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Roth Conversions within retirement plans

Including 401(k), 403(b), and governmental 457(b) plans

Investors in defned contribution plans, including 401(k), 403(b), and governmental 457(b), can convert balances within their savings plan into Roth accounts.

In-plan Roth conversions allow participants to convert existing pre-tax elected deferrals into a designated Roth account.

What plans can offer a Roth conversion?

The Roth in-plan conversion option is permitted for plans that currently offer (or will be amended to allow) participants the ability to designate elective deferrals as Roth contributions. A plan cannot establish a Roth feature with only the intention to accommodate Roth conversions. A 401(k), 403(b), or governmental 457(b) plan that already offers a designated Roth account can make available the Roth conversion feature, although it is not required. However, a profit-sharing plan cannot offer the Roth conversion feature without first amending to a 401(k) plan (and allowing the Roth feature).

What amounts are eligible to be converted?

The American Taxpayer Relief Act of 2012 modified the in-plan Roth conversion to allow participants to convert any amount, regardless if the participant meets a distributable event. The new provision also does not limit the amount available for conversion to only vested balances.

What are the tax implications of converting to a Roth account?

In-plan Roth conversions are taxed as ordinary income in the year which the conversion takes place. Converted amounts are treated as a direct rollover transaction (reportable on IRS form 1099R) thus, is not subject to the mandatory 20% federal withholding, nor the additional 10% early distribution penalty.

Can a Roth in-plan conversion be recharacterized?

Recharacterization is not available for in-plan Roth conversions; therefore, once a participant requests an in-plan Roth conversion, the taxable amount will be reported.

What updates are required to the plan for participants to take advantage of this provision?

The complexity of amendments that could be required to allow Roth conversions depends on the plan's current status. Key items to consider include:

- Does the plan currently offer the designated Roth account?
- Contribution sources, if any, that may be restricted from in-plan conversions.
- Has the retirement plan provider's system been updated to accommodate Roth conversions?

Key differences between designated Roth accounts and Roth IRAs

	Designated Roth	Roth IRA
RMD[1] requirement at age 70½ if attained this age prior to 1/1/2020, if attained on this date or later than the year in which the participant reaches age 72.	Yes	No
Distributions	Nonqualified distributions taxed on a pro-rata basis: part taxable and part nontaxable	Ordering of distributions: 1. Annual contributions 2. Converted balances 3. Earnings on account
Annual contributions restricted by MAGI[2]	No	Yes
Distribution availability	Must have a triggering event (outlined by the plan's terms) to take a distribution; however, taxes and/or penalty may apply.	Funds accessible at any time; however, taxes and/or penalty may apply.
Qualified distributions	Five-year holding requirement and one of the following: • Age 59½ • Death • Disability	Five-year holding requirement and one of the following: • Age 59½ • Death • Disability • Qualified first-time home purchase

[1] Required minimum distribution
[2] Modified adjusted gross income

For more information on Roth IRAs, ask your financial advisor for our Roth IRA fact sheet.

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