

LEGAL DEVELOPMENTS

IRS Issues New Guidance on Plan (and IRA) Distributions

Participants and plan sponsors should be aware that the IRS recently issued several pieces of guidance affecting qualified plans and IRA distributions. First, the IRS issued Notice 2014-54 [2014-41 I.R.B. 670], which provides favorable guidance on plan distributions to multiple destinations. It allows a participant to directly roll over pre-tax funds to a traditional IRA, while taking the after-tax or Roth amounts in cash (or rolling to a Roth IRA). Second, the IRS issued Notice 2014-74 [2014-50 I.R.B. 937], which replaces the existing safe harbor rollover notices set forth in Notice 2009-68. Third, the IRS issued Announcement 2014-32 [2014-48 I.R.B. 907], that imposes an aggregate one-per-year rule for all indirect rollovers between IRAs following the surprising Tax Court decision in Bobrow v. Comm’r [T.C. Memo. 2014-21 (Jan. 28, 2014)]. We take a closer look at each in turn below.

BY ELIZABETH THOMAS DOLD

Elizabeth Thomas Dold is a principal attorney at Groom Law Group, Chartered in Washington, DC. For over 15 years, her work has focused on employee benefits and compensation matters, including employment taxes and related reporting and withholding requirements. She regularly advises Fortune 500 companies (including corporate and tax-exempt employers, financial institutions, and third-party administrators) on plan qualification and employment tax issues. Ms. Dold is a past Chairperson of the Information Reporting Program Advisory Committee (IRPAC) and a former adjunct professor at Georgetown Law Center.

I. Notice 2014-54—Plan Distributions to Multiple Destinations

It was five years in the making, and the IRS issued Notice 2014-54 and proposed regulations [79 Fed. Reg. 56310 (Sept. 19, 2014)] that support the benefits community’s long-standing interpretation of Section 402(c)(2) of the Internal Revenue Code of 1986, as amended (the “Code”)—permitting direct rollovers of plan distributions to be treated as a single distribution, with pre-tax amounts being rolled first. This guidance confirms that a participant may direct the pre-tax portion of their distribution to a traditional IRA, and the after-tax portion of their distribution to be paid to themselves or a Roth IRA tax-free.

A. Background

In 2001, EGTRRA expanded the rollover provisions to permit rollovers of after-tax amounts (directly and indirectly), and expressly provided (in the flush language of Code Section 402(c)(2)) that the amount transferred shall be treated as consisting first of “the portion of such distribution that is includible in gross income.” The legislative history similarly stated that “if a distribution includes both pre-tax and after-tax amounts, the portion of the distribution that is rolled over is treated as consisting first of pre-tax amounts.” Accordingly, plan sponsors and TPAs have historically permitted a participant to directly or indirectly roll over the entire pre-tax amount first.

For example, if a participant took a full distribution of his account in the amount of \$10,000, which consisted of \$2,000 of after-tax contributions and the remainder of pre-tax amounts, the participant could elect to roll over the entire \$8,000 pre-tax amount to a traditional IRA and the remaining \$2,000 to be paid in cash (or beginning in 2008, rolled to a Roth IRA) to the participant tax-free.

The Service’s model 402(f) (rollover) notice—Notice 2009-68—issued in 2009, challenged this approach. Specifically, the rollover notice states that if the distributee elects to roll over only a portion of the distribution in a direct rollover, an allocable portion of any after-tax contributions are considered rolled over.

A similar approach was taken for a partial direct rollover of Roth accounts under IRS Regulations—an allocable portion of the earnings are considered rolled over.

B. New Guidance

Notice 2014-54 adopts the long-standing position that treats a plan distribution paid to multiple destinations (but is otherwise scheduled to be made at the same time) as a single distribution for Code Sections 72 and 402(c) purposes. The following rules (along with examples in the Notice) help illustrate that the pre-tax amounts are treated as rolled over first (for either a direct or indirect rollover):

- **Pre-Tax Amount “Is Less Than” the Amount Directly Rolled to an Eligible Retirement Plan(s).** The entire pre-tax amount is treated as rolled over, and if directly rolled to more than one plan, the participant can select (prior to the time of the direct rollover) how the pre-tax amount is allocated among the plans.
- **Pre-Tax Amount “Equals or Exceeds” the Amount Directly Rolled to an Eligible Retirement Plan(s).** The pre-tax amount is first treated as directly rolled over (up to the direct rollover amount), then assigned to any 60-day rollovers (with the participant selecting the allocation among the plans if the remaining pre-tax amount is less than the indirect rollovers), and lastly any remaining amount is included in gross income. Therefore, only to the extent that the rollover exceeds the pre-tax amounts are after-tax amounts treated as rolled over.

Consistent with this approach, the proposed regulations would eliminate the separate distribution requirement for direct rollovers under the Roth IRA provisions. [Treas. Reg. § 1.402A-1, Q&A-5(a)]

C. Effective Date

These changes are generally effective January 1, 2015. However, for distributions on or after September 18, 2014, through December 31, 2014, taxpayers may apply a reasonable interpretation of Code Section 402(c)(2) to allocate after-tax and pre-tax amounts among multiple destinations (e.g., use the pro rata approach or the single-distribution approach). Moreover, for distributions prior to September 18, 2014, taxpayers can apply this same reasonable interpretation standard (except for distributions made from a designated Roth account, which must have complied with IRS regulations).

