

Roth and Roll Simplified

A potentially valuable gem buried in the Small Business Jobs Act of 2010 will enhance Roth conversions for some plan participants. Prior to the Act, plan participants wishing to convert current retirement funds to a Roth were required to distribute the funds to an IRA. The new rules allow the conversion without requiring money to leave the plan.

Basically:

- The subject funds must be eligible for a Qualified Rollover Distribution from the plan.
- Employees making this conversion election must include the amount in their gross income. For those making this election in 2010, rules permit the employee to include the entire amount in their 2010 income or to spread it over 2 years, 2011 and 2012.
- A plan sponsor may amend the plan to expand the distribution options.

Below are some important details to further clarify:

Which Plans are permitted to allow the Roth account conversion?

401(k) plans, 403(b) plans, and beginning in 2011, governmental 457(b) plans. The provision does not apply to money purchase pension plans, profit sharing plans, or defined benefit plans (such as traditional pension or cash balance plans). A Roth feature may be added to a 401(k) or 403(b) plan now, but it must permit Roth contributions as well as Roth conversions.

Are Plan Sponsors required to offer Roth account conversions?

No.

Who is eligible to complete an in-plan Roth Conversion?

Assuming the plan contains a Roth feature, any participant (including an active or former participant with an account balance in the plan) who is eligible to receive a Qualified Rollover Distribution can make the Roth conversion election. The election is available to surviving spouses, but not non-spouse beneficiaries. There is no income limit or filing status restriction for this election.

What funds are eligible for conversion to a Roth?

The conversion applies to any type of vested contributions (and earnings thereon) that are currently distributable and would be treated as a Qualified Rollover Distribution.

These include the following contributions and earnings thereon: (1) pre-tax 401(k) and 403(b) deferrals (beginning in 2011, governmental 457(b) deferrals), (2) matching contributions (3) profit sharing contributions, and (4) after-tax contributions.

Can a plan "liberalize" its distribution rules to permit greater access to the Roth Conversion option?

A plan's in-service distribution rules can be expanded to permit conversion of additional amounts. For example, after-tax contributions and rollover amounts that are held in separate accounts might be made available for distribution at any time. In addition, "in-service" distribution age requirements can be lowered.

As always, 401(k) contributions distributed prior to age 59-1/2 are not considered to be Qualified Rollover Distributions.

Does the plan have to be amended to utilize the Roth Conversion option?

Yes. In general, a good-faith amendment should be adopted by the end of the 2010 plan year as this would likely be viewed as a discretionary plan amendment. This amendment may specify that any distribution made pursuant to the amendment remain in the plan. At this time, the law does not specifically address the timing of a plan amendment. We anticipate that the IRS will provide a special remedial amendment period to allow employers to offer the conversion in 2010 and amend later.

We would be happy to discuss this latest option and how we can help ensure an in-plan Roth conversion is available for your plan.

