



New Distribution Option – Transfer to a Designated Roth Account Within the Same Plan

The Small Business Jobs Act of 2010, which President Obama signed on September 27, 2010, includes a new distribution option for 401(k), 403(b) and governmental 457(b) plans. This alert will briefly describe this new distribution option.

Under this new law, a participant or a surviving spouse may elect to transfer an eligible rollover distribution to a designated Roth account in the same plan. This new distribution option is available immediately for 401(k) and 403(b) plans and may be added to a governmental 457(b) plan as early as the beginning of its 2011 plan year.

It is important to note that this new law does **not** authorize the conversion of plan accounts from pre-tax to after-tax designated Roth after-tax accounts without a distribution event having occurred. Instead, this is a new distribution option and only applies to eligible rollover distributions such as lump sum distributions due to retirement, termination of employment, death or an in-service withdrawal after age 59-1/2 (provided the plan permits in-service withdrawals).

The designated Roth account cannot be maintained solely for the transfer of eligible rollover distributions. It must also be maintained for after-tax elective Roth contributions by participants.

If a participant or surviving spouse elects to transfer an eligible rollover distribution to a designated Roth account in the same plan, the distributee must include the transferred amount (reduced by any previously taxed amounts, such as after-tax contributions) in his or her gross income for federal (and some state) income tax purposes. However, the transferred amount will not be subject to the 10% early withdrawal tax.

For 2010 only, if a participant or surviving spouse transfers an eligible rollover distribution to a designated Roth account in a 401(k) or a 403(b) plan, he or she can elect to either:

- include one-half of the taxable amount of the transfer in 2011 gross income and the remaining one-half in 2012 gross income; or
- include the entire amount of the transfer in 2010 gross income.

There are several differences between a designated Roth account in a 401(k) or 403(b) plan and a Roth IRA. For example, a taxable direct rollover in 2010 to a Roth IRA may be recharacterized as a tax-free direct rollover to a traditional IRA (or recharacterized as a non-taxable direct

rollover), provided the recharacterization election is made by the due date for the 2010 federal income tax return (including extensions). This recharacterization option does not apply to the transfer to a designated Roth account within the same 401(k) or 403(b) plan in 2010.

Our comments—This new distribution option may be of interest to some retired or terminated participants or surviving spouses, primarily because of the option to elect a taxable rollover to a Roth account in 2010 and delay payment of the federal income taxes into 2011 and 2012. If it is, information about this distribution option will need to be provided to all eligible retired or terminated participants and surviving spouses in the plan as expeditiously as possible.

Furthermore, plan amendments may be required to be made in 2010 before a transfer to a designated Roth account can be made. The legislative history encourages the IRS to permit required plan amendments to be made during a “remedial amendment period” (presumably ending sometime in 2011 and, perhaps, even later), but does not mandate such relief. This may explain why the IRS in a press release about this new law on October 1, 2010 said “stay tuned for additional information in our newsletters and our website.”

Please let us know if you have any questions, or if we can be of assistance.

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