It is worth noting that even though a distribution will be treated as a single distribution for allocation purposes, it may still require separate Form 1099-R reporting to reflect the appropriate tax treatment of each portion of the payout. Moreover, the Notice does not change the long-standing allocation rules set forth in Code Section 408(e)(8), but rather applies these rules as if a single distribution has been made if otherwise scheduled to be paid at one time (regardless if disbursements are made to multiple destinations).

II. Notice 2014-74—Updated Safe Harbor Rollover Notices

As promised in Notice 2014-54 (described above), the IRS issued two updated safe harbor rollover notices in Notice 2014-74. This Notice replaces the existing safe harbor notices in Notice 2009-68. Notably, the guidance updates the 402(f) safe harbor notices for all law changes occurring after September 28, 2009, through December 8, 2014, and makes other minor clarifying changes. The Notice provides a summary of each of the changes, along with the amended notices incorporating them.

The key changes are highlighted below:

- **Basis Allocation for Partial Rollovers.** Amends the basis allocation rules for partial rollovers, following Notice 2014-54, to eliminate the pro rata allocation method (as these changes, generally effective January 1, 2015, can be applied now).
- **In-Plan Roth Rollovers.** Adds the “in-plan Roth rollover” rules to the non-Roth account sample notice, largely tracking the initial sample language in Notice 2010-84. (Presumably, the notice also would include a reference for any in-plan rollovers for which no plan distribution is available, *etc.*)
- **Rollovers to Roth IRAs.** Eliminates the historic pre-2010 restrictions (and 2010 tax relief of spreading the taxation over two years) on rollovers to Roth IRAs.
- **Minor Clean-Up Changes.** Clarifies the treatment of Code Section 414(w) automatic contribution withdrawals. Also clarifies the Code Section 72(t) exception to the 10 percent early distribution tax for certain health insurance premiums following unemployment.
- **Publication 590.** Replaces the reference to IRS Publication 590 to IRS Publication 590-A, *Contributions to IRAs*, and/or IRS Publication 590-B, *Distributions from IRAs*.

III. Announcement 2014-32—One-Year Limitation on Indirect IRA Rollovers

The IRS also issued its second Announcement, Announcement 2014-32, which follows Announcement 2014-15 [2014-16 I.R.B. 973], regarding the IRS's change in position following the surprising Tax Court decision in *Bobrow v. Comm'r*, which imposed a one-per-year limitation on indirect rollovers, applied on an aggregate basis to all of the taxpayer's IRAs. This new approach replaces the long-standing IRA-by-IRA approach. Accordingly, earlier in 2014, the IRS withdrew its proposed regulations under Code Section 408(d)(3)(B) that historically permitted such an IRA-by-IRA approach. This new rule is reflected in the new IRS Publication 590-A.

This latest guidance makes a few important clarifications to the new, more restrictive interpretation:

- **One-Year Rule.** Only one tax-free indirect (60-day) rollover is permitted between IRAs within any 12-month period. This 12-month period runs from the date of the last distribution, not the date that the rollover was actually made. If this rule is violated, the indirect rollover will be treated as a taxable distribution (and subject to 10 percent early withdrawal tax under Code Section 72(t)), and may trigger an annual 6 percent excise tax as the contribution to the receiving IRA will be treated as regular contributions that are subject to annual IRS limits.
- **Types of Plans.** Traditional IRAs, Roth IRAs, SEPs, and SIMPLE IRAs are all affected by this one-year aggregation limit on indirect rollovers. Therefore, all these IRAs are counted for purposes of the one-year limit. However, the following rollovers are not subject to this rule (and are *not* taken into account for the one-per-year limit)—(a) a conversion from a traditional to Roth IRA, (b) rollover to or from a qualified plan, and (c) trustee-to-trustee transfers between IRAs (which

includes providing the IRA owner with a check payable to the receiving IRA trustee).

- **Effective Date.** The new aggregation rule will apply to distributions that occur on or after January 1, 2015. If an IRA owner previously took an IRA distribution and indirectly rolled it over to another IRA within a one-year period, no indirect rollover would be permitted for either IRA in that period.
- **Transition Relief.** For any distribution made in 2015, the IRA owner may ignore any 2014 IRA distributions that were indirectly rolled over, provided that the 2015 distribution is from an IRA that neither made nor received the 2014 distribution. The IRS is giving IRA owners a clean slate for IRAs that were not involved with a 2014 transaction.

We note that IRS Employee Plans News 2014-19 (Nov. 24, 2014), contains an up-to-date rollover chart reflecting the new position.

IV. Conclusion/Action Steps

Plan sponsors and administrators should consider taking the following action steps in light of the new plan distribution guidance:

- **Review basis allocation rules for plan distributions, particularly with split payments to multiple destinations.** And if a change in the allocation process was made following the release of the 402(f) notice in 2009, the procedures should be amended, effective no later than January 1, 2015, to conform to the new rules.
- **Update rollover notices.** All plan sponsors and administrators should adopt the new 402(f) notices. They also should continue to monitor their notices for any post-December 8, 2014 changes in the law that should be reflected in the notices. ■