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Qualified Plans Issues Relating to Rollovers for Roth Conversions

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In 2010, the rule prohibiting higher income taxpayers from converting their traditional IRAs to Roth IRAs is eliminated. This change, along with some people's view that tax rates are likely to increase in the future, has led to speculation that a significant number of individuals with adjusted gross income (AGI) over \$100,000 may want to convert part of their retirement savings to Roth IRAs in 2010. This column explores potential impacts on qualified defined contribution plans and legal issues that may be raised as more participants seek to take distributions from qualified plans in order to move funds to Roth IRAs. The column covers plan design, plan operation, and Internal Revenue Service (IRS) reporting issues to consider in light of potential increases in demand for in-service distributions from qualified defined contribution plans.

Background: Differences Between Roth IRAs and Retirement Plans May Lead Participants to Request Conversions to Roth IRAs

Treatment of Contributions and Earnings, and Distributions

Generally, under a traditional IRA, individuals make contributions that may be deducted from the individual's income for the year for

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which contributed (or for the prior year by April 15), and earnings on the IRA are not taxed year by year.¹ Instead, amounts distributed from the traditional IRA are included in taxable income when distributed, and if distributions are made prior to age 59½, subject to an additional 10 percent early distribution tax unless a special exception applies.² Similar tax treatment is accorded employee elective contributions to traditional 401(k) accounts, and employer contributions to qualified plans.³ In contrast, for a Roth IRA (or a designated Roth account in a 401(k) plan or a 403(b) arrangement),⁴ the individual includes the amounts contributed in income in the year the contributions are made. No deduction or exclusion from income is provided for the contributions. However, if the rules applicable to “qualified distributions” are met, then the earnings on the account are never taxed and the distributions from the Roth IRA or the designated Roth account in the 401(k) plan (the Roth 401(k) account) are tax-free. Traditional IRA and qualified plan rules generally require distributions to be made after age 70½,⁵ but Roth IRA rules do not mandate that the IRA owner take distributions while alive.⁶

Qualified distributions from a Roth IRA are subject to a five-year rule and must meet certain conditions. A qualified distribution from a Roth IRA must be made after the five-year period beginning with the first taxable year for which a contribution was made to *any* Roth IRA of the taxpayer. Either a regular or conversion contribution can start the period running.⁷ In addition to meeting the five-year requirement, a qualified distribution from a Roth IRA also must be made on or after attainment of age 59½, on account of disability or death, or for a qualified first home purchase (subject to a \$10,000 lifetime cap).⁸ For designated Roth accounts in 401(k) plans (Roth 401(k) accounts) the five-year period is measured starting on the first day of the year of the participant’s first contribution to *the* Roth 401(k) account in the plan. Periods attributable to contributions to a Roth 401(k) account in another plan are only counted for purpose of the five-year rule (“tacked”) if amounts are directly rolled into the plan from the other plan.⁹ If a distribution is rolled from a Roth 401(k) account to a Roth IRA, no credit is given under the Roth IRA five-year rule for periods which counted under the Roth 401(k) account five-year rule.¹⁰ In addition to meeting the five-year rule, qualified distributions from a Roth 401(k) account must be made on or after attainment of age 59½, or on account of disability or death. Distributions for qualified first year home purchases constitute qualified distribution only for Roth IRAs—not for Roth 401(k) accounts.¹¹

Even more importantly, the rule on when distributions must begin differs for Roth IRAs and Roth 401(k) accounts. Roth 401(k) accounts are subject to the required minimum distribution rules that generally apply to qualified plans. Distributions generally must begin by April 1 of the year following the later of the year in which the participant reaches age

70½ or retires, and must be made annually.¹² Required minimum distributions also must be made after the death of the participant. For Roth IRAs, no minimum distributions are required during the life of the IRA owner.¹³

