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Retirement Plan News

In-plan Roth rollovers

The in-plan Roth rollover (IRR) was created by the Small Business Jobs and Credit Act of 2010 (SBJCA). This was the first opportunity for participants to convert non-Roth accounts to Roth accounts within 401(k) and other "applicable" retirement plans.

However, only amounts that were eligible for distribution could be converted via IRR. That changed when the American Taxpayer Relief Act of 2012 (ATRA) was enacted. ATRA eliminated the requirement that participants must have a "distributable event" to move pretax amounts into a Roth 401(k) account.

IRS guidance

The IRS issued guidance (Notice 2010-84) that addresses the rollover of distributable amounts to Roth accounts under SBJCA and recently issued additional guidance (Notice 2013-74) that addresses the conversion of "otherwise nondistributable amounts" to Roth accounts as permitted under ATRA.

Notice 2013-74 treats conversion transactions under both laws as in-plan Roth rollovers rather than treating SBJCA conversions as in-plan rollovers and ATRA conversions as in-plan transfers. This makes sense from an IRS tax-reporting perspective, since the term rollover typically reflects an event that must be reported on Form 1099-R. In contrast, a transfer (like a transfer of trusteeship between two IRAs or a transfer of assets when two qualified plans merge) is not a reportable event and is not reported on Form 1099-R. Thus, all in-plan Roth rollovers are reported on Form 1099-R.

Otherwise nondistributable amounts

The term otherwise nondistributable amounts refers to amounts that are not eligible to be distributed but that may be converted via an in-plan Roth rollover. Note that only vested amounts can be converted to a designated Roth account.

Otherwise nondistributable amounts eligible for conversion via IRR include:

- Elective deferrals plus earnings,
- Matching contributions,
- Nonelective contributions,
- Qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs), and
- Annual deferrals in governmental 457(b) plans (including the federal government's Thrift Savings Plan).

Any restrictions that apply to the contribution source still apply after the IRR conversion. For example, if a 401(k) participant rolls over an amount from a restricted source (such as a QNEC) but he or she has not yet severed employment and is under age 59½, then the participant may not take a distribution of the amount converted from that source until the requirements are met and the funds become eligible for distribution (i.e., the participant reaches age 59½, severs employment, death, disability, etc.).

Employers are not required to supply a revised 402(f) notice (which outlines rollover options and applicable tax consequences) when the rollover is entirely from otherwise nondistributable amounts. However, income tax is due on

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What is a **402(f) notice?**

The administrator of a qualified plan (such as a 401(k) plan) is required to provide any participant who receives an eligible rollover distribution with a Section 402(f) notice. An eligible rollover distribution is a payment that may be rolled over to a qualified retirement plan or an individual retirement account (IRA). And the 402(f) notice is a comprehensive, plain-language explanation of a participant's distribution options and how distributions will be taxed, including possible special tax treatment. The notice is intended to help participants (1) decide whether to roll over an eligible distribution and (2) understand the tax consequences of their decision.

All amounts that are eligible to be distributed from the plan are also eligible to be rolled over — *except* the following:

- Certain payments spread over a period of at least 10 years or over the participant's life or life expectancy (or the lives or joint life expectancy of the participant and his/her beneficiary)
- Required minimum distributions after age 70½
- Hardship distributions
- ESOP dividends
- Corrective distributions of contributions that exceed tax law limitations
- Loans treated as deemed distributions (e.g., loans in default due to missed payments before employment ends)
- Cost of life insurance paid by the plan
- Contributions made under special automatic enrollment rules that are withdrawn pursuant to the participant's request within 90 days of enrollment
- Amounts treated as distributed because of a prohibited allocation of S corporation stock under an ESOP (also, there will generally be adverse tax consequences if a participant rolls over a distribution of S corporation stock to an IRA)

In-plan Roth rollovers

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all IRRs, so the IRS guidance reminds plan sponsors to inform employees that they may need to file estimated tax-withholding payments or increase withholding on wages to pay for their conversion.

