

In-Plan Rollovers to Designated Roth Accounts in Retirement Plans

Notice 2013-74

I. PURPOSE

This notice provides guidance on rollovers within a retirement plan to designated Roth accounts in the same plan (“in-plan Roth rollovers”). The guidance relates to the expansion of these rollovers under new § 402A(c)(4)(E) of the Internal Revenue Code (the Code), as added by § 902 of the American Taxpayer Relief Act of 2012 (“ATRA”), P.L. 112-240. This notice also provides guidance that applies to all in-plan Roth rollovers described in § 402A(c)(4).

II. BACKGROUND

Section 402A of the Code sets forth the rules for designated Roth contributions. A designated Roth contribution is an elective deferral that would otherwise be excludable from gross income but which has been designated by the employee as not being so excludable. An employee’s designated Roth contributions and attributable earnings must be maintained by the plan in a separate account (a designated Roth account). A qualified distribution, as defined in § 402A(d)(2), from an employee’s designated Roth account is excludable from gross income. A distribution from an employee’s designated Roth account that is not a qualified distribution is includible in gross income in proportion to the employee’s investment in the contract (basis) and earnings on the contract, pursuant to § 72.

Section 2112 of the Small Business Jobs Act of 2010 (“SBJA”), P.L. 111-240, added § 402A(c)(4) to the Code, effective for distributions made after September 27, 2010, to permit a plan that includes a qualified Roth contribution program to allow employees to roll over amounts from their accounts other than designated Roth accounts to their designated Roth accounts in the plan. To be eligible for an in-plan Roth rollover under SBJA § 2112, the amount had to satisfy the rules for distribution under the Code (an “otherwise distributable amount”) and had to be an eligible rollover distribution as defined in §402(c)(4). (See Revenue Ruling 2004-12, 2004-1 C.B. 478, for a discussion of the various distribution-timing restrictions applicable to amounts held in a plan.) SBJA also expanded the types of plans that could include a qualified Roth contribution program. Previously, only § 401(k) plans and § 403(b) plans were permitted to include qualified Roth contribution programs, but for taxable years beginning

after 2010, § 2111 of SBJA permitted governmental § 457(b) plans to include a qualified Roth contribution program.

Section 902 of ATRA added § 402A(c)(4)(E) to the Code to expand the type of amounts eligible for an in-plan Roth rollover. Section 402A(c)(4)(E) provides that the in-plan Roth rollover of these additional amounts (“otherwise nondistributable amounts”) will not be treated as violating the statutory distribution restrictions applicable to elective deferrals (or to annual deferrals in the case of governmental § 457(b) plans). Section 402A(c)(4)(E) is effective for in-plan Roth rollovers made after December 31, 2012.

Revenue Ruling 2004-12 provides that where an eligible retirement plan separately accounts for amounts attributable to an employee’s rollover contributions, the plan may permit distributions from that account to be made at any time pursuant to the employee’s request.

Notice 2010-84, 2010-51 I.R.B. 872, provides guidance on in-plan Roth rollovers under SBJA § 2112, including the provisions of SBJA that permitted an employee who made an in-plan Roth rollover in 2010 to include in gross income half of the taxable amount of the rollover in 2011 and half in 2012.

III. GUIDANCE

This Section III provides guidance on in-plan Roth rollovers. This guidance is in addition to the guidance provided in Notice 2010-84. Part A addresses the applicability of Notice 2010-84 to in-plan Roth rollovers of otherwise nondistributable amounts. Part B provides additional guidance relating to in-plan Roth rollovers of otherwise nondistributable amounts. Part C provides guidance relating to all in-plan Roth rollovers.

Part A – Application of Notice 2010-84 to In-Plan Roth Rollovers of Otherwise Nondistributable Amounts

Q-1. How does Notice 2010-84 apply after ATRA?

A-1. Generally, the rules in Notice 2010-84 apply to all in-plan Roth rollovers, including rollovers of otherwise nondistributable amounts, as permitted under ATRA. For example, in accordance with Q&A-2 of Notice 2010-84, to be eligible for an in-plan Roth rollover, an amount must be vested.

However, as a result of the expansion of eligibility for in-plan Roth rollovers made by ATRA, the part of Q&A-2 of Notice 2010-84 that provides that an amount is not eligible for an in-plan Roth rollover unless it satisfies the rules for distribution under the Code no longer applies. In addition, the following parts of Notice 2010-84 apply only to an in-plan Roth rollover of an otherwise distributable amount and do not apply to an in-plan Roth rollover of an otherwise

nondistributable amount: (i) the part of Q&A-1 that provides that an in-plan Roth rollover may be accomplished by an in-plan Roth 60-day rollover; and (ii) Q&A-5, relating to the requirement for a revised § 402(f) notice. Thus, a § 402(f) notice is not required for a participant making an in-plan Roth rollover of an otherwise nondistributable amount.

Part B – Additional Rules Applicable to In-Plan Roth Rollovers of Otherwise Nondistributable Amounts

Q-2. What amounts are eligible for an in-plan Roth rollover under § 402A(c)(4)(E) in addition to the amounts eligible under SBJA § 2112?

