



Alert

Employee Benefits & Executive Compensation

To: Our Clients and Friends

October 4, 2010

Employee Benefits Provisions of the Small Business Jobs Act of 2010

On September 27, 2010, the Small Business Jobs Act of 2010 (the "Act") was signed into law. While the Act mainly focuses on providing tax and other assistance to small businesses, it also includes provisions aimed at promoting retirement preparation that are not limited to small businesses. These include allowing governmental 457(b) plans to permit Roth contributions and permitting amounts deferred under Internal Revenue Code ("Code") section 401(k), 403(b) and 457(b) plans to be converted to designated Roth contribution accounts.

In-Plan Rollovers of Pre-Tax Elective Deferral Accounts to Roth Contribution Accounts

Effective as of the date of enactment, Code section 401(k) and 403(b) plans, and as of January 1, 2011, 457(b) plans (as described below), may allow certain pre-tax elective deferrals to be converted into after-tax Roth contribution accounts. Previously, a similar conversion required a rollover distribution into a Roth IRA. Now, certain plans may allow participants to roll, or convert, pre-tax elective deferrals into Roth contribution accounts within the plan. To do so, the following requirements must be satisfied:

- a plan must have a Roth contribution arrangement;
- the amount to be converted must be distributable under the plan; and
- the distribution must be an "eligible rollover distribution" under Code section 402(c).

For example, where an eligible plan does not permit in-service distributions before normal retirement age, a conversion to a Roth account would not be possible while an employed participant has not attained such age. Employers may amend their plans to allow for distributions that would make such a conversion available to those under normal retirement age. In fact, a plan may even limit any new distribution option so that it only applies in the case of a conversion into the Roth account. Any such distribution option would be subject to the other Code requirements that may limit distributions.

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Amounts converted to Roth accounts as described above shall be taxable to the participant, but will not be subject to the 10% early distribution tax under Code section 72(t). A special rule regarding rollovers from qualified retirement plans to Roth IRAs provides that amounts converted in 2010 will be recognized ratably over 2011 and 2012, unless the participant elects otherwise. This rule will also apply in the case of in-plan conversions to Roth accounts. However, whether allowing the recognition of such amounts to take place in later years would be the best option will depend on an individual taxpayer's circumstances. While a delay of income recognition is often viewed as a positive result, it is possible that tax rates for individuals in the highest income tax brackets may increase from 35% to 39.6% in 2011. Therefore, recognition of such income for those individuals in 2010 may be more tax advantageous than deferring the recognition to later years.

The tax advantages of converting during 2010 may make it desirable to amend plans to allow for such Roth conversions before the end of the tax year. While the intention of Congress is that the IRS allow formal plan amendments implementing such a change retroactively, the appropriate administrative procedures must be in place in 2010 to allow for the conversion by year end.

Roth Contribution Accounts Permitted Under 457(b) Plans

Prior to the Act, plans maintained by a state or local government pursuant to Code section 457(b) could not provide for Roth contributions like 401(k) or 403(b) plans. Effective for taxable years beginning after December 31, 2010, the Act amends Code section 402A (governing Roth contributions to applicable retirement plans) to include 457(b) plans in its definition of "applicable retirement plan," and extends the definition of "elective deferral" to include deferrals under 457(b) plans. Therefore, for plan years beginning on or after January 1, 2011, governmental 457(b) plans may permit Roth contributions, as well as the Roth conversions described above.

The attorneys of the Employee Benefits and Executive Compensation group of Bryan Cave LLP are available to answer your questions.

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