

# Client Alert.

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## New Legislation Allows 401(k) and Other Plans to Offer In-Plan Roth Rollovers

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On September 27, 2010, the Small Business Jobs and Credit Act of 2010 (H.R. 5297) (the “Act”) was signed into law. Sections 2111 and 2112 of the Act introduce two new changes allowing for the treatment of pretax contributions as in-plan Roth contributions. The first allows eligible 401(k), 403(b), and 457(b) (collectively, the “Eligible Plans”) plan participants to roll over Eligible Plan distributions into designated Roth accounts within the same Eligible Plans, effective immediately. The second change permits participants under eligible governmental 457(b) deferred compensation plans to treat elective deferrals of compensation as Roth contributions, effective January 1, 2011.

### BACKGROUND

Prior to the passage of the Act, certain individuals who wished to roll over eligible amounts held in non-Roth accounts into Roth accounts could either: (i) roll over a traditional IRA into a Roth IRA; or (ii) roll over amounts from an Eligible Plan into a Roth IRA. As of January 1, 2010, individuals with adjusted gross incomes of more than \$100,000, who were once ineligible to make a rollover, became eligible to participate in such rollovers as well.

### NEW CHANGES INTRODUCED UNDER THE ACT

#### Rollovers to Roth Designated Accounts Within Eligible Plans

Under the Act, participants in Eligible Plans are permitted to roll over distributions into designated Roth accounts within the same plans. Although the rollover will be treated as a taxable event, the rollover amounts will not be subject to an early withdrawal penalty. It is important to note that: (i) the Eligible Plan must include a designated Roth contribution program; (ii) rollover distributions must be permitted under the existing plan, including in-service distributions of employer matching contributions; (iii) rollover distribution amounts are from a non-Roth program to a designated Roth program maintained for the participant within the same plan; and (iv) **the participant must be currently eligible under the Eligible Plan terms for a distribution**. Many plans only allow for in-service withdrawals for participants 59 ½ years old and older. As such, many participants are ineligible to make in-service rollovers to an in-plan Roth account.

#### *Special Rule for 2010 Rollovers*

For participants electing to roll over eligible amounts into an in-plan Roth account in 2010, it is important to note a special rule for 2010 rollovers in which distributions made in 2010 otherwise required to be included in the 2010 tax year may now instead be included in gross income in equal amounts for the 2011 and 2012 tax years, unless the participant affirmatively elects to have the income taxable in 2010.

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## Governmental 457(b) Plan Inclusion

Under changes enacted by the Act effective January 1, 2011, participants in governmental 457(b) plans are allowed for the first time to treat elective deferrals as Roth contributions. Prior to the Act, such 457(b) plan participants were excluded from making such contributions.

### CONCLUSION

The Act has provided a valuable opportunity for companies to amend existing plans to allow for in-plan Roth rollovers. In addition, participants electing to make Roth rollovers in 2010 will be able to take advantage of the special income inclusion rule for 2010 rollovers.

If you have any questions, contact your Morrison & Foerster attorney or any member of the Employee Benefits and Executive Compensation Group.

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