

November 2010

How to Use the New Roth Rollover Opportunity Within Your 401(k) Plan

Starting in 2010, the just-passed Small Business Jobs Act of 2010 allows participants in 401(k), 403(b), and 457 governmental plans to roll over their pre-tax account balances in those plans to a designated Roth account set up by their employers within those plans. By converting account balances to a Roth designated account, distributions upon eventual retirement will be completely tax free both as to the amount rolled over and all subsequent earnings. Rollovers made in 2010 only also have the added advantage of deferring tax on the rollover for two years, into 2011 and 2012. As a result, the sooner someone with a 401(k) or similar account can decide whether or not this rollover opportunity is right for him or her, the greater the tax savings that can be achieved.

Limited Rollover Opportunity

The Small Business Jobs Act of 2010 authorizes 401(k), 403(b) and 457 governmental plans to allow participants to roll over pre-tax account balances into a designed Roth account set up within the plan provided the plan also makes certain amendments to its governing rules to allow such rollovers. Unfortunately, the rollover is taxable, except for any after-tax contributions. Often evaluating this tax aspect comes down to a question of whether paying tax on what is a smaller amount now will save more overall dollars for your retirement years than paying the tax at retirement on a balance that has grown over the years. Many individuals will find that paying the rollover tax now does make sense. This is especially the case if the cash used to pay the tax is drawn from other savings rather than from a withdrawal from the plan balance itself. In this regard, special treatment for 2010 rollovers can help delay coming up with the cash for several years. Participants who elect to make the rollover in 2010 will be taxed on the income over a two-year tax period, beginning in 2011, unless an election is made to recognize all of the income in 2010. This election – involving the ability to spread the income from the 2010

rollover in ratably 2011 and 2012 – echoes existing rules for converting a traditional IRA to a Roth IRA in 2010.

If a 401(k), 403(b), or 457(b) governmental plan has a qualified designated Roth contribution program, a distribution to an employee (or surviving spouse) from a non-Roth account to a Roth account is allowed to be rolled over into a designated Roth account under the participant's plan. The distribution that the individual wants to roll over must be otherwise allowed under the plan. For example, amounts under a 401(k) plan that are subject to distribution restrictions cannot be rolled over to a designated Roth account.

Taking Advantage of the Special Rule for 2010

First, the plan must be amended by the plan sponsor to allow for such rollovers as provided in the Small Business Jobs and Credit Act of 2010. It is intended that the IRS will provide employers with a remedial amendment period to allow the employers to offer this option for distributions during 2010 and then have adequate time to amend their plan.

Most importantly, participants must take action before year-end if they want to take advantage of either the two-year deferral into 2011 or 2012 or lower tax rates in 2010 if Congress does not extend the 2001 individual marginal income tax rate reductions which will disappear after December 31, 2010.

If you participate in a 401(k), 403(b) or 457 plan, you should investigate whether a rollover to a Roth designated account now makes sense for you. There are many variables to consider but inaction can mean a costly missed opportunity. Please do not hesitate to contact Doeren Mayhew for assistance.



DOEREN MAYHEW