Proskauer

IRS Provides Guidance on In-Plan Roth Rollovers

December 23, 2010

The IRS has issued guidance in question-and-answer format in Notice 2010-84 (the “IRS Guidance”) explaining how to implement in-plan Roth rollovers in Section 401(k) and 403(b) plans under new Section 402A(c)(4) of the Internal Revenue Code of 1986, as amended (the “Code”). Section 401(k) and 403(b) plans that offer a Roth contribution feature are now permitted to allow participants the opportunity to roll over amounts in their plan accounts other than Roth designated amounts to a Roth designated account within the same plan. For a complete description of in-plan Roth rollovers, refer to our client alert of October 21, 2010 here: In-Plan Conversions Under the Small Business Jobs Act. Highlights from the IRS Guidance are discussed below.

The IRS Guidance clarifies that in-plan Roth rollovers may be achieved directly or indirectly (i.e., by means of a distribution to a participant who has sixty days to roll over the amounts into his or her designated Roth account). Significantly, plans must have a Roth contribution feature in place for a participant to effect an in-plan Roth rollover. Plans may add an in-plan Roth direct rollover option for amounts that would otherwise not be distributable under the Plan terms (but which could be distributed under the Code) without permitting any other rollover or distribution option for these amounts. For example, a plan that does not otherwise permit distributions at age 59½ may allow for in-plan Roth direct rollovers for participants who have attained age 59½.

The IRS Guidance also clarifies that plan amendments providing for in-plan Roth rollovers are not required to be adopted by December 31, 2010 even if effective prior to that date. Instead, for 401(k) plans, the deadline for adopting these amendments is the later of the last day of the plan year in which the amendment is effective and December 31, 2011. For 403(b) plans, the deadline for adopting plan amendments is the later of the end of the plan’s remedial amendment period pursuant to IRS Announcement 2009-89 and the last day of the first plan year in which the amendment is effective.

Participants will be required to include the taxable amount of the in-plan Roth rollover in their gross income. The amount includible equals the amount that would be included if the amounts were rolled over into a Roth IRA. However, distributions that are rolled over in an in-plan Roth rollover in 2010 may be included ratably in gross income in 2011 and 2012 under a special rule, unless the taxpayer irrevocably elects to include the income in 2010. Mandatory 20 percent withholding will not apply to in-plan Roth direct rollovers, but the IRS Guidance encourages participants to increase their withholding or make estimated tax payments to avoid an underpayment penalty.

In-plan Roth direct rollovers will not be subject to the 10 percent penalty under Section 72(t) except in cases where an early distribution occurs. If an amount that is allocable to the taxable portion of an in-plan Roth rollover is distributed to the participant within five years (measured from the first day of the participant's taxable year in which the rollover occurred), the amount that is distributed will be treated as includible in gross income for purposes of the 10 percent penalty under Code Section 72(t). Special income acceleration rules will apply if a participant receives in 2010 or 2011 an early distribution of any amount of the taxable portion of the in-plan Roth rollover that otherwise would not have been includible in gross income until 2011 and 2012. In this case, a participant's gross income in the year of distribution will be increased by the amount of the distribution that he or she could have otherwise deferred to a later year.

The IRS Guidance also clarifies that a participant who elects an in-plan Roth rollover may not "unwind" that rollover as is permitted with rollovers to Roth IRAs. Additionally, spousal consent will not be required to make an in-plan Roth rollover. Separately, in-plan Roth rollovers will not be treated as distributions for purposes of plan loans; plan loans transferred in an in-plan Roth direct rollover will not be treated as new loans. Finally, plans that offer in-plan Roth rollovers must include a description of the option in the notice otherwise required by Code Section 402(f).

For more information on how to effect in-plan Roth rollovers, please contact a member of our ERISA Practice Center.

Related Professionals

- **Steven D. Weinstein**

Partner

- **Andrea S. Rattner**

  Partner