

LEGAL DEVELOPMENTS

IRS Issues Guidance on In-Plan Roth Rollovers and the Latest Cumulative List (for “Cycle D” Determination Letter Filings)

The IRS issued two Notices at the end of 2013 that plan sponsors have been eagerly awaiting. First, the IRS issued Notice 2013-74, which provides the ground rules for implementing in-plan Roth rollovers (IRRs), clarifying, in Q&A format, both the rules for existing IRRs that have been available since 2010 (as described in Notice 2010-84), and the expanded IRRs that have been available since January 2013 following the enactment of the American Taxpayer Relief Act of 2012. The chart set forth below reviews each of the Q&As therein, and describes the impact on both types of IRRs. Second, the IRS issued Notice 2013-84, which opens the determination letter program for Cycle D filers beginning February 1, 2014 (and ending with the January 31, 2015, filing deadline), and provides a list of Internal Revenue Code provisions that will be the subject of IRS review.

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In-Plan Roth Rollovers— Clarification of Rules

The latest IRR guidance is summarized below, with two columns to indicate the differences between the original IRRs that generally required that the conversion amount be eligible for rollover treatment, and the new IRRs that apply to amounts that are not otherwise distributable:

Notice 2013-74	Clarifying Provision	Original IRRs—Eligible Rollover Distributions	New IRRs—Not Otherwise Distributable
Q&A-1	Application of Notice 2010-84 (the original set of guidance for IRRs).	<p>Applies.</p> <p>Plans Covered—Only to plans that have been amended to permit Roth elective deferrals under a 401(k) plan, 403(b) plan, or governmental 457(b) plan.</p> <p>Generally Not a Distribution—Not subject to spousal consent or the notice to defer, but subject to the 402(f) (rollover) notice requirement (as a direct or indirect rollover is available). The IRR is not available to non-spouse beneficiaries.</p> <p>Irrevocable—All IRRs are irrevocable (unlike Roth IRA conversions).</p>	For new IRRs, the existing rules generally apply, but (1) they are only available with a direct rollover, and (2) the 402(f) notice does not need to be updated for this feature, nor provided to the participant.

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Notice 2013-74	Clarifying Provision	Original IRRs—Eligible Rollover Distributions	New IRRs—Not Otherwise Distributable
		<p><i>Required Minimum Distribution Rules</i>—Lifetime and death MRD provisions apply.</p> <p><i>10% Tax Recapture</i>—May apply if paid out within 5 years.</p>	
Q&A-2	Eligible Amounts.	Vested contributions (and earnings thereon) that are “currently distributable” and would be treated as an eligible rollover distribution if distributed (including amounts only eligible for in-plan rollover), and the plan so provides.	Vested contributions (and earnings thereon) that are not “currently distributable,” and the plan so provides. This includes elective deferrals, match, profit-sharing, non-elective contributions, QNECs, QMACs.
Q&A-3	Distribution Restrictions.	No. These amounts are already eligible for distribution.	Yes—same as original source. This requires tracking/recordkeeping the converted amounts (<i>e.g.</i> , IRRs of elective deferrals generally cannot be distributed until age 59-1/2).
Q&A-4	Income Tax Withholding.	Yes—voluntary withholding (optional).	No. As the amount is not distributable, no amounts can be withheld to pay for the resulting income taxes. Participant should consider paying estimated taxes or increasing W-4 (wage) withholdings.
Q&A-5	Timing of Plan Amendment.	Discretionary amendment—adopt by plan year-end.	<p>Generally adopt by the later of plan year-end or 12/31/14. Therefore, plan sponsors have through 2014 to amend their plans for 2013 IRRs, and to make mid-year 2013-2014 IRR changes for safe harbor plans through 12/31/14.</p> <p>For 403(b) plans, plan sponsors have until the later of the last day of the plan year in which the new IRR rules are effective, or end of the remedial amendment period, whichever is later.</p> <p>This amendment period also covers the following related amendments: (1) adding Roth deferral feature, (2) accepting rollovers of designated Roth accounts, and (3) permitting in-plan Roth rollovers of some or all otherwise distributable amounts.</p> <p>The Notice does not, however, provide sample amendment language.</p>

