

New In-Plan Roth Conversion Option

The Small Business Jobs and Credit Act of 2010 created a new way to save using Roth accounts in a 401(k) plan.

Roth 401(k) contributions are contributions made to a 401(k) plan on an **after-tax** basis. Unlike regular 401(k) contributions, the Roth 401(k) contributions are taxable at the time they are made to the plan. The contributions are held in a specially designated account and accumulate earnings tax-free. If the distribution timing rules are followed, all distributions from the Roth 401(k) account are nontaxable. Roth 401(k) distributions will lose their tax favored status if they are distributed before 1) the earlier of the date the participant reaches age 59 1/2, dies or is disabled, or 2) five years from the date the participant began making Roth contributions to the 401(k) plan. Roth 401(k) accounts may only be rolled over to other 401(k) or 403(b) plans with Roth accounts or to Roth IRAs.

Previously, if a 401(k) plan participant wanted to convert non-Roth money into Roth money, he or she would take a distribution from the 401(k) plan and roll it to a Roth IRA. Under the new law, a participant can convert non-Roth money into Roth money without taking a distribution from the plan; the conversion can happen inside the plan. Any money other than existing Roth money can be converted to Roth money (i.e., pre-tax deferrals, matching contributions, profit sharing contributions, rollover contributions, after-tax contributions, and their earnings).

As with the old method, in order to use the new conversion option, a participant must be entitled to receive a distribution from the plan (other than a hardship distribution, a required minimum distribution, annuity payments or installment payments for more than 10 years). In addition, as before, the participant will have a taxable event upon the conversion. If the conversion takes place in 2010, the converted amount may be included in income one-half in the 2011 tax year and one-half in the 2012 tax year (or all in the 2010 tax year, if the participant prefers). For post-2010 conversions, the converted amount is includible in income in the year of conversion. The conversion is not subject to the 10% early withdrawal penalty. Surviving spouses can do a Roth conversion inside a plan, but non-spouse beneficiaries cannot.

In order for a participant to do a Roth conversion inside a plan, the plan must be amended to allow such conversions. It is anticipated that the IRS will allow some time for such amendments to be made, even for 2010 conversions. A plan that doesn't currently provide for in-service distributions could be amended to add them, and could limit such in-service distributions to distributions solely for Roth conversion purposes. However, a plan cannot add a Roth feature solely to allow Roth conversions; it must allow Roth deferral contributions to be made as well.

There are two disadvantages to using an in-plan Roth conversion as opposed to taking a distribution from the plan and rolling it to a Roth IRA. First, Roth IRAs are not subject to the required minimum distribution rules, so payments from a Roth IRA do not have to begin at age 70½. In-plan Roth accounts are subject to those rules, so payments may be required at 70½. Second, if the conversion becomes disadvantageous (for example, because of a drop in the market after the conversion), the conversion cannot be reversed if it is an in-plan conversion; the conversion can be reversed if a distribution is taken and rolled to a Roth IRA.

If you would like more information regarding Roth deferrals and the in-plan conversion option, please contact your Employee Benefit Resources consultant.

New In-Plan Roth Conversion Option for 403(b) Plans

The Small Business Jobs and Credit Act of 2010 created a new way to save using Roth accounts in a 403(b) plan.

Roth 403(b) contributions are contributions made to a 403(b) plan on an after-tax basis. Unlike regular 403(b) contributions, the Roth 403(b) contributions are taxable at the time they are made to the plan. The contributions are held in a specially designated account and accumulate earnings tax-free. If the distribution timing rules are followed, all distributions from the Roth 403(b) account are nontaxable. Roth 403(b) distributions will lose their tax favored status if they are distributed before 1) the earlier of the date the participant reaches age 59 1/2, dies or is disabled, or 2) five years from the date the participant began making Roth contributions to the 403(b) plan. Roth 403(b) accounts may only be rolled over to other 403(b) or 401(k) plans with Roth accounts or to Roth IRAs.

Previously, if a 403(b) plan participant wanted to convert non-Roth money into Roth money, he or she would take a distribution from the 403(b) plan and roll it to a Roth IRA. Under the new law, a participant can convert non-Roth money into Roth money without taking a distribution from the plan; the conversion can happen inside the plan. Any money other than existing Roth money can be converted to Roth money (i.e., pre-tax deferrals, matching contributions, profit sharing contributions, rollover contributions, after-tax contributions, and their earnings).

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OUR VISION

We will become famous for our amazing service and our unique, comprehensive approach to meeting our clients' needs efficiently and effectively.

