foreman Jordan

Included in the Small Business Jobs Act of 2010 is a provision whereby amounts accumulated in a 401(k) plan can be converted into Roth accounts through in-plan Roth rollover. Until that option was added, Roth conversion could be accomplished only through direct rollover from the plan to a Roth IRA.

Immediately after the new law was passed, the IRS strongly cautioned plan sponsors not to permit in-plan Roth rollovers unless and until additional guidance had been issued. Guidance came in the form of Notice 2010-84 — released the day after Thanksgiving — and it was no turkey! To the contrary, it was **stuffed** with helpful clarification, as well as a bonus of an extended remedial amendment period.

The Notice, issued in question and answer form, makes it clear any vested amount held in a plan account for a plan participant, whether attributable to elective deferrals, employer contributions or earnings (other than amounts held in a designated Roth account), is eligible for Roth rollover within the same plan, provided the disbursement is an “eligible rollover distribution.” Thus, a participant who has not had a severance from employment is eligible for in-plan Roth rollover only if the participant has reached age 59-1/2, died, become disabled or received a qualified reservist distribution.

Although treated as a distribution for tax purposes, an in-plan Roth direct rollover will not be treated as a

distribution with respect to plan loans, elimination of optional forms of benefit or spousal annuities. This means spousal consent will not be needed for in-plan Roth rollover. Likewise, rights to optional forms of benefits will not be eliminated through an in-plan rollover, and amounts transferred to the Roth account through in-plan rollover must be taken into account when determining if the participant’s account balance exceeds \$5,000 for purposes of consent for future distributions.

Contrary to some initial interpretations of the in-plan rollover option, the Notice makes it clear a plan may be amended to permit in-plan Roth rollover by participants who have reached age 59-1/2 but need not permit any other rollover or distribution option for these amounts. Thus, a plan may be amended to permit in-plan Roth rollovers by participants who have attained age 59-1/2, without having to permit in-service withdrawal.

In general, the tax consequence of in-plan Roth rollover is inclusion — in the participant’s gross income for the year in which the rollover occurs — of an amount equal to the fair market value of the distribution reduced by any basis the participant has in the distribution. The special tax rule available to Roth IRA rollovers occurring in 2010 is extended to in-plan Roth rollovers: for an in-plan rollover made in 2010, one-half of the taxable amount will be includable in the participant’s gross income for 2011, and the other half will be includable in

2012, unless the participant elects to include the entire taxable amount in his gross income in 2010. In any event, in-plan Roth rollovers are not subject to mandatory income tax withholding.

An in-plan Roth rollover can be accomplished by a participant or, if the participant is deceased, by a beneficiary, provided that he or she is the surviving spouse. In addition, an alternate payee, who is the spouse or former spouse of the participant designated under a qualified domestic relations order (QDRO), may effect an in-plan Roth rollover.

The Notice cautions that although a Roth IRA rollover can be unwound, recharacterization is **not** available for in-plan Roth rollover. Conversion to Roth through an in-plan rollover is irrevocable.

A plan must be amended to authorize in-plan Roth rollover. Normally, such an amendment would be considered a discretionary amendment that must be adopted by the end of the plan year in which the amendment is to be effective. However, in order to give

plan sponsors sufficient time to adopt the necessary amendments and thereby enable plan participants to make in-plan Roth rollovers before the end of the 2010 plan year, the IRS has extended the deadline for adopting the necessary amendments to the last day of the plan year in which the amendment is effective or, if later, December 31, 2011, provided the amendment is adopted with retroactive effect.

If a plan sponsor wishes to permit in-plan Roth rollovers during 2010, pending formal plan amendment, availability of the option should be confirmed by board resolution or other appropriate action and communicated to participants. In addition, distribution election forms must be modified to incorporate appropriate tax elections and include (in the safe harbor tax notice) an explanation of the in-plan Roth rollover option.

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