Practical Effect of Differences Between Roth and Traditional Arrangements

As a general matter, individuals who believe their tax rate will be lower in retirement than in the year of a deferral will prefer traditional IRA or 401(k) contributions. Those who believe that their tax rates in retirement may be higher than current rates, or who may want additional flexibility or ability to retain funds in a tax advantaged account, may want to consider converting some assets to a Roth IRA. Since distributions from a Roth IRA need not commence at age 70½, more funds can be preserved longer in a tax advantaged account and can be potentially passed to heirs. Also, Roth IRAs can be used to reduce potential estate tax liability. The Roth IRA owner pays taxes on the amount in the IRA during life, and, at death, can pass the full value of the IRA to heirs, who will not need to use the inherited assets to pay income tax on the amounts distributed. Similarly, an individual with ready cash can in effect contribute more funds to tax advantaged savings using a Roth vehicle. Some participants may wish to make rollovers to Roth IRAs in order to start the running of the Roth IRA five-year period or have funds available for a qualified first-time home purchase (assuming they met the Roth IRA five-year rule with a previously established IRA, or plan to wait five years to purchase their first home).

Income Limits Affecting Roth IRA Contributions and Conversions

Individuals whose adjusted gross income (AGI) is above certain limits are not permitted to make contributions to a Roth IRA.¹⁴ Prior to 2010, taxpayers with AGI of \$100,000 or more were not permitted to convert a traditional IRA to a Roth IRA or to roll funds from qualified plans into Roth IRAs. Effective 2010, the AGI limits for *conversions* to Roth IRAs no longer apply, though individuals with AGI over certain thresholds still may not make contributions to Roth IRAs. Generally, an individual rolling funds from a qualified plan or traditional IRA to a Roth IRA will include the fair market value of funds rolled (less any applicable basis) in gross income for the year of the rollover. For rollovers made in 2010, however, a special rule provides that these amounts will be ratably included in income for 2011 and 2012, unless the taxpayer elects to have them included in income for 2010.¹⁵

Effect of These Changes on Plan Administrators

This column focuses on issues for qualified plan administrators regarding rollovers from qualified plans to Roth IRAs. This column does not provide comprehensive information on Roth IRAs for those considering opening such accounts or making rollovers to them. Moreover, although this column provides some background as context for the issues that plan administrators will face, in order to avoid potential liability, plan administrators and human resources departments generally should refrain from advising participants on their individual tax situations and would be prudent to clearly indicate that the plan does not provide legal advice to participants. Instead, the plan administrator or staff could suggest that participants seek advice from the participant's lawyer or tax advisor and see IRS Publication 590, *Individual Retirement Arrangements (IRAs)*.

Background: Distributions from Qualified Plans

Defined contribution plans qualified under Internal Revenue Code (IRC) Section 401(a) are primarily plans of deferred compensation. Tax deferral is permitted in order to promote the public policy goal of encouraging *retirement* savings. Pre-retirement distributions are permitted only under special circumstances. Employer contributions may not be distributed for a fixed number of years (at least two), until the employee reaches a specified age, or until the occurrence of a particular event, such as a layoff, illness, disability, death, or severance from employment.¹⁶ A plan may permit a participant with at least five years of participation to withdraw all amounts credited to the participant's account, including employer contributions made within the previous 24 months.¹⁷ This "two/five"-year rule permitting in-service distributions does not apply to elective deferrals from 401(k) plans.¹⁸ These elective deferrals may not be distributed prior to death or disability, retirement, severance from employment, attainment of age 59½, or hardship.¹⁹

Many qualified plans, including 401(k) plans, permit in-service withdrawals after age 59½, but some do not. Many plans do not permit distributions of employer contributions that have been in the plan for two years or more or after five years of participation. Given the desire of some high-level executives to convert pre-tax retirement savings to Roth IRAs, pressure may be exerted on plan sponsors to amend their plans to provide for these in-service distributions.

Plan sponsors may want to consider whether to amend their plans to change rules regarding in-service withdrawals. Plan sponsors and plan administrators will want to review their plan operating procedures to ensure that they are prepared to handle potential increases in the

volume of requests for in-service distributions and that they avoid problems due to timing and valuation issues. Issuers of Forms 1099-R will want to ensure proper reporting of distributions.