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Notice 2013-74	Clarifying Provision	Original IRRs—Eligible Rollover Distributions	New IRRs—Not Otherwise Distributable
Q&A-6	Plan Restriction on Type and Frequency of Rollover.	Notice 2013-74 clarified that a plan is permitted to restrict the type of contributions eligible for the IRRs and the frequency of the IRRs, subject to the standard BRF (benefit, rights, features) testing requirements under Code Section 401(a)(4).	Same.
Q&A-7	Anti-Cutback Violation if Eliminate the Feature. This has long been a concern of plan sponsors.	No. Notice 2013-74 clarified that discontinuation of the IRR feature does not violate the anti-cutback provision of Code Section 411(d)(6), but the timing of the amendment is subject to the nondiscrimination requirements under Treas. Reg. § 1.401(a)(4)-5.	Same (but still need to track balances for distribution restrictions).
Q&A-8	Qualified Distribution. (This is the significant potential advantage of the IRR feature, (1) it permits participants to convert non-Roth assets into Roth assets under the current tax rates, and (2) if a later distribution qualifies as a “qualified distribution,” then the earnings that accrued after the conversion date are tax-free (<i>i.e.</i> , never subject to federal income tax).)	Begin counting the 5-year period from first day of the first taxable year in which the rollover is made (if the first contribution to the Roth account is an IRR). If there is an existing Roth account in the plan, the IRR gets “tacking” of the 5-year period equal to that which applies to the account.	Same.
Q&A-9	Net Unearned Appreciation (NUA) Treatment (Q&A-9).	Treated as a distribution for determining eligibility for NUA treatment. Therefore, this feature does require the participant to forego favorable NUA treatment for employer stock.	Same.

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Notice 2013-74	Clarifying Provision	Original IRRs—Eligible Rollover Distributions	New IRRs—Not Otherwise Distributable
Q&A-10	Treatment for Top-Heavy Status (Q&A-10).	The IRR is counted as a “related rollover” for purposes of determining the plan’s top-heavy status, which means that the conversion amount must be counted in determining the present value of accrued benefits.	Same.
Q&A-11	Excess Amount To Be Distributed (and no other plan sources).	Notice 2013-74 clarified that, if an employee rolls over all his non-Roth funds into a designated Roth account, excess amounts (attributable to 402(g), ADP, or ACP testing) shall be distributed from the Roth account.	Same.

Cumulative List of Changes—The Latest Skinny on Plan Documents

The latest annual Cumulative List of plan qualification requirements is set forth in Notice 2013-84, which applies to single employer plans whose sponsors’ EINs end in 4 or 9 and to multiemployer plans. (Of course, any plan sponsor can review the annual list, organized in accordance with applicable Code sections, to ensure that its plan has been timely updated for the various items of IRS guidance.) This latest list includes a number of new items, which are summarized below, that will be part of the IRS determination letter review process:

- *DOMA Guidance.* The Notice lists *United States v. Windsor*, along with Revenue Ruling 2013-17, regarding the definition of “spouse” including same-sex marriages. This is interesting, as many plan sponsors are awaiting the pending guidance regarding the effective date of this change for qualified plans, and the related corrective measures necessary to ensure plan qualification.
- *ESOPs.* The Notice lists Notice 2013-7, which provides relief from anti-cutback rules for amendments to an ESOP to eliminate all in-service distribution options previously used to satisfy the diversification requirements of Code Section 401(a)(28)(B).

- *Mid-Year Safe Harbor Reductions/Suspensions.* The Notice lists the final regulations that were recently issued under Code Sections 401(k) and 401(m), regarding mid-year reduction or suspension of 401(k) safe harbor matching or nonelective contributions.
- *In-Plan Roth Rollovers.* The Notice lists Notice 2013-74 (described above) regarding rules for IRRs.
- *MAP-21 Funding Rules.* The Notice lists Notice 2013-11 regarding guidance on the 25-year average segment rates used to compute the minimum contribution requirements for single employer defined benefit plans under Code Section 430 for plan years beginning in 2013.

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Now that the rules for IRRs are clarified, plan sponsors may wish to take a second look at the in-plan Roth feature and consider the possibilities of providing this new plan design feature. Moreover, as the latest Cumulative List is now available, it is a good time to start thinking about the determination letter process, and for all plan sponsors reviewing the list of IRS requirements to ensure that the plan is in compliance with the ever-changing and complex IRS provisions. ■