



AMERICAN BENEFITS COUNCIL

October 8, 2010

Delivered via email

George H. Bostick
Benefits Tax Counsel
Office of Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Re: Need for Immediate Guidance on In-Plan Roth Conversions

Dear George,

As we discussed, the recent enactment of the Small Business Jobs and Credit Act (H.R. 5297), which allows for conversions of traditional pre-tax contributions to Roth contributions within a defined contribution plan (and was effective upon enactment), has resulted in an immediate and urgent need for guidance necessary to implement this provision. As you know, some participants are eager to transact conversions during 2010 because of favorable tax treatment so plan sponsors and their service providers are working to make it happen.

We understand that the Treasury Department and the Internal Revenue Service are discussing possible guidance and we thought it would be helpful to provide for you a detailed list of the issues being raised with the American Benefits Council. Although we have discussed some of these issues with you, this is a more comprehensive list of the needed guidance.

List of Roth conversion questions:

1. It appears that a distribution that is converted to a Roth account within a plan is not subject to any withholding under Code section 3405. Guidance confirming this would be very helpful.
2. Will a remedial amendment period be provided in which to amend a plan to permit conversions? If so, how long will the remedial amendment period be? Will it apply to related amendments, such as an amendment to permit regular Roth contributions or an amendment to establish a new distribution event? Will a model amendment be provided?

- a. Please confirm that a plan may be amended to allow participants to take advantage of in-plan Roth conversions even if the plan does not otherwise allow some or all participants to make a rollover contribution to the plan?
3. In the case of a plan that does not currently permit regular Roth contributions, but wants to add that feature for 2010, so as to allow 2010 conversions, what needs to be done by the end of 2010? Do participant elections have to be made? Do those elections have to apply to compensation that would otherwise be payable in 2010? Or is it sufficient for an employer to make a binding commitment to establish a regular Roth program as soon as is administratively practicable?
 - a. It should be noted that in order for elections to apply to compensation in 2010, not only do the plans' recordkeepers and other plan service providers need to accomplish the necessary work to commence Roth deferrals before the end of the year but payroll providers would need to make changes to their processes. Given the delayed passage of the Act, the Council encourages you to treat a binding commitment as the adoption of a regular Roth program for this purpose.
4. It would be helpful if the following analysis could be confirmed and the unclear issues resolved.
 - a. There are two five-year periods applicable to converted amounts. First, there is the five-year period applicable in determining if a distribution is a "qualified distribution". For that purpose, currently applicable "tacking" rules under Code section 402A(d)(2)(B) apply. So, for example, assume that a participant made a regular Roth contribution to a plan in 2006. Assume further that the participant converts amounts to the Roth account in the same plan in 2010. The five-year period expires at the end of 2010, so a distribution of all amounts in the Roth account after 2010 would be a qualified distribution if it is made after age 59 ½, death, or disability or for a first-time home purchase.
 - b. Second, there is the five-year period for determining whether the special early distribution tax rule applies. In the above example, under that special early distribution tax rule, a distribution from the plan of the converted amount would, for purposes of applying the 10% early distribution tax, be treated as includible in income if it is made before the end of the five-year period beginning in the year of the conversion, i.e., 2010. So, if the converted amount is distributed before 2015, then it would be treated as includible in income for purposes of the early distribution tax. For example, if the individual takes a distribution of the converted amount prior to 2015, such amount could be subject to the 10% tax unless an exception to that tax applies (such as the individual having attained age 59 ½).
 - c. Because of the five-year rule in "b" above, an ordering rule is needed in some cases to determine if a distribution is made from regular Roth contributions or from converted amounts.

- d. For purposes of determining the tax treatment of distributions, there is no need to separately track earnings attributable to regular Roth contributions and earnings attributable to converted amounts. There may be a need to track such earnings separately for certain purposes, such as (a) applying the rules regarding the permissibility of withdrawals, since different withdrawal rules might apply to the different amounts (see separate issue), and (b) correcting nondiscrimination testing failures.
5. The ability to undo a conversion by October 15th of the next year applies to an IRA to Roth IRA conversion and does not apply to a conversion within a plan. It appears, though not clearly, to apply to a plan to Roth IRA conversion, but clarification would be helpful.
6. What needs to be done for a conversion to be treated as occurring in a year, e.g., 2010? Is it sufficient that the participant's election occurs in 2010? Or is it also necessary that the plan's records reflect the conversion by 12/31/10? What if the plan's records reflect the conversion by 12/31/10, but subsequently minor changes are made to correct or supplement the records?
7. Will an employer be permitted to condition the application of a new distribution event on the participant converting the amount permitted to be distributed?
 - a. If an employer initially does not impose conditions on a new distribution event for purposes of converting to Roth for 2010 because guidance currently is unclear whether conditions are permissible under Code Section 401(a)(31), and later amends the plan to provide conditions based on subsequent guidance, would those pre-tax balances as of the amendment date be protected under Code Section 411(d)(6) or could they now condition all existing pre-tax money? If section 411(d)(6) would prevent the imposition of conditions, could this problem be solved by limiting the original amendment to 2010 distributions (as long as such limitation satisfied section 401(a)(4))?
8. Guidance on reporting conversions on a Form 1099-R is needed.
9. It is unclear if a conversion of a participant's account could qualify for the favorable treatment of net unrealized appreciation or grandfathered income averaging. Guidance on this would be helpful.
10. It appears that plans that subject distributions to spousal consent must obtain spousal consent to a conversion. It would be helpful for this to be clarified.
11. Please confirm that prototype and volume-submitter documents can support the Roth conversion feature via a unilateral amendment.
12. Please confirm that outstanding loans of any participant may be converted even if the loan has been deemed distributed.

13. In deciding whether to (1) include the converted amount in 2010 income, or (2) use the 2011-2012 income spreading option, is there any consistency rule governing in-plan conversions and IRA conversions? For example, can a participant choose the first option for the in-plan conversion, while choosing the second option when rolling over to a Roth IRA or converting a traditional IRA to a Roth IRA?
14. Is the plan required to provide a 402(f) notice and will the model 402(f) notice be updated?
15. In the case of a plan that has a nondiscrimination failure for the year of the conversion, guidance is needed regarding situations where an excess (or a matching contribution related to an excess) has been converted.
16. Please confirm that the conversion is treated as a distribution and rollover for all purposes, including, for example, (a) the inapplicability of withdrawal restrictions to the converted amounts, (b) the ability to exclude converted amounts in applying the \$5,000 small-sum cash-out rule, (c) for terminated participants, forfeiting non-vested amounts, (d) ordering rules regarding the portion of any distribution that is treated as basis (such as pre-1987 or post-1986 after-tax contributions), and (e) reporting. Please confirm in addition that the plan may adopt special rules for such distributions, such as permitting distributions in kind that are not otherwise permitted or not forfeiting non-vested amounts. Plans would similarly be permitted to apply new withdrawal restrictions on converted amounts (for example, no withdrawal until separation or age 59-1/2), just as plans receiving direct rollovers from other plans can do (Treas. Reg. Section 1.411(d)-4, Q&A-3(a)(4)).
17. Please confirm that a plan may permit conversion of any distribution-eligible non-Roth contributions.

Please feel free to contact me if you have any questions or need further input. Thanks so much for all of the work you are putting into this much-needed guidance.

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Jacobson", written in a cursive style.

Jan Jacobson
Senior Counsel, Retirement Policy
American Benefits Council