A-2. Section 402A(c)(4)(E) provides that a plan with a designated Roth account can permit an in-plan Roth rollover of an amount not otherwise distributable under the plan. Thus, the following contributions (and earnings thereon) may now be rolled over to a designated Roth account in the same plan, without regard to whether the amounts satisfy the conditions for distribution: elective deferrals in § 401(k) plans and § 403(b) plans; matching contributions and nonelective contributions, including qualified matching contributions and qualified nonelective contributions described in § 1.401(k)-6; and annual deferrals made to governmental § 457(b) plans. (The federal government's Thrift Savings Plan is treated as a § 401(k) plan for this purpose.)

Q-3. Is an amount rolled over to an employee's designated Roth account pursuant to § 402A(c)(4)(E) subject to any distribution restrictions after the in-plan Roth rollover?

A-3. Yes. If an amount is rolled over to a designated Roth account pursuant to § 402A(c)(4)(E), then, notwithstanding Revenue Ruling 2004-12, the amount rolled over and applicable earnings remain subject to the distribution restrictions that were applicable to the amount before the in-plan Roth rollover. Thus, for example, if a § 401(k) plan participant who has not had a severance from employment makes an in-plan Roth rollover of an amount from the participant's pre-tax elective deferral account prior to age 59½, that amount and applicable earnings may not be distributed from the plan prior to attainment of age 59½ or the occurrence of another event described in § 401(k)(2)(B).

Q-4. Does withholding under § 3405 or 3402(p) apply to an in-plan Roth rollover of an otherwise nondistributable amount?

A-4. No. An in-plan Roth rollover of an otherwise nondistributable amount is treated as an eligible rollover distribution for purposes of § 3405, and because an in-plan Roth rollover of an otherwise nondistributable amount must be made by a direct rollover, no withholding under § 3405 applies. See § 3405(c)(1)(A) and (c)(2). Also, because this amount is not distributable (other than for purposes of making an in-plan Roth rollover), no part of the rollover may be

withheld for voluntary withholding under § 3402(p). An employee making an in-plan Roth rollover may need to increase his or her withholding or make estimated tax payments to avoid an underpayment penalty.

Q-5. When is a plan amendment providing for in-plan Roth rollovers of otherwise nondistributable amounts required to be adopted in order to be effective for a plan year?

A-5. (a) Section 401(k) plans generally. Under section 5.02 of Rev. Proc. 2007-44, 2007-2 C.B. 54, which sets forth certain deadlines for adopting amendments to qualified plans, a plan amendment that provides for in-plan Roth rollovers of otherwise nondistributable amounts is a discretionary amendment that is not permitted to be adopted later than the last day of the first plan year in which the amendment is effective. However, to give plan sponsors sufficient time to adopt such an amendment and thereby enable plan participants to make in-plan Roth rollovers of otherwise nondistributable amounts before the end of the 2013 plan year, the Internal Revenue Service (IRS) is extending the deadline for adopting a plan amendment described in paragraph (e) of this Q&A-5 to the later of the last day of the first plan year in which the amendment is effective or December 31, 2014, provided the amendment is effective as of the date the plan first operates in accordance with the amendment. Thus, in the case of a § 401(k) plan that has a calendar-year plan year, in order for the plan to permit an in-plan Roth rollover of an otherwise nondistributable amount during 2013, a plan amendment providing for that option must be adopted no later than December 31, 2014.

(b) Section 401(k) safe harbor plans. Under § 1.401(k)-3(e)(1), sponsors of § 401(k) safe harbor plans described in § 401(k)(12) or (13) are prohibited from making mid-year changes to plan provisions that satisfy § 1.401(k)-3 except as provided in § 1.401(k)-3(g) (relating to certain reductions or suspensions of safe harbor contributions) or in guidance of general applicability published in the Internal Revenue Bulletin. For purposes of the preceding sentence, a “mid-year change” is a change made after the beginning of a plan year that is effective during that plan year.

In accordance with § 1.401(k)-3(e)(1), this notice provides a temporary period during which sponsors of safe harbor plans are permitted to make a mid-year change to provide for in-plan Roth rollovers of otherwise nondistributable amounts. The period ends December 31, 2014. Thus, in the case of a § 401(k) safe harbor plan that has a calendar-year plan year, in order for the plan to permit an in-plan Roth rollover of an otherwise nondistributable amount during 2013 or 2014, a plan amendment providing for that option must be adopted by December 31, 2014.

(c) Section 403(b) plans. Rev. Proc. 2013-22, 2013-18 I.R.B. 985, provides that if an employer adopts, on or before December 31, 2009 (or, if later,

the date the plan is established), a written § 403(b) plan intended to satisfy the requirements of § 403(b) and the regulations thereunder, the employer has a remedial amendment period in which to amend the plan to correct any form defects retroactive to January 1, 2010 (or the date the plan is established). The IRS will announce the end date of this remedial amendment period around the time the IRS issues opinion and advisory letters for pre-approved § 403(b) plans under Rev. Proc. 2013-22. The end date of the remedial amendment period is expected to be more than a year after the date of that announcement. In the case of a § 403(b) plan that has a remedial amendment period pursuant to Rev. Proc. 2013-22, a plan amendment permitting in-plan Roth rollovers of otherwise nondistributable amounts is permitted to be adopted on or before the last day of that remedial amendment period or, if later, the last day of the first plan year in which the amendment is effective, provided the amendment is effective as of the date the plan first operates in accordance with the amendment. See Rev. Proc. 2013-22, Section 21.

