



AMERICAN BENEFITS COUNCIL

March 13, 2013

AREAS OF NEEDED GUIDANCE ON SECTION 902 OF ATRA: EXPANDED IN-PLAN ROTH CONVERSIONS

For ease, we refer to an in-plan Roth conversion of amounts that are not otherwise distributable, as described in Code section 402A(c)(4)(E), as an “in-plan Roth transfer” or just a “transfer.” We refer to conversions under pre-ATRA law as “in-plan Roth rollovers.”

CONFIRMATION OF PRIOR GUIDANCE

Many of the questions and answers in Notice 2010-84 that apply to in-plan Roth rollovers would appear to continue to apply to an in-plan Roth transfer. It would be helpful if Treasury and the Service could confirm that the following guidance from Notice 2010-84 continues to apply to in-plan Roth transfers:

- Recharacterization is not allowed. Q&A-6.
- Tax consequences of in-plan Roth transfer. Q&A-7, 9.
- No withholding is required (and none would be allowed as these amounts are by definition not distributable). Q&A-8.
- Application of Code section 72(t). Q&A-12, 13.
- Plan must have qualified Roth contribution program. Q&A-19, 20.

NONVESTED CONTRIBUTIONS

Can a plan allow employer contributions that are not vested to be transferred? The legislative language allows for the transfer of “any amount” that is not otherwise distributable, and therefore it is not clear if a plan may allow nonvested employer contributions to be transferred. The tax consequences, however, of converting nonvested contributions could be complex. A simple solution is to provide that only vested amounts may be transferred because designated Roth accounts generally must be nonforfeitable. *See* Treas. Reg. § 1.401(k)-1(f)(4). The recordkeeping and

administrative complexities of allowing nonvested contributions and partially vested contributions is significant. If Treasury and the Service allow for in-plan Roth transfers of amounts that are nonvested or partially vested, **we strongly urge clarification** that a plan may limit in-plan Roth transfers to (a) vested contributions or (b) contribution sources that are fully vested.¹ In addition, if Treasury and the Service allows for in-plan Roth transfers of amounts that are nonvested or partially vested, guidance is needed on the tax implications to a participant at the time of conversion and upon forfeiture if the participant terminates before full vesting.

OTHER RESTRICTIONS ON TRANSFERS

Are there any restrictions on the kinds of contributions that can be transferred? Are there any contribution sources that cannot be part of an in-plan Roth transfer? For example, we assume, but would like confirmation, that employer contributions to a money purchase plan can be transferred. Similarly, we assume that non-Roth after-tax employee contributions may be transferred. Finally, please provide guidance on whether a participant may make multiple transfers during a year and, if so, whether a plan may limit the number of conversions per year or the total number of conversions a participant may have.

PLAN FLEXIBILITY

Can a plan limit in-plan Roth transfers to particular contribution sources? Notice 2010-84 made clear that a plan is not required to offer pre-ATRA in-plan Roth rollovers, and may limit distributions to amounts that are directly rolled back into the account. We ask for confirmation that a plan may limit the types of contributions eligible for in-plan Roth transfers. For example, a plan sponsor may wish to limit in-plan Roth transfers to elective deferrals because the recordkeeping requirements are similar to designated Roth contributions. Finally, we ask for confirmation that a plan can decide to limit in-plan Roth conversions to distributable amounts, that is, conversions allowed under pre-ATRA law.

DISTRIBUTION RESTRICTIONS

Must distribution restrictions continue to apply to transferred amounts or are they eligible to be distributed like other rollover contributions? A participant may convert from an amount that contains a distribution restriction that need not apply to a designated Roth account. For example, if a participant converts a safe harbor

¹ In addition, we ask for confirmation that such a limit would not need to be treated as a benefit, right or feature for purposes of the Code section 401(a)(4). See Treas. Reg. § 1.401(a)(4)-4(e)(3)(iii)(I).

contribution, QNEC, or QMAC, would the restriction against hardship distributions continue to apply? And, if so, how should the plan account for any pre-1989 grandfathered amounts of earnings, QNECs, or QMAC?² Similarly, if a participant converts an amount held in a money purchase plan account, would the transferred amounts be restricted from in-service distributions and subject to the QJSA and QPSA requirements? A related question relates to plan-imposed restrictions (that is, distribution restrictions imposed by the plan but not required by the Code) for transferred amounts. For example, assume a profit sharing plan generally does not allow in-service distributions of employer contributions. Could it allow in-service distributions at age 59½ solely for amounts transferred to the designated Roth account?

