

September 30, 2009

## MEMORANDUM TO CLIENTS

**RE: IRS Clarifies Tax Impact of Qualified Plan Rollovers to Roth IRA**

Recent IRS Notice 2009-75 (Sept. 28 IRS Bulletin) summarizes the availability and tax impact of a rollover from a qualified plan to a Roth IRA. In large part, this notice merely provides an overview of the relevant statutory and regulatory guidance that now permits rollovers to Roth IRAs. Unfortunately, it does not address any reporting and withholding issues. The only new guidance is in Part III of the Notice, in Q&A format, clarifying two taxation issues summarized below.

**Measuring Taxable Income and Tax Calculation** – What amount is includable in gross income as a result of the rollover from a qualified plan (e.g., 401(a), 403(a), 403(b), governmental 457)) to a Roth IRA? (Q&A 1)

- **Rollover From Non-Designated Roth Account:** The amount rolled over, reduced by the amount of any after-tax contributions that are included in the amount rolled over. This calculation is determined as if the distribution had been rolled to a traditional IRA and then converted to a Roth IRA. Therefore, the special rules relating to net unrealized appreciation ("NUA") on employer stock under Code section 402(e)(4), and certain favorable methods for calculating tax available to participants born on or before January 1, 1936 (e.g., capital gains rate and income averaging), are not applicable. This guidance is intended to shut down tax schemes claiming to avoid taxation on NUA by rolling such amounts to a Roth IRA.
- **Rollover From Designated Roth Account:** None, whether or not the distribution is a qualified distribution from the Roth Account.

**AGI Limits:** What are the modified adjusted gross income ("MAGI") limits and joint filing requirements for a rollover to a Roth IRA? (Q&A 2)

- Before January 1, 2010:
  - **Rollover From Non-Designated Roth Account:** \$100,000, and married filing joint return (if married). If these limits prohibit the rollover to a Roth IRA, the distributee can roll over to a traditional IRA and then convert, on or after January 1, 2010, to a Roth IRA.
  - **Rollover From Designated Roth Account:** None.
- **On or After January 1, 2010:** None, from either account. In recent weeks, tax policy groups highlighted this upcoming tax flexibility noting that it raised

revenue in the short-term, but was a huge revenue loser when viewed outside the normal budget window.

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Please call one of the following, or the Groom attorney you regularly contact, if you have any questions about this or any other matter.

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## Notice 2009-75, 2009FED ¶46,476 , Internal Revenue Service, (Sep. 9, 2009)

<http://prod.resource.cch.com/resource/scion/document/default/%28%40%40ADC01+NOTICE2009-75%2909013e2c85993aaa>

*News and Current Awareness > Federal Taxes Current Features and Journals > ADVANCE RELEASE Documents > Notice 2009-75, Internal Revenue Service, (Sept. 9, 2009)*

2009FED ¶46,476

[Code Sec. 408A](#)

### Retirement plans: Rollovers: Roth IRAs

#### Part III - Administrative, Procedural and Miscellaneous

#### Rollovers from Employer Plans to Roth IRAs

Notice 2009-75

#### I. PURPOSE

This notice describes the federal income tax consequences of rolling over an eligible rollover distribution from a qualified plan described in [§ 401\(a\)](#) of the Internal Revenue Code (Code), an annuity plan described in [§ 403\(a\)](#) , a plan described in [§ 403\(b\)](#) , or an eligible governmental plan under [§ 457\(b\)](#) to a Roth IRA described in [§ 408A](#) .

#### II. BACKGROUND

[Section 401\(k\)](#) sets forth rules for qualified cash or deferred arrangements under which an employee may make an election between cash and an employer contribution to a plan qualified under [§ 401\(a\)](#) . [Section 403\(b\)](#) permits a similar salary reduction agreement under which payments are made to a [§ 403\(b\)](#) plan. Amounts contributed pursuant to these qualified cash or deferred arrangements and salary reduction agreements are defined in [§ 402\(g\)\(3\)](#) as elective deferrals.

A designated Roth contribution is described in [§ 402A](#) , which was added to the Code by section 617(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (115 Stat. 103) (EGTRRA), for taxable years beginning after December 31, 2005. A designated Roth contribution is an elective deferral, as described in [§ 402\(g\)\(3\)\(A\)](#) or (C) of the Code, that has been designated by an employee, pursuant to [§ 402A](#) , as not excludable from the employee's gross income. Under [§ 402A\(b\)\(2\)](#) , designated Roth contributions made to the plan must be maintained in a separate account (a designated Roth account).

Under [§ 402\(a\)](#) , a distribution from a plan qualified under [§ 401\(a\)](#) generally is taxable under [§ 72](#) to the distributee in the taxable year distributed. However, pursuant to [§ 402A\(d\)\(1\)](#) , a qualified distribution from a designated Roth account is excludable from gross income. A qualified distribution is defined in [§ 402A\(d\)\(2\)](#) as a distribution that is made after completion of a specified 5-year period and the satisfaction of other specified requirements. If the distribution is not a qualified distribution, then, pursuant to [§ 72](#) , the distribution is included in the distributee's gross income to the extent allocable to income on the contract and excluded from gross income to the extent allocable to investment in the contract (commonly referred to as basis).