Plan Design and Options

Should a Plan Sponsor Liberalize In-Service Distribution Rules to Accommodate Roth IRA Conversions?

Whether or not to liberalize in-service distribution rules is a business, rather than a legal, decision for the plan sponsor to make. Tax law rules do not require the liberalization. Many plan sponsors prefer to limit in-service withdrawals in order to limit administrative burdens on plans and to enhance employee loyalty as employees see their retirement accounts grow. Some sponsors want to encourage their employees to build greater retirement savings and therefore do not adopt liberal in-service distribution rules.

Some plan sponsors who generally wish to encourage retention of retirement assets in their defined contribution plans but wish to accommodate the desire of some participants to convert retirement assets to Roth accounts have considered adopting plan amendments liberalizing distribution options *only* for direct rollovers to Roth IRAs. Assuming the amendment allows distributions for all participants, it should be permissible and not violate plan non-discrimination rules because the option would be currently available to all participants.²⁰

Other sponsors who previously did not permit distributions at age 59½, or based on the two/five-year rule, are choosing to amend their plans to permit distributions generally in these circumstances.

Note that plan sponsors who are considering amending their plans to adopt more liberal in-service distribution rules should also consider their plan structure and the effect on plan qualification. If the sponsor has adopted a master or prototype plan, the change could result in converting the plan to an individually designed plan, necessitating a separate determination letter, unless the plan sponsor's adoption agreement contains the new distribution provision.

Should Plan Sponsors Liberalize Rules Permitting Rollovers from IRAs into Their Qualified Plans?

A qualified plan may, but is not required to, permit rollovers from IRAs (or from other qualified plans) into the plan. Many plan sponsors already permit rollovers from IRAs into qualified plans, and those who do not may have determined they do not want to incur the added expenses that may be associated with accounting for and handling these funds. It is possible that plans will receive some additional requests to

roll IRA funds into qualified plans as part of increased Roth IRA conversion activity, given some strategies being promoted to decrease the tax liability of a Roth conversion.²¹ In deciding whether to amend a plan to permit rollovers into the plan, in addition to considering costs and burdens relating to recordkeeping and plan administration, the plan sponsor should consider the same issues regarding the potential effects of changes to a master or prototype plan discussed above.

Can a 401(k) Plan That Includes Roth 401(k) Accounts Permit Conversion of Amounts from Pre-Tax Elective Contribution or Employer Contribution Accounts to Roth Accounts?

As of mid-March, neither the Internal Revenue Code nor IRS rules or regulations permitted a conversion of a 401(k) salary deferral pre-tax employee contribution account, or any other defined contribution account, into a designated Roth account in a 401(k) plan. In fact, the regulations governing Roth 401(k) accounts specify that a direct or indirect transferring of value from another account into a Roth 401(k) account would violate the separate accounting rules that apply to Roth 401(k) accounts.²²

Some plan sponsors and groups have requested a legislative change that would amend the Internal Revenue Code to permit internal conversions within 401(k) plans. They have raised concerns about increased distributions from qualified plans for conversions and the fear that smaller employers may be tempted to terminate their plans in order to provide for conversions by rolling accounts to Roth IRAs.²³ Practitioners have pointed out that internal conversions within a 401(k) account are unlikely to be as attractive as conversions through a rollover to a Roth IRA—since Roth 401(k)s are still subject to the required minimum distribution rule, and computation of the five-year rule for Roth 401(k) accounts is kept separate from computation for Roth IRAs, without permitting crediting between Roth 401(k) accounts and Roth IRAs.