TRANSFER OF CONTRIBUTIONS VS. EARNINGS

What portion of a transfer from elective deferrals is deemed earnings for purposes of a later hardship distribution? Participants may request a hardship distribution from pre-tax elective deferrals and designated Roth contributions only from contributions, and not earnings. If a participant transfers pre-tax elective deferrals in an in-plan Roth transfer, how should the plan account for earnings (pro rata, earnings first, contributions first)?

TREATMENT OF DISTRIBUTABLE AMOUNTS

What rules apply to amounts that could be distributed? The effect of Section 902 of ATRA is to allow any amount, whether or not distributable, to be eligible for an in-plan Roth conversion. The issue, then, is whether the rules for in-plan Roth rollovers (that is, pre-ATRA conversions) continue to apply to all amounts that *could* be distributed. For example, assume a participant has employer contributions that are distributable, and elective deferrals that are not distributable. Is the participant required to convert one of these sources first? Could a participant decide to “transfer” an amount that could be “distributed” and rolled back into the plan?³ (Put another way, if an amount is distributable, does the rule described in Notice 2010-84 requiring that it be rollover-eligible still apply?⁴) This could be relevant in a number of situations. For example,

² See Treas. Reg. § 1.401(k)-1(d)(3)(ii)(B).

³ Assume a profit sharing plan allows distributions of employer contributions after five years. Assume a participant has \$20,000 in the profit sharing account, \$15,000 of which was contributed more than five years ago, and the remainder within the last five years. (For simplicity, assume all amounts are fully vested.) Assume the participant elects an in-plan Roth transfer of the entire \$20,000. Is the plan required to do anything different with respect to the \$15,000 that is distributable versus the \$5,000 that is not distributable?

⁴ One Council member suggested that the position in Notice 2010-84 that a pre-ATRA in-plan Roth rollover could be done *indirectly* made little sense. Whether or not you reconsider that position, you should confirm that indirect rollovers are not an option with in-plan Roth transfers under ATRA.

suppose a participant is subject to required minimum distributions (“RMDs”), which are not eligible rollover distributions. One reading of Code section 402A(c)(4) would be that the amounts that represent the required minimum distributions for the year cannot be converted either through an in-Plan rollover or transfer? In other words, would the participant be forced to take his or her RMD *first*?⁵ A general point here is that it would be costly and inefficient to create a requirement to track conversions separately based on whether they came from amounts that are distributable versus those that are not. We ask you to harmonize the recordkeeping requirements as much as possible.

NON-DISCRIMINATION TESTING AND INDIVIDUAL LIMIT REFUNDS

Can amounts that have been transferred be removed if required by Code limits? It is possible that amounts may be transferred during the year must be returned to the participant (or removed from a participant’s account) if required by non-discrimination testing or limits like Code sections 402(g) and 415. In that case, can they be removed from the designated Roth account, without violating the prohibition on recharacterization, and what are the tax consequences?

TRANSFER TO ANOTHER PLAN

Can a participant do an in-plan Roth transfer to another plan maintained by the employer? Unlike pre-ATRA law, which requires that an in-plan Roth rollover be made to the designated Roth account maintained “under such plan,” section 902 of ATRA does not explicitly require that the transfer be made to the same plan. This suggests that a transfer to a plan maintained by the same employer (or another employer in the controlled group) might be allowed. Treasury and the Service should address whether the transfer must be made within the same plan.

FIVE-YEAR WINDOW

Does an in-plan Roth rollover or transfer count towards a qualified distribution? An issue not addressed by Notice 2010-84 is whether an in-plan Roth rollover or transfer is treated as a “contribution” for purposes of the five-year window for qualified distributions. Code section 402A(d)(2)(B) does not directly address this because it refers to contributions and rollovers from another designated Roth account. We think the better reading is that an in-plan Roth rollover or transfer begins the five-year period, and ask for confirmation.

⁵ This would not appear to affect the amount of RMDs required to be distributed by the end of the year.