RETIREMENT PLAN START UP COST TAX CREDIT

Eligible employers who establish a retirement plan may be eligible to receive a tax credit for the cost of implementing the plan. This tax credit is in addition to the tax deduction you may receive for the contributions made to the plan. You are an eligible employer if you had no more than 100 employees who earned at least \$5,000 in compensation in the previous tax year, and have not sponsored another plan covering substantially the same employees in the three-year period prior to the first year the tax credit is claimed. The tax credit is limited to 50% of the qualified startup costs paid or incurred during the tax year, not to exceed \$500 per year, for the first credit year and each of the following two tax years.

Retirement plans eligible for the tax credit include qualified plans such as 401(k), profit-sharing, and defined benefit plans, as well as SEP IRAs and SIMPLE IRAs. The plan must cover at least one employee eligible to participate who is not a highly compensated employee.

To claim the tax credit, you must file IRS Form 8881 – Credit for Small Employer Pension Plan Startup Costs.

SAVERS CREDIT

Certain taxpayers are entitled to a tax credit for making retirement savings contributions to a 401(k) plan, 403(b) plan, SIMPLE, SARSEP, governmental 457(b) plan or their personal IRA. The credit is determined by the income level of the taxpayer and only applies to contributions up to \$2,000. The income levels and the related percentage of the contributions that can be claimed as a tax credit for 2010 are show on the table below.

Adjusted Gross Income Brackets For 2010						
Joint return		Head of Household		All other filers		Applicable Percentage
Over	Not over	Over	Not over	Over	Not over	
\$0	\$33,500	\$0	\$25,125	\$0	\$16,750	50%
\$33,500	\$36,000	\$25,125	\$27,000	\$16,750	\$18,000	20%
\$36,000	\$55,500	\$27,000	\$41,625	\$18,000	\$27,750	10%
\$55,500		\$41,625		\$27,750		0%

For 2011, the AGI limits increase to \$56,500 for joint returns; \$42,375 for heads of households; and \$28,250 for all other filers.

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2011 PLAN LIMITS

ANNUAL DOLLAR LIMITS – Based on IRS cost of living adjustments, the Internal Revenue Code (IRC) limits for 2011 are as follows:

- **401(k), 403(b) and 457(b) plans:** The maximum elective deferral limit under IRC §402(g) for 401(k), 403(b) and 457(b) plans is \$16,500. In a 457(b) plan, the limit also includes any employer contributions.
- **401(k), 403(b) and governmental 457(b) catch-up contributions:** The catch up contribution limit is \$5,500 for 2011. A participant who is age 50 or older during 2011 will have a total contribution limit of \$22,000.
- **Compensation limits:** The maximum annual compensation amount that can be used to determine benefits or calculate contributions for a plan is \$245,000.
- **Annual individual contribution amounts:** The maximum annual addition limit under defined contribution plans is the lesser of 100% of pay or \$49,000 (\$54,500 for 401(k) or 403(b) participants age 50 or older in 2011). This limit includes the sum of all contributions and forfeitures allocated to a participant's account during the year.
- **Annual defined benefit plan limit:** The maximum annual payout under defined benefit plans is \$195,000 at age 62 or older. This payout is the annual benefit payable to a participant receiving monthly benefits from the plan.
- **Highly Compensated Employees:** The compensation limit for determining Highly Compensated Employees is \$110,000.
- **Key Employees:** The compensation limit for determining if an officer is a Key Employee is \$160,000.
- **Taxable Wage Base:** The Social Security taxable wage base remains \$106,800.

AT A GLANCE

Limits	2011	2010
401(k)/403(b)/457 Deferrals	\$16,500	\$16,500
401(k)/403(b)/457 Catch Up Contributions	\$5,500	\$5,500
Maximum Annual Addition (Under Age 50)	\$49,000	\$49,000
Maximum Annual Addition (Age 50 or Older)	\$54,500	\$54,500
Highly Compensated Employee Income Limit	\$110,000	\$110,000
Social Security Wage Base	\$106,800	\$106,800
Annual Compensation Limit	\$245,000	\$245,000

IMPORTANT LIMITS AND DEADLINES FOR QUALIFIED PLANS

DEDUCTION LIMIT

- **Deduction limit** - 25% of covered compensation, plus elective deferrals under a 401(k) plan.