Some have asked whether it would be possible to achieve an internal conversion of funds to a Roth 401(k) account within a qualified plan via rollovers through a Roth IRA. They inquired whether a participant could make rollover conversion distribution from an employer contribution or employee pre-tax contribution account to a Roth IRA and then roll the funds back into a Roth 401(k) account in the same qualified defined contribution plan. This strategy is not available because rollovers are not permitted from Roth IRAs to Roth 401(k) accounts.²⁴ Roth IRAs may only roll over funds into Roth IRAs.²⁵

It is unclear, at the time of writing this column, whether a legislative change will be enacted permitting conversions from non-Roth accounts to Roth 401(k) accounts. Plan administrators should monitor

developments or contact their tax counsel for updates. An amendment was included in tax extender legislation passed by the Senate that would permit a qualified rollover distribution from a non-Roth account to be made to the Roth 401(k) account of the individual taking the distribution.²⁶ It is uncertain whether or not, this provision or a modified version, will be included in conference with the House or in any legislation sent to the President for signature.

Plan Operation

For all plans, whether they historically permitted in-service distributions or they are being amended to liberalize their rules, the potential increased distribution activity can place pressure on distribution procedures, particularly in a volatile market. When qualified plan funds are converted to Roth IRAs, the value of the assets at the time of conversion must be included in taxable income. This places strong incentives on converting when values are low. If participants are attempting to time the market for their conversions, there is potential for disputes to arise if the plan does not have clear procedures on the method and timing for distribution processing. Accordingly, plan administrators should review their distribution procedures and institute clear rules regarding the information required and timing regarding processing of distribution and direct rollover requests.

In addition, to the extent that a plan may permit investment in assets not listed on an established exchange with daily values, issues can arise concerning the proper valuation for IRS reporting purposes. The Form 1099-R issued by the plan should reflect the fair market value of the amounts directly rolled to a Roth IRA at the time of distribution. The taxable amount would be the total fair market value of assets distributed, less basis, if any, attributable to after-tax employee contributions.²⁷ The amount reported would be included in income by the participant for the year of the conversion to the Roth IRA (or, unless the taxpayer elects otherwise, ratably over 2011 and 2012 for 2010 conversions). If the plan permits investment in hard to value assets, it should establish procedures for valuing the assets at the time of distribution. The plan should also consider who should bear the costs of such valuations.

Plans must permit direct rollovers to IRAs or Roth IRAs, unless eligible rollover distributions for the participant for the year can reasonably be expected to be less than \$200 and must provide for automatic rollover for mandatory distributions above \$1,000.²⁸ A plan may apply the \$200 exception and the \$1,000 threshold to the Roth 401(k) account separately from application to other plan accounts.²⁹ Though many plans directly transmit rollover funds to trustees or custodians of recipient IRAs (and Roth IRAs), it is permissible for a plan to comply with the direct rollover rules by sending the participant a check made payable to the trustee of the IRA (or Roth IRA) and instructing the participant to deliver the check to the IRA (or Roth IRA).³⁰

Notice

A direct rollover to a Roth IRA is a distribution that must comply with the general notice requirements that apply to all eligible rollover distributions from qualified plans. The plan must provide the participant with a notice—often referred to as a “402(f) Notice”—describing direct rollover rules, mandatory withholding rules for amounts not directly rolled, and the tax treatment of distributions and rollovers.³¹ The IRS has published two safe harbor 402(f) Notices, one for distributions not from a 401(k) Roth account and one for distributions from a Roth 401(k) account.³² A plan may use the safe harbor notices, as written or modified to eliminate inapplicable sections, or may craft its own 402(f) Notices. The 402(f) Notice must be provided at least 30 days, and no more than 180 days prior to the distribution.³³ However, the 30-day period can be waived by the participant if the plan administrator clearly indicates to the participant that the participant has at least 30 days in which to consider whether or not to elect a direct rollover.³⁴ The 402(f) Notice can be provided electronically in accordance with general qualified plan rules on electronic notices.³⁵

Reporting

A plan must report a direct rollover to a Roth IRA on Form 1099-R. To properly report the distributions, the plan administrator or payer needs to determine:

1. What separate accounts exist within the plan for purposes of allocating basis;
2. From which accounts amounts are being distributed; and
3. Whether or not the distribution is being made as a direct rollover.