Limiting sources and frequency

A plan may restrict the type of contributions eligible for and the frequency of IRRs (subject to nondiscrimination testing). For example, a plan could provide that only otherwise distributable amounts are eligible for IRR (i.e., they could use only the SBJCA rules under Notice 2010-84 for in-plan Roth rollovers). As such, the plan would not have to separately account for withdrawal-restricted IRR amounts.

The option to restrict the sources available for IRRs may also be useful for a 401(k) plan with assets from a former money purchase plan that have been kept separate. The sponsor may amend the plan to add ATRA in-plan Roth rollovers (i.e., otherwise nondistributable amounts) but exclude "money purchase plan assets" to avoid the need for separate accounting of those as in-plan Roth rollovers subject to the qualified joint and survivor annuity (QJSA) rules.

The plan's ability to restrict the frequency of in-plan Roth rollovers may help avoid administrative burdens and the possibility of additional recordkeeping fees.

Additional IRR guidance

IRR provisions are not protected benefits and may be discontinued by a plan amendment, provided the amendment does not have the effect of discriminating significantly in favor of highly compensated employees (current or former).

An IRR is a taxable distribution triggering the more favorable special tax treatment known as net unrealized appreciation rules if employer securities are part of the in-plan Roth rollover. For top-heavy purposes, an IRR is a "related rollover" and must be counted as such in the determination date balance.

If an employee converts amounts to a designated Roth account via an IRR and it is later determined that all or a portion of the rollover is an excess deferral, excess contribution, or excess aggregate contribution that must be distributed from the plan, the excess plus applicable earnings must be distributed from the designated Roth account.

Amendment timing

For 401(k), safe harbor 401(k), and government 457(b) plans, a Roth rollover amendment must be adopted by the last day of the first plan year the IRR amendment is effective or December 31, 2014, whichever is later. For example, a calendar-year plan starting IRRs in 2013 or 2014 must adopt the amendment by December 31, 2014.

Although safe harbor 401(k) plans generally may not be amended midyear, the IRS has consistently made exceptions in the past, permitting Roth provisions to be added midyear (Announcement 2007-59) and adding in-plan Roth rollovers midyear (Notice 2010-84). In keeping with that precedent, safe harbor 401(k) plans may adopt the IRR amendment midyear without violating the safe harbor rules (Notice 2013-74).

For 403(b) plans that timely adopted a written plan document, the plan sponsor has until the last day of the 403(b) remedial amendment period to adopt the IRR amendment. This date will be announced when the preapproved 403(b) plans are approved by the IRS (in 2015 or 2016).

Midyear changes to a safe harbor 401(k)

Thanks to recently issued final regulations, the rules for stopping or reducing safe harbor contributions — nonelective (NECs) *and* matching — are now identical.

Under the new regs, for plan sponsors to be eligible to stop or reduce either type of safe harbor contribution midyear, they must satisfy either of the following two criteria:

(1) The employer is operating at an economic loss for the plan year or

(2) The employer included language in the plan's annual safe harbor notice stating that the plan may be amended during the plan year to stop or reduce safe harbor contributions.

New versus prior guidance

Prior rules permitted sponsors to stop *safe harbor matching contributions* midyear without a business hardship. So the "economic loss" criterion in the final regs is new for sponsors with a safe harbor matching arrangement.

Previous guidance permitted plan sponsors to reduce or suspend a *safe harbor NEC* midyear as well, but only if the sponsor satisfied four business hardship requirements (Code Section 412(c)). So the economic loss criterion in the final regs makes it easier for sponsors with a nonelective contribution arrangement to make changes midyear.

No loss necessary

The new regs say *either* type of safe harbor contribution may be stopped or reduced midyear by satisfying *either* of the two criteria. Thus, if the sponsor provides a safe harbor notice saying that the plan may be amended midyear to stop or reduce the safe harbor contribution, then the economic loss requirement does not come into play.