CONTRIBUTION DEPOSIT DUE DATES

- **Employee deferrals** - Under Department of Labor (DOL) deadlines, employee deferrals must be deposited to the trust *as soon as administratively feasible*, but no later than the 15th business day of the month following the month they are withheld from the employees' pay. For small plans (with under 100 participants), the DOL has proposed a safe harbor rule. Under the safe harbor, contributions deposited by the 7th working day following the payroll date are considered to have been deposited timely. The DOL is soliciting comments about providing a safe harbor for large plans. Without the safe harbor, large plans must meet the "*as soon as administratively feasible*" standard. The DOL has been very clear in defining their policy and interprets "*as soon as administratively feasible*" to be as soon as the contributions can be reasonably segregated from the employer's general assets. This means that the deposit of employee deferrals and loan payments withheld should coincide with the employer's remittance of FICA and FIT withholding to the appropriate agencies, i.e., within two to three days after the pay date to coincide with the federal tax withholding deposit requirements.
- **Employer contributions** (pension, profit sharing and matching) – Unless otherwise dictated by the plan document, employer contributions must be deposited to the trust by the due date of the employer's tax return, including extensions. For pension plans subject to minimum funding requirements, the contribution must generally be paid within 8 ½ months after the close of the plan year. Safe harbor matching contributions to a 401(k) plan that are calculated on a payroll period basis must be deposited at least quarterly.

401(k) SAFE HARBOR PLAN NOTICES

- Annual written notice of the safe harbor provisions must be provided to eligible employees within a *reasonable time*, 30 – 90 days, before the first day of the plan year. For calendar year plans, the 2011 notice must be posted by December 1, 2010.

ANNUAL 401(k)/401(m) DISCRIMINATION TESTING

- The required annual nondiscrimination testing for salary deferrals and matching contributions in 401(k) plans without special automatic enrollment provisions must be completed within 2 ½ months after the end of the plan year to avoid the 10% excise tax assessed by IRS on excess contributions. Excess contributions distributed are taxable to the recipient in the year distributed. Excess contributions are contributions returned to highly compensated employees to correct a failed discrimination test.
- Excess elective deferrals, deferrals in excess of the 402(g) dollar limit, must be distributed by April 15 following the close of the participant's taxable year to avoid double taxation. If the excess elective deferrals are distributed by April 15th, the excess is taxable to the recipient in the year of deferral. If the excess is distributed after April 15th, the excess is taxable to the recipient in *both* the year of deferral and the year of distribution.

5500 FILINGS

- The 5500 filing is due 7 months after the end of the plan year, or 9 ½ months if an extension, Form 5558, is filed.

Treatment of Differential Wages for Plan Purposes

When an employee is serving in the military, some employers pay the employee a portion of the compensation the employee would have received had the employee performed services for the employer during the period of active military service. This pay is known as “differential wages.” Prior to the Heroes Earnings Assistance and Relief Tax Act of 2008 (the “HEART Act”), these payments were not wages for employment tax purposes. They also generally were not compensation for retirement plan purposes. Under the HEART Act, differential wages are subject to income tax withholding and count as compensation for certain retirement plan purposes.

Last year, we amended your retirement plan to comply with the HEART Act. In that amendment, we provided that compensation included differential wages for all plan purposes. This approach was based on the language of the statute. However, the IRS has since issued guidance that says that differential wages can be excluded from compensation for plan contribution purposes. This is true even though differential wages must count in determining compensation for purposes of applying the 100% of compensation limit on plan contributions and forfeitures (the Code Section 415 limit), calculating the minimum contribution for top heavy plans, and for other technical purposes.

If you pay differential wages and would like to exclude them from your plan’s definition of compensation for contribution purposes, please contact your account manager as soon as possible. In order for the amendment to be effective retroactive to the effective date of this provision of the HEART Act, the amendment must be adopted by the end of your 2010 plan year. For calendar year plans, this is December 31, 2010. Keep in mind that if you adopt such a provision, you will need to indicate the amount of differential wages paid on the census information you provide to us, so that we can ensure these amounts are properly excluded for contribution purposes.

Distributions Upon Deemed Severance of Employment

Also under the HEART Act, an employee who is on active military duty may elect to receive a distribution from the plan as if the employee had severed from employment. In other words, for distribution purposes, the employee is deemed to have severed from employment. Under the HEART Act amendment adopted for your plan last year, this provision was mandatory. However, under IRS guidance issued recently, allowing an employee who is on active military duty to receive a distribution from the plan as if the employee had severed from employment is an optional provision and need not be offered. If you want to prohibit employees who are on active military duty from receiving distributions from the plan during their period of active military service, please contact your account manager as soon as possible.