In apportioning basis under the plan, the amount allocable to income on the contract generally is determined pro-rata,³⁶ treating the Roth 401(k) as a separate contract.³⁷ Most participants seeking to convert to a Roth IRA will make direct rollover distributions from non-Roth 401(k) accounts. In this case, report the total amount rolled in box 1, the taxable amount in box 2a, and basis in box 5. Use code G in box 7.³⁸ Even though a 2010 rollover to a Roth IRA generally is taxable in 2011 and 2012, the payer must report the full amount rolled only on a 2010 Form 1099-R.³⁹

While most direct rollovers from qualified plans to Roth IRAs will be Roth conversion, some participants, such as younger workers who want to have Roth funds available for a home purchase, or older workers who want to start the running of the five-year period for Roth IRAs,

may seek to make a direct rollover from a Roth 401(k) account to a Roth IRA. The reporting of such a distribution would be somewhat different. For a direct rollover from a Roth 401(k) to a Roth IRA, enter the amount rolled over in box 1, zero in box 2a, and use code H in box 7.⁴⁰ Upon request, the plan administrator (or other responsible party) must provide the participant with a statement indicating the portion of the distribution that is attributable to investment in the contract under IRC Section 72 (*i.e.*, unrecovered designated Roth contributions that will constitute basis with respect to the participant's Roth IRAs).⁴¹ Though not mandated, the plan may want to consider instituting procedures to automatically provide this information to participants even absent a request.

An eligible rollover directly rolled to a Roth IRA is not subject to mandatory 20 percent withholding, even if the distribution is includible in income. The payer and plan administrator may enter into a voluntary withholding agreement for the direct rollover to a Roth IRA.⁴²

Future Guidance

As the volume of direct rollover distributions from qualified plans to Roth IRAs increases, and the level of conversions to Roth IRAs increases with the expiration of the AGI income limit on conversions, it is quite possible that new issues will arise and the IRS will issue new guidance or require different reporting. Plan administrators should monitor for future guidance or changes in IRS instructions for reporting, or contact their tax counsel, to keep abreast of possible new developments.

Notes

1. Taxpayers with higher incomes who participate in qualified plans, or whose spouses participate, may not deduct their IRA contributions, but they still are entitled to make contributions to traditional IRAs and benefit from tax free earnings. (At certain income levels, the deduction is reduced rather than eliminated.) *See* IRC § 219(g). References to "IRC" are to the Internal Revenue Code of 1986, as amended.
2. The 10 percent early distribution tax does not apply to IRA distributions: on account of death or disability; that are annuity distributions over life or life expectancy; for unreimbursed medical expenses in excess of 7.5 percent of AGI; to unemployed individuals for health insurance premiums; of not more than qualified higher education expenses; used to buy, purchase, or rebuild a first home (but subject to a \$10,000 lifetime cap); due to an IRS levy, or that constitute a qualified reservist distribution. *See* IRC § 72(t).
3. Employee elective contributions and employer contributions are excluded from income, rather than deducted by the taxpayer, when paid into the plan. The exceptions to the 10 percent early distribution tax applicable to qualified plans, including 401(k) plans, are somewhat different than the exceptions applicable to IRAs. For qualified plans, the 10 percent early distribution tax does not apply to distributions: on account of death

or disability; that are annuity distributions over life or life expectancy that begin after separation from service; if the participant separated from service on or after the year the participant reached age 55 (50 for public safety employees); for unreimbursed medical expenses in excess of 7.5 percent of AGI; to an alternate payee under a qualified domestic relations order (QDRO); for employee stock ownership plan dividends; due to an IRS tax levy or that constitute a qualified reservist distribution. *See* IRC § 72(t).

4. The designated Roth account and rollover rules applicable to 401(k) plans generally also apply to designated Roth accounts in 403(b) plans. *See* IRC § 402A(e)(1).

5. Distributions generally must commence by April 1 of the later of the year following attainment of age 70½ or (except for five percent owners) retirement. *See* IRC § 401(a)(9)(A) and (C) and Treas. Reg. § 1.401(a)(9)-2, Q&A 2; *see also* Treas. Reg. § 1.403(b)-6(e)(3) (for 403(b)s).

