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Guidance on In-Plan Conversions (12/08/2010)

Pamela D. Perdue's Pension & Benefits Update,

Guidance on In-Plan Conversions

The Small Business Jobs Act of 2010 (HR 5297), signed into law on September 27, 2010, allows for limited in-plan conversions.

The provision is quite limited and is really designed to address the potential for leakage that might otherwise occur in the plan as participants take money from the plan to take advantage of the special 2-year spread rule previously only available with respect to IRA conversions for 2010.

Specifically, the new law provides that if a [Code Sec. 401\(k\)](#) plan, [Code Sec. 403\(b\)](#), or governmental [Code Sec. 457\(b\)](#) arrangement maintains a designated Roth contribution program, a distribution to an employee (or to a surviving spouse) after the date of enactment from an account under the plan that is not a designated Roth account will be permitted to be rolled over into a designated Roth account under the plan. ([Code Sec. 402A\(c\)\(4\)\(B\)](#)) Thus, under this provision, amounts eligible for distribution can be rolled over within the plan into the plan's Roth accounts.

However, a plan is not permitted to adopt such accounts solely for purposes of accepting such rollovers. Thus, the Roth accounts must allow new Roth contributions in addition to accepting rollovers from the plan's non-Roth accounts.

The provision applies only with respect to distributions. ([Code Sec. 402A\(c\)\(4\)\(A\)](#)) That is, the provision does not allow the wholesale conversion of a participant's account to a Roth account, but rather allows the conversion only of amounts otherwise eligible for distribution.

The incentive to allow for such conversions in 2010 is that the 2-year spread rule applicable to 2010 Roth IRA conversions applies equally to 2010 in-plan Roth conversions.

[Notice 2010-84, 2010-51 IRB](#) provides much needed clarification.

First, the Notice makes it clear that an in-plan Roth conversion can be done as either a direct rollover (i.e., an in-plan direct rollover) or by a distribution to the participant who then rolls the funds into his/her designated Roth account under the same plan within 60 days (an in-plan 60-day rollover). ([Notice 2010-84](#), Q & A-1)

The Notice confirms that only amounts that are otherwise eligible for distribution and which otherwise qualify as an eligible rollover distribution can be converted. Thus, in the case of a Code Sec. 401(k) participant who has not had a severance from employment, an in-plan Roth rollover from the participant's pre-tax elective deferral account is permitted to be made only if the participant has reached age 59- 1/2, has died, become disabled, or receives a qualified reservist distribution. ([Notice 2010-84](#), Q & A-2)

The Notice clarifies that an in-plan Roth direct rollover is not treated as a distribution for all purposes. For example, a direct rollover would not require spousal consent. Further, a plan loan transferred in an in-plan Roth direct rollover without changing the repayment schedule is not treated as a new loan so that the rule in [Reg. § 1.72\(p\)-1](#), Q & A-20 does not apply. ([Notice 2010-84](#), Q & A-3)

The Notice reflects the legislative history permitting plans to liberalize their distribution rules to permit distributions in accordance with the Code, but which were previously subject to more restrictive plan-imposed distribution limitations to take advantage of the in-plan conversion. ([Notice 2010-84](#), Q & A-4)

Plans must ensure that their written explanation issued pursuant to [Code Sec. 402\(f\)](#) includes a description of the in-plan conversion feature. The Notice includes some sample language that might be included for this purpose. ([Notice 2010-84](#), Q & A-5)

[Notice 2010-84](#) confirms that, unlike the case with IRAs, recharacterization is not available with respect to in-plan conversions. ([Notice 2010-84](#), Q & A-6)

For purposes of the 5-year holding period that applies in triggering the early distributions tax of [Code Sec. 72\(t\)](#), the 5-year period begins with the first day of the participant's taxable year in which the rollover was made. ([Notice 2010-84](#), Q & A-12)

Beneficiaries who are not spouses may not take advantage of this in-plan conversion. This is because in-plan Roth rollovers can only be elected with respect to distributions that are eligible rollover distributions as defined in [Code Sec. 402\(c\)\(4\)](#) that can be rolled over to a Code Sec. 401(k) plan. ([Notice 2010-84](#), Q & A-14)

With respect to amending a plan to provide for in-plan Roth rollovers, although such is a discretionary amendment, plan sponsors are given until the later of the last day of the plan year in which the amendment is effective or December 31, 2011 to actually adopt an amendment to a Code Sec. 401(k) plan. ([Notice 2010-84](#), Q & A-15) In the case of a safe harbor Code Sec. 401(k) plan, the extension of time to adopt an in-plan Roth rollover provision is to the later of December 31, 2011 or the time specified in [Reg. § 1.401\(k\)-3\(e\)\(1\)](#) (requiring generally, that safe harbor provisions be adopted before the first day of the plan year in which they are effective). Thus, for example, a Code Sec. 401(k) safe harbor plan with a plan year beginning July 1 may operationally comply with the in-plan Roth rollover provision during the plan year beginning July 1, 2010 (for distributions made after September 27, 2010) and the plan year beginning July 1, 2011, without having to be amended until December 31, 2011. ([Notice 2010-84](#), Q & A-18)

Different rules are provided with respect to the timing requirements for amending Code Sec. 403(b) arrangements. ([Notice 2010-84](#), Q & A-16)

Finally, [Notice 2010-84](#) provides that a plan must have a qualified Roth contribution program in place at the time a rollover contribution to a designated Roth account is made in an in-plan Roth rollover. Thus, in order for participants to be eligible for the 2-year income deferral, the distribution must be made no later than December 31, 2010, and, at the time of the rollover contribution to the designated Roth account the plan must have a qualified Roth contribution program in place. ([Notice 2010-84](#), Q & A-19)