[Section 402\(c\)](#) sets forth rules under which an eligible rollover distribution from a plan qualified under [§ 401\(a\)](#) may be rolled over to an eligible retirement plan. In such a case, the distribution generally is not currently includable in the distributee's gross income. An eligible retirement plan means an individual retirement plan or an "eligible employer plan." An individual retirement plan (IRA) is defined in [§ 7701\(a\)\(37\)](#) as an individual retirement account described in [§ 408\(a\)](#) or an individual retirement annuity described in [§ 408\(b\)](#) . For purposes of this notice, an eligible employer plan means a plan qualified under [§ 401\(a\)](#) ,

including a profit-sharing or stock bonus plan (whether or not the plan includes a qualified cash or deferred arrangement under [§ 401\(k\)](#) ), a money purchase pension plan, or a defined benefit pension plan; a [§ 403\(a\)](#) annuity plan; a [§ 403\(b\)](#) plan; and an eligible [§ 457\(b\)](#) plan maintained by a governmental employer described in [§ 457\(e\)\(1\)\(A\)](#) (a “governmental [§ 457\(b\)](#) plan”).

Under [§§ 402\(c\)\(8\)](#) and 402A(c)(3), a distribution from a designated Roth account may be rolled over only to another designated Roth account or to a Roth IRA under [§ 408A](#) . A Roth IRA is a type of IRA under which contributions are not deductible and qualified distributions are excludable from gross income. Under [§ 408A\(d\)\(2\)](#) , a qualified distribution from an individual's Roth IRA is a distribution that is made (1) after the 5-taxable-year period beginning with the first taxable year for which the individual had a Roth IRA; and (2) after age 59½, after death, on account of disability, or for a first-time home purchase under certain circumstances. [Section 408A\(d\)\(4\)](#) sets forth special ordering rules for the return of after-tax contributions in the case of a distribution from a Roth IRA. Under these ordering rules, after-tax contributions are recovered before income.

A taxpayer may convert an amount held in an IRA that is not a Roth IRA (non-Roth IRA) to an amount held in a Roth IRA, pursuant to the rules in [§ 408A](#) relating to qualified rollover contributions. A conversion may be accomplished by means of a rollover, trustee-to-trustee transfer, or account redesignation. Regardless of the means used to convert, any amount converted from a non-Roth IRA to a Roth IRA is treated as distributed from the non-Roth IRA and rolled over to the Roth IRA.

In the case of such a conversion, the taxpayer must include in gross income the value of the non-Roth IRA being converted (other than the amount of any after-tax contributions included in the conversion). For taxable years beginning before January 1, 2010, such a conversion is not permitted to be made by a taxpayer whose modified adjusted gross income for the year of the distribution exceeds \$100,000 (or who, if married, does not file jointly). The regulations under [§ 408A](#) , in particular [§§ 1.408A-4](#) and 1.408A-5, provide guidance relating to conversions from a non-Roth IRA to a Roth IRA (including special rules where a non-Roth IRA annuity is converted into a Roth IRA annuity). These sections of the regulations were issued in 1999 and, thus, do not reflect the statutory revisions described below. Treasury and the Internal Revenue Service expect to incorporate the guidance in this notice into the regulations when those regulations are updated to reflect those statutory revisions.

Under [§§ 402A](#) and 408A (as amended by a technical correction in section 108(d) of the Worker, Retiree, and Employer Recovery Act of 2008, Pub. Law No. 110-458, 122 Stat. 5092 (WRERA 2008)), an eligible rollover distribution made from a designated Roth account in an eligible employer plan can be rolled over to a Roth IRA.

Prior to enactment of section 824 of the Pension Protection Act of 2006, Public Law 109-280 (120 Stat. 780) (PPA '06), an eligible rollover distribution from an eligible employer plan not made from a designated Roth account could be rolled over to a non-Roth IRA and then converted to a Roth IRA, but could not be rolled over to a Roth IRA without an intervening rollover to a non-Roth IRA followed by a conversion to a Roth IRA. See [Notice 2008-30](#) , 2008-12 I.R.B. 638.

Section 824 of PPA '06 amended the definition of qualified rollover contribution in [§ 408A](#) of the Code (relating to Roth IRAs) for distributions on or after January 1, 2008, to allow the recipient of an eligible rollover distribution not made from a designated Roth account to roll over the amount of the distribution to a Roth IRA without first contributing that amount to a non-Roth IRA. The Joint Committee on Taxation Report explains the change made by section 824 of PPA '06 as follows:

The provision allows distributions from tax qualified retirement plans, tax-sheltered annuities, and governmental 457 plans to be rolled over directly from such plan into a Roth IRA, subject to the present law rules that apply to rollovers from a traditional IRA into a Roth IRA. For example, a rollover from a tax-qualified retirement plan into a Roth IRA is includible in gross income (except to the extent it represents a return of after-tax contributions), and the 10-percent early distribution tax does not apply.