Administrative requirements

If an employer does decide to reduce or suspend either type of safe harbor contribution midyear, the following requirements must be satisfied:

- Provide all eligible employees with a supplemental notice announcing the reduction or suspension,
- Furnish the supplemental notice at least 30 days prior to the effective date of the amendment,
- Give eligible employees a reasonable period to change their salary deferral elections,
- Amend the plan to add that current-year nondiscrimination testing will be satisfied for the entire plan year in which the reduction or suspension occurs, and
- Provide safe harbor contributions through the effective date of the amendment.

Effective date

For plans with safe harbor matching contributions, the new regulations apply for plan years beginning on or after January 1, 2015. The prior rules are still in effect for 2014, which means calendar-year safe harbor plans may be amended midyear to reduce or suspend safe harbor matching contributions without having "amendment" language in the 2014 safe harbor notice or meeting the economic loss requirement.

For plans with nonelective contributions, the effective date is generally May 18, 2009 (the effective date of the proposed regulations for stopping or reducing safe harbor NECs).

Compensation cap

If safe harbor contributions are stopped midyear, contributions must be calculated from the beginning of the plan year through the effective date of the amendment and the compensation limit for the calculation must be prorated based on the compensation cap. The limit is $255,000 for 2014.

Here is a hypothetical example: A calendar-year plan employer amends the plan to eliminate the safe harbor NEC and provides employees with the supplemental notice. For this example, assume that June 30, 2014, is 30 days after the notice is provided, which means the safe harbor NEC would cover from January 1, 2014, until June 30, 2014 (six months). So the 3% safe harbor NEC for the six-month period would be limited to a prorated maximum compensation of $127,500 (50% × the 2014 limit of $255,000).

Top-heavy issues

If a safe harbor 401(k) plan is top heavy and is deemed exempt from the top-heavy rules for this year because only deferrals and safe-harbor-permitted contributions are being made, and if the plan is amended to stop the safe harbor contribution, the plan is then subject to the top-heavy rules for the year. If a key employee made a deferral and/or received a safe harbor allocation before the plan was amended, there is a top-heavy allocation requirement for the year (generally a contribution of 3% of compensation on behalf of nonkey employees). Therefore, suspending the safe harbor NEC midyear may mean replacing one contribution requirement with a similar one to satisfy the top-heavy rules.

Further, the definition of compensation for the safe harbor NEC may be different from the top-heavy definition (a full year of compensation with no exclusions). Bottom line: Employers with top-heavy plans will want to consider whether stopping the safe harbor NEC is more cost-effective than making the top-heavy allocation.

RECENT developments

Advisory Opinion 2013-04A

A summary prospectus is a brief recap of an investment's key information written in plain English. It includes investment objectives, risks, fees, management, and compensation of financial intermediaries. The Securities and Exchange Commission (SEC) published disclosure rules in 2009 that allow a summary prospectus to satisfy prospectus delivery requirements in lieu of a statutory prospectus. Since then, the Department of Labor (DOL) has adopted a similar approach to satisfying the prospectus delivery obligations required by various retirement plan disclosures.

Under Advisory Opinion 2013-04A, the DOL has concluded that a summary prospectus delivered to a second fiduciary in lieu of a statutory prospectus satisfies the prospectus distribution requirements of prohibited transaction exemption (PTE) 77-4. PTE 77-4 provides relief for the purchase or sale of certain plan investments when the advisor for the investment is a plan fiduciary and not an employer of the employees covered by the plan. It states that a plan may not pay a sales commission to an affiliated broker on such a transaction, nor can a plan pay management/advisory fees on the plan assets invested in such a fund.

Change of responsible party

For retirement plans, a "responsible party" is the person who has a level of control, directly or indirectly, over the funds or assets in the retirement plan. Effective January 1, 2014, the IRS requires any entity with an employee identification number (EIN), such as a plan sponsor, to report a change in the plan's responsible party on Form 8822-B, *Change of Address or Responsible Party — Business*, within 60 days. If a change in responsible party occurred before 2014 and the IRS has not been notified, Form 8822-B must be filed prior to March 1, 2014. The instructions for Form 8822-B contain a detailed definition of responsible party and an explanation of who must sign the form. Currently, there is no penalty for failing to file Form 8822-B.

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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