6. *See* IRC § 408A(c)(5) and Treas. Reg. § 1.408A-6, Q&A 14.

7. *See* IRC § 408A(d)(B) and Treas. Reg. § 1.408A-6, Q&A 2.

8. *See* IRC §§ 408A(d) and 72(t)(2)(F) and Treas. Reg. § 1.408A-6, Q&A 1.

9. *See* Treas. Reg. § 1.402A-1, Q&A 4(b). Plan administrators directly rolling amounts from Roth 401(k) accounts to a qualified plan must provide the recipient plan with a statement either indicating the first year of the five-year period and the portion of the distribution constituting basis or that the distribution is a qualified distribution. *See* Treas. Reg. § 1.402A-2, Q&A 2(a)(1).

10. *See* Treas. Reg. § 1.408A-10, Q&A 4(a).

11. *See* IRC § 402A(d)(2)(A).

12. *See supra*, n.5.

13. *See supra*, n.6.

14. *See* IRC § 408A(c). For 2010, an individual may make contributions of up to \$5,000 (\$6,000 if over age 50) to a Roth IRA if AGI is less than \$167,000 if married filing jointly and \$105,000 if single. These limits do not apply to rollovers from qualified plans to Roth IRAs or conversions from traditional IRAs to Roth IRAs. This column focuses on the impact of rollovers to Roth IRAs on qualified plans, not the rules governing Roth IRAs themselves. For more detailed information on rules and limits applicable to Roth IRAs (including phase-out AGI ranges for which lesser contributions may be made), *see* IRS Publication 590, *Individual Retirement Arrangements (IRAs)*.

15. *See* IRC § 408A(d)(3)(A)(iii).

16. *See* Treas. Reg. § 1.401-1(b)(1)(ii) and Rev. Rul. 71-295, 1971-2 C.B. 184.

17. *See* Rev. Rul. 68-24, 1968-1 C.B. 150.

18. *See* IRC § 401(k)(2)(B)(ii). The two/five-year rule also does not apply to matching and nonelective contributions used to satisfy the design-based safe harbor for 401(k) plans (“safe harbor contributions”). *See* IRC § 401(k)(12)(E)(i).

19. *See* IRC § 401(k)(2)(B). Safe harbor contributions and non-grandfathered qualified matching contributions, qualified nonelective contributions and earnings may not be distributed prior to death or disability, retirement, severance from employment or attainment of age 59½. Hardship is not a distributable event for contributions other than

elective contributions. *See* IRC § 401(k)(2)(B)(i)(IV), Treas. Reg. § 1.401(k)-1(d)(3)(ii), and Notice 98-52, 1998-2 C.B. 634.

20. *See* Treas. Reg. § 1.401(a)(4)-4.

21. Rollover of the total pre-tax funds from all of a taxpayer's IRAs into a qualified plan is the first step in a process used by some taxpayers to isolate all their after-tax IRA money in a stub IRA. If a taxpayer first rolls all pre-tax IRA money into a qualified plan, it appears that the taxpayer could then convert the remaining after-tax IRA money to a Roth IRA without income inclusion for the conversion. *See* Natalie B. Choate, *Roth: Ready for 2010*, online at <http://www.macpa.org/Content/25251.aspx>; *see also* IRC § 408(d)(3)(A)(ii) (permitting rollover from IRAs into qualified plan only up to total of pre-tax money in all IRAs) and Notice 87-13, 1987-1 C.B. 432, Q&A 18. If, instead, the taxpayer rolled an equivalent amount from a traditional IRA to a Roth IRA, the taxpayer would have income inclusion equal to the amount rolled to the Roth IRA times (the total value of all IRAs minus total after tax contributions) divided by the aggregate value of all IRAs. *See* Treas. Reg. § 1.408A-4, Q&A 7 and 2009 IRS Form 8606 and Instructions for Form 8606.

22. *See* Treas. Reg. § 1.402A-1, Q&A 13.

