In-Plan Conversions Under the Small Business Jobs Act

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The Small Business Jobs Act of 2010, signed into law on September 27, 2010, includes a new Roth "in-plan" conversion option for 401(k) and 403(b) plans that permits plan participants to convert pre-tax amounts into after-tax Roth amounts in the same plan. Generally, Roth contributions are made on an after-tax basis to a designated Roth account under a plan and earnings on the Roth account accrue on a tax-free basis if certain distribution requirements are satisfied.

In order for this in-plan conversion option to be available, the 401(k) or 403(b) plan must offer the ability for participants to make after-tax Roth contributions from their pay to a designated Roth account. If a plan does not already include a Roth feature, it may be amended to provide for Roth contributions. In order to be eligible to elect an in-plan conversion, a participant must be eligible for a distribution under the plan's terms. For example, an amount held in a 401(k) account that is subject to distribution restrictions cannot be converted to a designated Roth account. However, an employer may elect to amend its plan to provide for expanded distribution options beyond those currently in place, such as the addition of in-service distributions after age 59½. In addition, the plan may condition eligibility for a new distribution option on an employee's election to make an in-plan Roth conversion.

The converted amount will be fully taxable to the electing participant; however, the 10 percent early distribution penalty will not apply. If a participant chooses to convert his or her pre-tax account to a Roth account in 2010, the participant may elect to pay the taxes incurred due to the conversion fully in 2010, or in equal installments in tax years 2011 and 2012 at the rates in effect for 2011 and 2012. A participant who does not want to run the risk of tax rate increases after 2010 may opt to pay the full tax incurred on the conversion in 2010 so as to benefit from the 2010 rates.

Plan sponsors that wish to offer their plan participants the in-plan conversion option will need to amend their plans to allow for the in-plan conversion. It is expected that the IRS will provide plan sponsors with a remedial amendment period that permits them to offer in-plan conversions to participants in 2010, and still have sufficient time to amend plans to include this option. If you have any questions or need assistance with implementing in-plan conversions, please contact a member of the ERISA Practice Center.

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