

December 3, 2010

## IRS Issues Guidance on In-Plan Roth Rollovers

On November 26, 2010, the IRS issued [Notice 2010-84](#), providing guidance, in the form of 20 questions and answers, regarding in-plan Roth rollovers. The Notice answers certain questions regarding eligible distributions, plan amendments and tax recognition rules.

### Background

Section 2112 of the Small Business Jobs Act (P.L. 111-240), signed into law by President Obama earlier this year, permits rollovers of eligible distributions from a non-Roth account into a designated Roth account in the same plan. Prior law allowed participants to roll over qualified plan distributions to a Roth IRA outside of the plan, but did not permit rollovers to designated Roth accounts within the plan.

Highlights of Notice 2010-84 include:

#### Distribution Rules

- In-plan Roth rollovers may be accomplished through a direct rollover or an indirect rollover following distributions made after September 27, 2010.
- Distributions are eligible for an in-plan Roth rollover only if the distribution meets the eligible rollover rules under Internal Revenue Code (Code) § 402(c)(4). Distributions following separation from service, death or disability are eligible for in-plan Roth rollover, as well as age 59½ and qualified reservist distributions.
- An in-plan Roth direct rollover is not treated as a plan distribution for the following purposes:
  - Plan loans. A plan loan transferred in an in-plan Roth direct rollover is not treated as a new loan if the loan repayment schedule remains unchanged.
  - Spousal consent rules. Spousal consent is not required in connection with an election to make an in-plan Roth direct rollover.
  - Mandatory distribution rules. The amount rolled over is not treated as “distributed” and continues to be taken into account in determining whether the participant’s total accrued benefit exceeds \$5,000 for purposes of the mandatory distribution rules.
  - Elimination of optional forms of benefit. If a participant had a distribution right (such as a right to an immediate distribution of the amount rolled over) prior to the rollover, the distribution right cannot be eliminated following the in-plan Roth rollover.

#### Plan Amendments

- A plan may be amended to add an in-plan Roth direct rollover for amounts that are not otherwise distributable under the plan’s terms. However, the Notice provides that plan sponsors should consider whether the amendment would constitute an impermissible cutback pursuant to Code § 411(d)(6).
  - For example, a plan that does not currently allow for in-service distributions at age 59½ may be amended to permit such distributions for purposes of in-plan Roth direct rollovers, but may prohibit distributions at age 59½ for any other reason. However, a plan that currently allows distributions to participants at age 59½ cannot be amended to restrict such distributions to in-plan Roth rollovers without violating anti-cutback rules.

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- Plans may be retroactively amended to provide for in-plan Roth rollovers. This is welcome news for many plan sponsors concerned about completing amendments before year end. Generally, amendments permitting rollovers during the 2010 plan year will need to be made by December 31, 2011.
  - The amendment extensions apply to any plan amendment that permits elective deferrals under the plan to be designed as Roth contributions, provides for the acceptance of rollover contributions by the designated Roth account, and permits in-plan Roth rollovers.
  - Amendment extension dates differ for safe harbor plans. Such plans must amend by the later of December 31, 2011 or the time specified in Treas. Reg. § 1.401(k)-3(e)(1) (requiring, generally, that safe harbor plan provisions be adopted before the first day of the plan year in which they are effective).
- Pre-approved § 403(b) plans have an extension for adopting amendments relating to in-plan Roth rollovers.
- Model § 402(f) notices must be amended for plans that offer in-plan Roth rollovers and plans that provide new distribution options restricted to Roth rollovers. The Notice provides sample amendment language.

## Special Tax Rules

- Unlike Roth IRA conversions, no recharacterization (revocation) is permitted for amounts that are rolled over to an in-plan Roth account.
- The “two-year income spread” applicable to 2010 Roth IRA distributions also applies to in-plan Roth rollovers made in 2010. Thus, a participant may include half of the taxable amount of a 2010 in-plan Roth rollover in his or her gross income in 2011 and half in 2012, unless the individual elects to include the entire taxable amount in gross income in 2010. An individual’s election to include income in 2010 may not be changed after the due date (including extensions) for filing the individual’s 2010 income tax return.
- A special income acceleration rule applies for participants deferring inclusion of income of the taxable amount from a 2010 in-plan Roth rollover if the participant takes a subsequent distribution of the taxable amount from the Roth account. However, the income acceleration rule does not apply to a distribution that is rolled over to a participant’s designated Roth account under another plan or to a Roth IRA owned by the participant.
- The 10% additional tax under Code § 72(t) applies to rollover to Roth IRAs from a plan’s designated Roth account if the distribution is allocable to the taxable amount of an in-plan Roth rollover made within the preceding five years.
- Plans will need to maintain separate accounts for in-plan Roth rollover amounts for purposes of the income acceleration and five-year recapture rules discussed above.
- Non-spouse beneficiaries are not eligible to elect an in-plan Roth rollover, but surviving spouses and alternate payee spouses can elect an in-plan Roth rollover.
- Consistent with the rule applicable to a Roth IRA rollover, 20% mandatory withholding will not apply to an in-plan Roth rollover.



*If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.*

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