23. Distributions upon plan termination generally are permitted. *See* Rev. Rul. 56-693, 1956-2 C.B. 282 *as modified by* Rev. Rul. 60-323, 1960-2 C.B.148; *see also* IRC § 401(k)(10) (regarding 401(k) plans).

24. *See* Treas. Reg. § 1.408A-10, Q&A 5. This rule applies even if all the amounts in the Roth IRA are attributable to a rollover distribution from a Roth 401(k) account.

25. *See* IRC § 408A(c)(6) and 408A(e) and Treas. Reg. §1.408A-6, Q&A 17.

26. *See* Senate Amendment 3374, 156 Cong. Rec. S1223 (daily ed. Mar. 5, 2010) (as modified and agreed to in Senate by unanimous consent), *amending* H.R. 4213, 111th Cong. (2010) (American Workers State Business Relief Act, passed by Senate on Mar. 10, 2010).

27. *See* Notice 2009-75, 2009 I.R.B. 436, Q&A 1.

28. *See* Treas. Reg. § 1.401(a)(31)-1, Q&A 1 and 11; Notice 2008-30, 2008-I.R.B.638, Q&A 4.

29. *See* Treas. Reg. § 1.401(k)-1(f)(4)(ii).

30. *See* Treas. Reg. § 1.401(a)(31)-1, Q&A 4.

31. *See* IRC § 402(f) and Treas. Reg. § 1.402(f)-1.

32. *See* Notice 2009-68, 2009-39 I.R.B. 423.

33. *See* Prop. Treas. Reg. §1.402(f)-1, Q&A 2(a): Pension Protection Act of 2006, Pub. L. No. 109-280 § 1102, 120 Stat. 780 (2006) (directing that final regulation be modified to permit notice to be provided 180 days before date of distribution) and Treas. Reg. § 1.402(f)-1, Q&A 2.

34. *See* Treas. Reg. § 1.402(f)-1, Q&A 2.

35. *See* Treas. Reg. § 1.401(a)-21.

36. *See* IRC § 72(e)(2)(B) and (8) and Notice 87-13, 1987-1 C.B. 432, Q&A 11 and 12. (With respect to non-Roth 401(k) accounts, a special grandfather rule permits pre-1987

after tax contributions maintained in a separate contract to be distributed first. *See* IRC §§ 72(d)(2) and (e)(8)(D) and Notice 87-13, 1987-1 C.B. 432, Q&A 14 and 15, as modified by Notice 89-25, 1989-1 C.B. 662.) In its model 402(f) Notice, the IRS provided that where a participant takes a direct rollover and cash distribution at the same time, the pro-rata basis recovery rule would apply to the direct rollover separately from its application to the cash distribution. A special rule of IRC § 402(c)(2) treating rollovers as coming first from pre-tax money was applied only to a distribution to the participant followed by a 60-day partial rollover not to a direct rollover accompanied by a cash distribution. *See* Notice 2009-68, 2009-39 I.R.B. 423. Some have requested that the IRS reconsider its position and issue further guidance on allocation of basis where a direct rollover and cash distribution is made concurrently.

37. For purpose of basis allocation under IRC § 72, all Roth 401(k) contributions and related earnings are treated as one separate contract, regardless of whether or not separate accounts are maintained for Roth 401(k) rollovers. If a separate account is established for an alternative payee under a QDRO, or for beneficiaries after the death of a participant, then the separate account for the alternative payee, and the separate account for each beneficiary, are treated as separate contracts under Code Section 72. *See* Treas. Reg. §1.402A-1, Q&A 9.

38. *See* 2010 Instructions for Forms 1099-R and 5498, page 4. If the direct rollover is made for a non-spouse beneficiary, also enter code 4 in box 7. *Id.*

39. *Id.*

40. *Id.*

41. *See* Treas. Reg. § 1.402A-2, Q&A 2. The statement must be provided within a reasonable period after the request, but in no event later than 30 days following the request. *Id.*

42. *See* Notice 2008-30, 2008-12 I.R.B. 638, Q&A 6.

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