REPORTING AND RECORDKEEPING

What reporting and recordkeeping is required of the plan upon a transfer or subsequent rollover? Because an in-plan Roth transfer is not a distribution, the plan's reporting implications are unclear. We expect that some reporting on Form 1099-R required.⁶ In addition, what information will plan administrators be required to maintain for participants that complete a direct rollover from another qualified employer plan? For instance, will plan administrators be required to determine amounts rolled into a plan that are subject to Code section 72(t) (and, therefore, be required to track applicable amounts and years prior to the rollover)? It is important this be clarified with other guidance to allow proper programming.⁷

SPECIAL TAX NOTICE

Is a Code section 402(f) Special Tax Notice, or other notice required? Pre-ATRA in-plan Roth rollovers are generally treated as distributions of eligible rollover contributions, and thus a Code section 402(f) Special Tax Notice is provided. Amounts transferred under ATRA are not distributions and therefore not eligible rollover distributions. Providing a Code section 402(f) Special Tax Notice would be very confusing to participants. If Treasury and the Service will require some notification, then model or safe harbor language should be provided.

NUA TREATMENT

Will a transfer affect lump sum NUA treatment? When a participant receives a distribution of employer securities from a plan, the participant can exclude from gross income the net unrealized appreciation ("NUA") of the employer securities if the distribution (a) is part of a total "lump sum distribution" of the balance to the credit of the participant in the plan and (b) is payable on account of certain specified events. Notice 2010-84 did not address the extent to which an in-plan Roth rollover would affect NUA treatment of a subsequent lump sum distribution.⁸ In any event, it would

⁶ One Council member indicated that reporting rules mirroring the reporting rules for pre-ATRA in-plan Roth direct rollovers would be easiest to implement.

⁷ A Council member indicated that there is some confusion regarding reporting relating to the Code section 72(t) recapture rule. In particular, Q&A-12 of Notice 2010-84 indicates that the recapture rule does not apply in all circumstances, including a distribution subsequently rolled over, and the Form 1099-R instructions are somewhat unclear on whether the plan is required to track enough information to confirm whether the Code section 72(t) penalty applies. (This is an issue that existed under pre-ATRA law.)

⁸ The Council has previously asked Treasury and the Service to provide guidance on this issue as part of their business plan. See Council Letter dated May 1, 2012, available at http://www.americanbenefitscouncil.org/documents2012/irs_guidance-priority_council-letter050112.pdf.

appear that an in-plan Roth transfer would not have an effect on subsequent NUA treatment.

ANTI-CUTBACK TREATMENT

Is the right to an in-plan Roth transfer protected under Code section 411(d)(6)? We do not believe that the right to make an in-plan Roth rollover of distributable amounts under pre-ATRA law is an “optional form of benefit” that must be protected under Code section 411(d)(6).⁹ Similarly, we do not believe that the right to transfer contributions to a designated Roth account would be an optional form of benefit for purposes of Code section 411(d)(6). We ask you to confirm our understanding. The importance of this issue should not be underestimated. Because of the complexities of this provision, not all service providers will necessarily implement the feature in the same way, which may make it difficult for plans to preserve the precise rules if they change service providers. Similarly, plan sponsors may add this feature and later determine in light of experience that it is too complex or costly to administer, and the administrative cost does not justify the usage.

NON-SPOUSE BENEFICIARIES

Can non-spouse beneficiaries make in-plan Roth transfers? Notice 2010-84, Q&A-14, states that an in-plan Roth rollover can be elected by a beneficiary only if he or she is a surviving spouse and by an alternate payee only if he or she is a spouse or former spouse, on the theory that only distributions that are eligible rollover distributions are eligible. Since in-plan Roth transfers are not distributions, it is unclear whether a non-spouse beneficiary or alternate payee may make such a transfer. More broadly, can a plan limit conversions only to participants who would otherwise be permitted to make rollover contributions?

AMENDMENT GUIDANCE

What is the deadline to amend a plan? We ask for guidance on the amendment deadline for a plan to add in-plan Roth transfers. Further, because guidance on Section 902 of ATRA is unlikely until well into 2013, **we urge Treasury and the Service to provide an extension**, so that the deadline is no earlier than the later of the last day of the plan year in which the amendment is effective or December 31, 2014. We also urge Treasury and the Service to allow safe harbor plans to add this feature mid-year.

⁹ Notice 2010-84 states that a participant who had a distribution right (such as a right to an immediate distribution of the amount rolled over) prior to the rollover cannot have this right eliminated through an in-plan Roth direct rollover. We are asking a different question, that is, whether the right to in-plan Roth rollovers and transfers are themselves an optional form of benefit that must be protected.