



# CLIENT ACTION Bulletin

Employee Benefits

## Rollovers to 401(k), 403(b), and 457(b) Designated Roth Accounts Newly Permitted

### SUMMARY

The President has signed into law the “Small Business Jobs Act of 2010” (SBJA, H.R.5297). The new law permits plan sponsors to adopt a provision allowing rollovers from 401(k) and 403(b) accounts to the plans’ existing “designated Roth” accounts beginning this year. The SBJA will also permit governmental 457(b) plans to treat elective deferrals as Roth contributions starting in 2011, and thus will allow for rollovers to designated Roth accounts under such plans.

### DISCUSSION

#### Rollovers to Designated Roth Accounts

Effective for distributions made after the Sept. 27, 2010 date of the SBJA enactment, 401(k), 403(b), and governmental 457(b) plans that have a qualified designated Roth contribution component may permit plan participants (or their surviving spouses) to roll over some or all of their pretax account balances into the after-tax account. The law, however, prohibits a plan that does not already have designated Roth accounts to establish such features solely to accept the newly eligible rollover contributions. The ability of governmental 457(b) plans to permit participants to make contributions to Roth accounts is provided by a separate provision (see below) under the SBJA.

To qualify for the new provisions, the following applies:

- An eligible elective deferral plan must allow for the rollovers to the designated Roth accounts.
- An eligible plan may be amended, if necessary, to expand the plan’s current distribution options to permit in-service distributions or distributions prior to attaining the plan’s normal retirement age.
- The plan may condition eligibility for the new distribution option on an employee’s election to have the distribution directly rolled over to the plan’s designated Roth account.
- Plan participants electing to transfer funds from their pretax accounts to the designated Roth accounts must include the distribution in their gross incomes as if the amounts were rolled over into a Roth IRA. Thus, for rollovers made in 2010, a special rule allows individuals to include the amounts in their gross incomes in equal parts in 2011 and 2012.
- If the employee withdraws amounts from the designated Roth account before the five-year holding period that is otherwise required for Roth contributions, a 10% early distribution penalty tax will apply.
- If the plan allows for the transfer of property, rather than cash, the amount rolled over to the designated Roth accounts is the fair market value of the property on the date of the transfer.

#### Roth Contributions to Governmental 457(b) Plans

Effective for taxable years beginning in 2011, the law brings parity for Roth accounts to 457(b) plans maintained by a state, a state’s political subdivision, or an agency or instrumentality of a state’s political subdivision. As a result, governmental employers that sponsor 457(b) plans for their employees will be able to offer designated Roth accounts, allowing participants to elect to make after-tax contributions in lieu of all or a portion of the elective deferrals they would otherwise make to the plan.

### ACTION

Sponsors of 401(k) or 403(b) plans should consider the opportunity for participants to roll over funds to designated Roth accounts. While the Pension Protection Act of 2006 and the IRS’s implementing guidance permit plan participants separating from service to convert pretax funds to Roth IRAs, the SBJA’s permission to allow participants to make the conversion within the employer-sponsored plan while remaining employed

is likely to spark some interest, particularly because of uncertainties about the future of current tax rates. (See “Employer’s Guide to 2010 Roth IRA Conversions” in the Spring issue of *Benefits Perspectives* for a discussion of the issues that plan sponsors may wish to consider.)

For those eligible plan sponsors that decide to proceed with the newly available option, plan amendments will be necessary. The IRS is expected to provide for a remedial amendment period to enable plan sponsors to offer the Roth conversion option for 2010 and have sufficient time to amend the plan. However, an immediate amendment will be necessary for plan sponsors that seek to add Roth contribution accounts, to expand a plan’s existing distribution options, or to restrict certain distributions to direct rollovers to the plan’s designated Roth accounts only. Governmental 457(b) plan sponsors also will have to amend their plans if they decide to offer designated Roth accounts.

Appropriate administrative systems will have to be modified to track and report the amounts, requiring any third-party recordkeepers or administrators to be involved in discussions about processing changes. Sponsors also will have to revise their employee communications materials and may wish to provide for educational workshops, being careful to avoid giving tax or investment advice.

And governmental employers that sponsor 457(b) plans should determine whether or not to include designated Roth accounts.

For information about the SBJA’s provisions dealing with Roth accounts under a 401(k), 403(b), or 457(b) plan, please contact your Milliman consultant.