

New Law Provides In-Plan Roth Conversion Option

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The House passed the Small Business Jobs and Credit Act of 2010 (H.R. 5297) on September 23, 2010. Identical legislation was passed by the Senate on September 16, so the bill will become law upon being signed by the President, as is expected. H.R. 5297 includes ASPPA's Roth conversion proposal permitting plans to offer conversion of otherwise distributable 401(k) and 403(b) account balances to a Roth account in the plan instead of requiring transfer to a Roth IRA to complete a conversion. The bill also permits governmental 457(b) plans to include a qualified Roth contribution program. The conversion provision will be effective upon enactment. The 457(b) provision is effective for years beginning after December 31, 2010.

With enactment of this provision, 401(k) and 403(b) plans with designated Roth accounts will be able to permit elective deferrals for employees who have attained age 59 ½ to be transferred to the Roth account. Vested employer contributions that are not subject to elective deferral distribution restrictions could be transferred to the Roth account, regardless of the participant's age, if the contributions have aged for two years, or the employee has been a participant in the plan for at least five years.

Amounts converted in 2010 will be eligible for the special tax treatment that applies to conversions to Roth IRAs in 2010 – the taxpayer can choose to recognize the income in 2011 and 2012 instead of in the year of transfer. However, the ability to reverse the transaction if the timing of the conversion turns out to be bad (for

example, the market drops the day after the conversion) is *not* available to in-plan Roth conversions, as it would be for similar IRA conversions.

The language of the bill, which refers to “distributions,” not rollovers or transfers, has led to some confusion. Practitioners have been concerned that the plan would have to actually write a check for the distribution, then have the funds rolled back into the plan's Roth account to effect the conversion. The Technical Explanation Of The Tax Provisions In Senate Amendment 4594 To H.R. 5297 (JCX-47-10) published by the Joint Committee on Taxation (JCT), which explains many key provisions that may not be clear in the reading of the law, (<http://www.jct.gov/publications.html?func=startdown&id=3707>) says the conversion can be accomplished operationally by a “transfer of assets” from the non-Roth account to the Roth account within the plan. Key committee staff has assured us that no actual distribution or other physical movement of assets will be required to accomplish a conversion under the provisions of this law. The transfer referred to in the JCT publication is an accounting transfer, not a physical transfer of assets.

The JCT explanation also shed light on several other issues:

- Plans can permit conversions to Roth accounts without having to permit actual distributions from the plan. The JCT explanation says a plan that does not currently permit in-service or pre-

normal retirement age distributions will have to add “distribution options” to facilitate these conversions. The options, however, can be limited to those who will be transferring the “distribution” to a Roth account within the same plan.

- The plan must have a Roth account that is accepting, or has accepted, Roth elective deferrals. The JCT explanation makes it clear that a plan cannot establish Roth accounts solely for the purpose of accepting these conversions.
- An amendment will be required. The JCT technical explanation says a plan amendment will be required, but “it is intended that” IRS provide a remedial amendment period so employers can permit conversions in 2010, then have sufficient time to amend to reflect the provision.

The Roth conversion proposal has been a key priority of ASPPA’s Government Affairs Committee. We are very pleased that in-plan Roth conversions will soon be law.