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Thus, under [§ 402A](#) and [§ 408A](#) , as amended by section 824 of PPA '06, a rollover from an eligible employer plan (other than from a designated Roth account) to a Roth IRA results in the same federal income

tax consequences for a participant as a rollover to a non-Roth IRA immediately followed by a conversion to a Roth IRA (except that the special rule at [§ 408\(d\)\(2\)](#) for aggregating after-tax amounts would not apply).

For taxable years beginning before January 1, 2010, a rollover from an eligible employer plan not made from a designated Roth account is available only to a taxpayer whose modified adjusted gross income for the year of the distribution does not exceed \$100,000 (and who, if married, files jointly). The mandatory withholding requirements provided in [§ 3405\(c\)](#) do not apply to a distribution paid from an eligible employer plan to a Roth IRA in a direct rollover, even though the distribution is includible in gross income. Also, the additional income tax on early distributions provided in [§ 72\(t\)](#) generally does not apply to a rollover from an eligible retirement plan to a Roth IRA. However, [§ 408A\(d\)\(3\)\(F\)](#), [§ 1.408A-6](#) A-5, and [Notice 2008-30](#), Q&A-3, describe a special rule relating to the additional income tax on early distributions for distributions made from a Roth IRA within a specified 5-year period after a rollover.

This notice supplements the regulations under [§ 408A](#) and [Notice 2008-30](#) to provide additional guidance on a rollover from an eligible employer plan to a Roth IRA. For additional information, see also Publication 590, Individual Retirement Arrangements.

### III. ROLLOVERS FROM AN ELIGIBLE EMPLOYER PLAN TO A ROTH IRA

Q-1: What amount is included in gross income as a consequence of a rollover to a Roth IRA from an eligible employer plan (i.e., a qualified plan described in [§ 401\(a\)](#), an annuity plan described in [§ 403\(a\)](#), a plan described in [§403\(b\)](#), or a governmental [§ 457\(b\)](#) plan)?

A-1: (a) *Rollovers to a Roth IRA of distributions that are not made from a designated Roth account*. If an eligible rollover distribution from an eligible employer plan is rolled over to a Roth IRA and the distribution is not made from a designated Roth account, then the amount that would be includible in gross income were it not part of a qualified rollover contribution is included in the distributee's gross income for the year of the distribution. For this purpose, the amount included in gross income is equal to the amount rolled over, reduced by the amount of any after-tax contributions that are included in the amount rolled over, in the same manner as if the distribution had been rolled over to a non-Roth IRA that was the participant's only non-Roth IRA and that non-Roth IRA had then been immediately converted to a Roth IRA. Thus, the special rules relating to net unrealized appreciation at [§ 402\(e\)\(4\)](#) and certain optional methods for calculating tax available to participants born on or before January 1, 1936 are not applicable.

(b) *Rollovers to a Roth IRA of distributions made from a designated Roth account*. If an eligible rollover distribution made from a designated Roth account in an eligible employer plan is rolled over to a Roth IRA, the amount rolled over is not includible in the distributee's gross income, whether or not the distribution is a qualified distribution from the designated Roth account.

Q-2: What are the modified adjusted gross income limitations and joint filing requirements for a rollover to a Roth IRA of a distribution from an eligible employer plan made either before January 1, 2010 or on or after January 1, 2010?

A-2: (a) *Distributions not made from a designated Roth account*. Except for a distribution from a designated Roth account, an eligible rollover distribution made before January 1, 2010 from an eligible employer plan may not be rolled over to a Roth IRA unless, for the year of the distribution, the distributee's modified adjusted gross income does not exceed \$100,000 and, in the case of a married distributee, the distributee files a joint federal income tax return with his or her spouse. The \$100,000 limit and the requirement that a married distributee file a joint return do not apply to distributions made on or after January 1, 2010. If an eligible rollover distribution made before 2010 is ineligible to be rolled over to a Roth IRA either because the distributee's modified adjusted gross income exceeds \$100,000 or because a married distributee does not file a joint return, the distribution can be rolled over into a non-Roth IRA and then the non-Roth IRA can be converted, on or after January 1, 2010, into a Roth IRA.

(b) *Distributions made from a designated Roth account*. There are no restrictions based on the modified adjusted gross income limitations and joint filing requirements that apply to a rollover of an eligible rollover distribution made from a designated Roth account under an eligible employer plan to a Roth IRA.

### EFFECT ON OTHER DOCUMENTS

[Notice 2008-30](#) , 2008-12 I.R.B. 638, is amplified and clarified.

#### **CONTACT INFORMATION**

The principal author of this notice is Kathleen Herrmann of Employee Plans, Tax Exempt and Government Entities Division. Questions regarding this notice may be sent via e-mail to [RetirementPlanQuestions@irs.gov](mailto:RetirementPlanQuestions@irs.gov).

<b>Footnotes</b>
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- 1 Joint Committee on Taxation, *Technical Explanation of H.R. 4, the Pension Protection Act of 2006, as Passed by the House on July 28, 2006, and as Considered in the Senate on August 3, 2006* (JCX-38-06), August 3, 2006, at 174.