New Law Eases Roth Account Conversions

Insights
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The Small Business Jobs Act of 2010 provides the opportunity to convert pre-tax retirement plan contributions to a Roth Account within that plan. Prior to this change, the only way to convert pre-tax retirement plan money to a Roth Account was to roll it over to a Roth IRA.

As with any Roth conversion, the amount converted is taxable, but increases in the account value are not taxed when withdrawn later. Roth Accounts are subject to additional Internal Revenue Code requirements. If the Roth conversion occurs in 2010, a special rule permits a delay in the payment of the tax with half of the amount taxable in 2011 and the other half in 2012.

Highlights
A qualified 401(k) or 403(b) plan can now give an eligible participant the option to move pre-tax money in a qualified retirement plan to a Roth Account established within that plan. The change is effective immediately, but the required plan amendment can be done later in accordance with IRS requirements.

The requirements for transferring funds to a Roth Account are:

- the participant must already be eligible for a distribution (e.g., age 59½); and
- the plan must allow Roth contributions as an alternative to 401(k) or 403(b) elective deferrals.

The plan can increase the number of participants eligible for this option by expanding distributions for current employees (e.g., vested matching contributions that have been in the plan at least two years or all matching contributions if the participant has been in the plan for five years can be eligible for distribution). The plan can restrict an in-service distribution to a Roth conversion.

Distribution of 401(k) and 403(b) pre-tax contributions for employees younger than 59 ½ generally cannot be distributed and so, are not eligible to be transferred to a Roth Account. Minimum required distributions at age 70½ do not apply to a Roth Account.

Who Can Benefit
The Roth Account provides a tax-planning opportunity. Examples of employees who may benefit are:

- highly paid employees who want to utilize the Roth Account for estate planning purposes; and

- workers who believe they will be in a higher tax bracket in the future or have many years to let the account grow.

For more information or to discuss how this new law might affect you or your operations, contact any member of our Employee Benefits Practice Group.

This Legal Alert provides information about a specific new law. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.