GROOM LAW GROUP

November 24, 2010

MEMORANDUM

RE: First Round of Guidance on Roth "In-Plan" Conversions

The IRS recently posted changes to the 2010 Form 1099-R to address some of the reporting and withholding questions on Roth "in-plan" conversions. (See previous Groom memorandum: http://www.groom.com/resources-540.html.) The actual guidance is set forth below (and available at http://www.irs.gov/formspubs/article/0,,id=109875,00.html) and is consistent with guidance we requested as part of our comment letter to the IRS on these issues.

Importantly, the guidance clarified that the conversion is not subject to a mandatory 20% withholding or the 10% early withdrawal tax. Presumably, employers will be permitted (but not required) to enter into voluntary withholding arrangements under Code section 3402(p) as is available for Roth IRA conversions.

The guidance also indicates how the conversion is reported to the IRS and the participant. As anticipated, Form 1099-R is used to report the distribution, and for conversions in 2010, the conversion is reported as follows: box 1: enter gross amount of the conversion; box 2a: enter the taxable amount of the conversion (e.g., amount of the conversion less after-tax contributions); box 5: enter employee after-tax contributions; box 7: enter Code G (presumably Code G4 is appropriate for a conversion by a surviving spouse). Therefore, as with Roth IRA conversions, regardless of the participant's election to have the conversion taxed in 2010 or spread over 2011 and 2012, the reporting requirement only applies to 2010.

Lastly, the guidance provides rules for when the converted funds are distributed from the plan. As with any designated Roth account, a separate Form 1099-R is used to report the distribution and all of the same rules apply as with any designated Roth account distribution. However, in the blank box to the left of box 10, the amount of the distribution allocable to the in-plan Roth conversion must be entered.

This is a helpful first step for plan sponsors and providers offering the new feature this year, and important in light of the increased reporting penalties that apply beginning January 1, 2011. (See previous Groom memorandum: http://www.groom.com/resources-542.html.)

IRS Guidance

Reporting direct rollovers from 401(k) and 403(b) plans to designated Roth accounts in the same plan and subsequent distributions allocable to the rollover on Form 1099-R in 2010

Section 2112 of the Small Business Jobs Act (Public Law 111-240), allows participants to make rollovers from their 401(k) and 403(b) plans to their designated Roth accounts ("in-plan Roth rollover") after September 27, 2010. The taxable amount rolled over is includible in income equally in 2011 and 2012, unless the taxpayer elects to include it in 2010. The additional tax under section 72(t) does not apply to these rollovers. Report the amount rolled over in box 1 (Gross distribution), the taxable amount in box 2a, and any basis in the rollover in box 5

(Employee contributions). Use Code G in Box 7 on Form 1099-R. Mandatory 20% withholding does not apply to in-plan Roth direct rollovers.

Distributions made to plan participants in 2010 from designated Roth accounts must be reported on a separate Form 1099-R. You must report on Form 1099-R the portion of a distribution from a designated Roth account that is allocable to an in-plan Roth rollover. Report the distribution as you would any other distribution from a designated Roth account; however, in the blank box to the left of box 10, enter the amount of the distribution allocable to the in-plan Roth rollover.

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