FOCUS ON 401K℠

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IRS Issues Guidance on In-Plan Roth Rollovers

Since 2010 plans have had the option of allowing participants to convert pre-tax accounts to Roth accounts by doing an in-plan Roth rollover. Participants must pay current income tax on amounts converted, but any future earnings on the converted account are distributed tax free if distributed as part of a qualified distribution. For years prior to 2013, only amounts otherwise available for distribution could be converted. The American Taxpayer Relief Act of 2012 expanded the availability of in-plan Roth rollovers to non-distributable accounts (for example, salary deferral accounts maintained by active participants who are younger than age 59 ½). This option to convert non-distributable amounts became legally available on January 1, 2013, but as a practical matter it has not been available to most plans due to lack of guidance from the Internal Revenue Service (IRS). On December 11, 2013, the IRS issued Notice 2013-74 providing guidance on both in-plan Roth rollovers of non-distributable accounts, as well as on all in-plan Roth rollovers.

Guidance on rollovers of otherwise non-distributable accounts:

- The guidance previously issued in IRS Notice 2010-84 on in-plan Roth rollovers of distributable accounts generally applies to rollovers of non-distributable accounts.
- The amount rolled over (and applicable earnings) remain subject to the distribution restrictions that were applicable to the account before the in-plan Roth rollover.
- In addition to the types of accounts that were eligible under pre-2013 rules, employee deferrals, matching and non-elective contributions, including qualified matching and qualified non-elective contributions (and any earnings thereon), are eligible for an in-plan Roth rollover.
- In-plan Roth rollovers of non-distributable amounts are treated as an eligible rollover so there is no withholding and no requirement to provide a §402(f) distribution notice.
- No part of the rollover may be withheld for voluntary withholding and non-distributable plan assets may not be used to pay the taxes due. The employee may need to increase his or her wage withholding or make estimated tax payments to avoid an underpayment penalty.

Additional rules applicable to all in-plan Roth rollovers:

- Only vested amounts are eligible for in-plan Roth rollover.
- If an in-plan Roth rollover is the employee's first Roth contribution, the 5-taxable-year period required for a qualified distribution begins on the first day of the first tax year the in-plan Roth rollover is made.
- If all funds in an employee’s plan accounts are rolled to a Roth account, any excess deferral, excess contribution, or excess aggregate contribution (plus any applicable earnings) must be distributed from the Roth account, even if otherwise non-distributable.
- Employers can restrict the type of accounts eligible for in-plan Roth rollover and the frequency of in- plan Roth rollovers. Employers may also amend their plans to discontinue the ability to do in-plan Roth rollovers as long as the amendment does not have the effect of discriminating in favor of highly compensated employees.
- Any amounts converted in an in-plan rollover are counted when determining the present value of accrued benefits for purposes of determining whether a plan is top-heavy.
- If employer securities are converted in an in-plan Roth rollover, the transaction is treated as a distribution for purposes of applying the special tax rules on net unrealized appreciation.

Plan Amendments

The addition or amendment of an in-plan Roth rollover feature would normally be considered a discretionary amendment that must be adopted by the end of the plan year in which the feature first became available, or by December 31st, 2013 for a calendar plan that added an in-plan Roth rollover option in 2013. However, in Notice 2013-74, the IRS created an extended amendment period allowing plans to adopt the amendment by the later of the last day of the plan year in which the amendment was adopted, or by December 31, 2014.

Safe-harbor 401(k) plans are generally restricted from making mid-year plan changes. However, Notice 2013-74 allows safe-harbor plans to adopt a mid-year amendment allowing for in-plan Roth rollovers of non-distributable accounts. This amendment relief for safe-harbor plans is in effect until December 31, 2014.

Additional information will be provided as it becomes available. In the meantime, if you have questions, please contact your local Great-West Financial℠ representative.

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