(d) Governmental § 457(b) plans. A governmental § 457(b) plan must reflect any optional provisions to ensure that the plan is operated in accordance with its plan terms. In the case of a governmental § 457(b) plan, an amendment permitting in-plan Roth rollovers of otherwise nondistributable amounts during 2013 or 2014 must be adopted by the later of the last day of the first plan year in which the amendment is effective or December 31, 2014, provided the amendment is effective as of the date the plan first operates in accordance with the amendment.

(e) Covered amendments. The extended amendment deadlines in this Q&A-5 apply not only to a plan amendment that permits in-plan Roth rollovers of otherwise nondistributable amounts but also to the following related amendments: (i) a plan amendment that permits elective deferrals under the plan to be designated as Roth contributions; (ii) a plan amendment that provides for the acceptance of rollover contributions by designated Roth accounts; and (iii) a plan amendment that permits in-plan Roth rollovers of some or all otherwise distributable amounts.

Part C – Additional Rules Applicable to All In-Plan Roth Rollovers

Q-6. Is a plan permitted to restrict the type of contributions eligible for an in-plan Roth rollover and the frequency of in-plan Roth rollovers?

A-6. Yes. Subject to the nondiscrimination requirements normally applicable to plan benefits, rights, and features (such as the right to make a rollover), a plan may limit the type of contributions eligible for an in-plan Roth rollover and the frequency of in-plan Roth rollovers. For example, to simplify recordkeeping in a designated Roth account, a plan could provide that only otherwise distributable amounts are eligible for an in-plan Roth rollover. Under this approach, the designated Roth account would include only rollover amounts

that could be distributed at any time upon the employee's request. Because the account would not accept rollovers of amounts that are subject to the distribution restrictions described in Q&A-3, the plan would not need to separately account for different types of in-plan Roth rollover amounts

Q-7. Would a plan with an ongoing qualified Roth contribution program violate § 411(d)(6) if it discontinued in-plan Roth rollovers?

A-7. No. An employee's ability to make an in-plan Roth rollover is not a section 411(d)(6) protected benefit. However, an amendment to eliminate in-plan Roth rollovers is subject to the rules in § 1.401(a)(4)-5, relating to whether the timing of a plan amendment or a series of plan amendments has the effect of discriminating significantly in favor of highly compensated employees or former highly compensated employees.

Q-8. If an in-plan Roth rollover is the first contribution made to an employee's designated Roth account, when does the 5-taxable-year period of participation that is required under § 402A(d)(2) for a qualified distribution from an employee's designated Roth account begin?

A-8. If an in-plan Roth rollover is the first contribution made to an employee's designated Roth account, the 5-taxable-year period of participation that is required under § 402A(d)(2) for a qualified distribution begins on the first day of the first taxable year in which the employee makes the in-plan Roth rollover.

Q-9. Is an in-plan Roth rollover treated as a distribution for purposes of determining eligibility for the special tax rules on net unrealized appreciation ("NUA") in employer securities paid in the form of a lump sum distribution under § 402(e)(4)(B)?

A-9. Yes. An in-plan Roth rollover is treated as a distribution for purposes of determining eligibility for the special tax rules on NUA, whether the rollover is made by an in-plan Roth direct rollover or by an in-plan Roth 60-day rollover. See also Q&A-7 of Notice 2010-84.

Q-10. How is an in-plan Roth rollover treated for purposes of determining top-heavy status under § 416?

A-10. An in-plan Roth rollover is a "related rollover" within the meaning of § 1.416-1, Q&A T-32. Accordingly, the accepting plan (which, in the case of an in-plan Roth rollover, is also the distributing plan) must count the rollover in determining the present value of accrued benefits for purposes of determining top-heavy status under § 416.

Q-11. If an employee rolls over into a designated Roth account all of his or her funds from other accounts in the same plan, what is the proper treatment of an amount rolled over that is later determined to be an excess amount?

A-11. If an employee rolls over into a designated Roth account all of his or her funds from other accounts in the same plan and all or a portion of the rollover is later determined to be an excess deferral described in § 402(g)(2)(A), an excess contribution described in § 401(k)(8)(B), or an excess aggregate contribution described in § 401(m)(6)(B), and the excess amount (plus applicable earnings) is to be distributed from the plan, then the excess amount (plus applicable earnings) must be distributed from the designated Roth account, even if the amount was an otherwise nondistributable amount at the time of the in-plan Roth rollover.

IV. EFFECT ON OTHER DOCUMENTS

Notice 2010-84 and Revenue Ruling 2004-12 are modified.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Employee Plans, Tax Exempt and Government Entities Division. Questions regarding this notice may be sent via e-mail to RetirementPlanQuestions@irs.gov.