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In-Plan Roth Conversions

The American Taxpayer Relief Act of 2012 permits a 401(k) plan that allows a participant to make Roth 401(k) contributions to now allow for an in-plan conversion of non-Roth accounts to a Roth account. Additional IRS guidance needed before Plan Administrators should permit in-plan Roth conversions.

Since the passage of the Small Jobs and Credit Act of 2010, a 401(k) plan that allows participants to make Roth salary deferral contributions is also permitted to allow a participant to make an in-plan Roth conversion. In order for the participant to request an in-plan Roth conversion, the funds in the participant's account must be eligible for distribution.

For example, assume that a 401(k) plan permits a participant who is still employed by the plan sponsor to take an in-service distribution at age 65. Prior to the passage of the Small Jobs and Credit Act, if the participant wanted to convert their plan account to Roth they would be required to distribute the account from the plan and make the conversion outside of the plan. Under the Small Jobs and Credit Act, the plan could be amended to allow the participant to make the Roth conversion within the plan.

The key points here are that the plan must permit Roth 401(k) salary deferral contributions, and that the participant's account must be currently distributable.

That recently changed, however, with the passage of the American Taxpayer Relief Act of 2012 ("ATRA").

Under ATRA, if the 401(k) plan allows for Roth 401(k) salary deferral contributions, the plan can be amended to permit a participant to request an in-plan Roth conversion even if the participant's account is not currently distributable. So unlike the Small Jobs and Credit Act which limited in-plan Roth conversion to only those participants who were eligible to currently request a distribution, ATRA allows any participant in a Roth 401(k) plan to request an in-plan Roth conversion.

As with any newly passed legislation it would be prudent to wait until the IRS releases guidance on how the plan should operate under these new rules before permitting a participant to request an in-plan Roth conversion under ATRA.

Additionally, the plan recordkeepers will no doubt need time to update their systems to allow for the additional recordkeeping requirements, as the in-plan Roth conversion may require more than one Roth account.

Finally, the plan document will require an amendment, although the amendment will most likely not be required to be adopted until the last day of the plan year in which in-plan Roth conversions are first permitted. Most document providers are waiting until there is more guidance available before preparing an in-plan Roth conversion amendment under ATRA for use by their plan sponsors.

We will continue to provide additional information as it becomes available, however please do not hesitate to contact our office if you would like to discuss in-plan Roth conversions in more detail.