



Tax Relief Bill Brings Changes To In-Plan Roth Conversions

Insights

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On January 2, 2013, President Obama signed the American Taxpayer Relief Act of 2012 into law, thus ending (for now at least) the crisis created by the so-called “fiscal cliff.” One of the law’s provisions offers more flexibility for retirement planning for participants in 401(k), 403(b) and 457(b) plans.

Prior to the new Act, in-plan Roth conversions were available only with respect to amounts under a plan that were otherwise eligible for distribution, meaning a participant had to be otherwise eligible for a plan distribution (such as over age 59 ½) in order to make an in-plan Roth conversion. The new law expands the in-plan Roth conversion provisions to include any vested amount under the Plan, whether or not the participant is otherwise eligible for a plan distribution.

Here’s a summary of the more important aspects of the Act:

Plans eligible for the in-plan Roth transfers:

All 401(k), 403(b) and 457(b) plans. But the plans must have adopted a provision to permit Roth contributions and Roth conversions. This new provision is optional, not mandatory.

Participants eligible to make such transfers:

All participants with an account under the plan, including former participants, beneficiaries, and alternate payees.

Amounts eligible for conversion:

All vested amounts under the plan, including deferral contributions, matching contributions, non-elective (profit sharing) contributions, and any after-tax contributions. Any earnings accrued under such accounts may also be converted. All in-plan Roth conversions are irrevocable once made.

Tax on amounts converted:

All taxable portions of the conversion are subject to federal and state income tax as if actually distributed and will be reported on a 1099-R in the year converted.

Tax advantages of Roth conversions:

Amounts converted are taxable at current income tax rates and if a later distribution is a qualified distribution from the Roth account, earnings accruing after the conversion are also distributed tax-free. A qualified distribution from a Roth account is one made after five years following the conversion or after the attainment of age 59 1/2.