



## **IRS Provides Guidance on Expansion of In-Plan Roth Rollovers**



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# IRS Provides Guidance on Expansion of In-Plan Roth Rollovers

On December 11, 2013, the Internal Revenue Service (“IRS”) issued Notice 2013-74 (“Notice”) which provided anxiously awaited guidance on “in-plan Roth rollovers”. The following summarizes the new guidance and how it impacts the in-plan Roth rollover rules that existed prior to the release of this new guidance.

## **Background**

An in-plan Roth rollover is a plan provision that a plan sponsor may voluntarily elect to employ which allows a participant of a properly designed 401(k), 403(b) or governmental 457(b) plan to “convert” certain pre-tax amounts held in the plan to an after-tax Roth account maintained within the same plan. Thus, a participant’s decision to exercise this provision results in a taxable rollover “distribution” to a Roth account. In connection with this “account conversion”, the participant is required to pay income tax in the year of the conversion on the converted amount. Then, as a result of the Roth treatment of such converted amounts, related earnings will not be subject to income tax when distributed from the plan if certain other requirements are satisfied.

The Small Business Jobs Act of 2010 (“SBJA”) was the first legislation that authorized in-plan Roth rollovers. However, the authorization granted under SBJA was limited to amounts that might otherwise be distributable under the terms of the plan. This limitation was significant because it essentially restricted the exercise of this provision to participants who usually already had the ability to move such amounts via a tax-free “eligible rollover distribution” from the plan at issue to an “individual retirement account” (“IRA”). Once such amounts were rolled to an IRA, it could then be converted to Roth monies. Thus, it is reasonable to argue that the in-plan Roth rollover authorization provided under SBJA had little to no practical impact on the ability of a participant to convert pre-tax amounts to Roth amounts.

In response to this limitation (and the additional tax revenue that Congress anticipated would result from a more permissive Roth conversion policy), the American Taxpayer Relief Act of 2012 (“ATRA”) expanded the availability of in-plan Roth rollovers to all pre-tax amounts held in 401(k), 403(b) and governmental 457(b) plans regardless of whether such amounts are otherwise distributable. By not requiring that any amount eligible for conversion must also be otherwise distributable from the Plan, ATRA provided a real opportunity for the conversion of pre-tax amounts to Roth monies that did not previously exist for eligible plan participants.

ATRA was signed into law on January 2, 2013. However, the welcome expansion of in-plan Roth rollovers under ATRA was limited by the fact that additional operational guidance from the IRS was necessary before such transactions could be effectuated. The Notice is intended to supply that necessary guidance.



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## New IRS Guidance

The IRS first provided guidance on in-plan Roth rollovers authorized under SBJA in 2010 within Notice 2010-84. The Notice confirms that the earlier guidance under Notice 2010-84, including the requirement that amounts eligible for in-plan Roth rollovers must be vested, continues to apply to all in-plan Roth rollovers with certain exceptions. For example, the Notice explains that two requirements under the earlier guidance—that a plan must provide a 402 (f) notice to a participant making an in-plan Roth rollover and that an in-plan Roth rollover may be accomplished by an in-plan Roth 60-day rollover—apply only to in-plan Roth rollovers of otherwise distributable amounts.

In addition to confirmation that the majority of the in-plan Roth rollover rules established under Notice 2010-84 continue to apply to the expansion of such rules, the Notice provides several rules that apply only to amounts not otherwise distributable from a plan. First, it confirms that amounts eligible to be rolled over into a designated Roth account include elective deferral contributions under 401(k) and 403(b) plans, matching and profit sharing contributions and deferrals made to governmental 457(b) plans.

The Notice also indicates that amounts not otherwise distributable that are converted to a Roth account remain subject to the same distribution restrictions that were applicable to such amounts before the in-plan Roth rollover occurred. Therefore, if a participant (who has not had a severance from employment) makes an in-plan Roth rollover from a pre-tax deferral account prior to age 59 ½, that rollover amount cannot be distributed to the participant prior to the participant's attainment of age 59 ½ or the occurrence of another event that permits a pre-tax deferral account to be distributed under the terms of the plan.

The Notice continues by clarifying that, for in-plan Roth rollovers of amounts not otherwise distributable, taxes are not required or permitted to be withheld from the rollover amount. Consequently, participants should be aware that they will be required to pay income tax in the year of the conversion on the full amount transferred without actually receiving a distribution from the plan to help satisfy the resulting tax liability. Thus, participants should consider increasing their tax withholding through payroll or making estimated tax payments to avoid an underpayment penalty.

The last aspect of the Notice discussed within this article involves the deadline for amending a plan to provide for in-plan Roth rollovers. A plan amendment providing for in-plan Roth rollovers of amounts not otherwise distributable qualifies as a "discretionary amendment". Discretionary amendments generally must be adopted no later than the last day of the first plan year in which such amendment is effective. However, the Notice extends the deadline for adopting plan amendments for in-plan Roth rollovers to "the later of the last day of the first plan year in which the amendment is effective or December 31, 2014." Therefore, a calendar-year plan could permit in-plan Roth rollovers of non-distributable amounts during the 2013 plan year as long as a plan amendment is formally adopted which authorizes such transaction by no later than December 31, 2014.

Please be advised that this article is intended as an informative summary of the new guidance but does not intend, or pretend, to be an exhaustive discussion of every aspect of the new guidance. Therefore, before you decide to either implement in-plan Roth rollovers in your plan as a plan sponsor or exercise your ability as a participant to convert such amounts within the plan you participate in, please consult with your professional retirement plan service provider and your personal tax advisor to make sure that you understand the full impact of any such decision. For more information about this issue please contact our marketing department at 484-483-1044 or your administrator at Legacy.



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