

Simplified 401(k) Roth Rollover Rules Finalized

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Final Roth Rollover Rules Retain Simplification of Prior Notice and Ease Rollovers for Participants with Both Roth and Pre-Tax Amounts in their 401(k) Plan Account

Prior to the proposed rules on Roth 401(k) rollovers issued in September 2014, participant rollovers from 401(k) plans which included Roth accounts had required that participant accounts that included both pre-tax 401(k) contributions and Roth contributions and which rolled over funds (via a distribution to the individual and the individual depositing the check in the new plan or IRA within 60 days, as opposed to the plan's trustee directly transferring the account to the new plan or IRA) to more than one plan or individual retirement account to include in the amounts allocated to each destination account for the rollover a pro-rata share of both the pre-tax and post-tax or Roth funds. This presented a problem for individuals who wanted to rollover the Roth accounts in their 401(k) Plan after receiving a check for the distribution by depositing the plan distribution in a Roth IRA and a standard IRA because it required inclusion of pre-tax funds in the amount allocated to the rollover to the Roth IRA which a Roth IRA is not designed to receive, and thus employees were forced to either wait for requesting a distribution until they had an employer with an employer plan that permitted Roth contribution (keeping the Roth funds in a plan or IRA for 5 years of participation and until age 59½ is required to get the Roth preferential tax treatment) or to keep their account in their former employer's plan or to arrange a direct rollover. The IRS issued Notice 2014-54 and proposed regulation relax the rollover rules and can be used by individuals making rollovers on and after September 18, 2014, but the distributions after January 1, 2015 will be subject to the new rules. These changes required plans to change the contents of the tax notice provided to participants communicating the information regarding the distribution and changes to distribution or rollover instructions, administrative procedures related to distributions and reporting of distributions, possibly changes to summary plan description information regarding distributions and rollovers. If you already made those changes, the good news is that those rules have been made permanent, at least until Congress changes the law.

The Proposed Rules were just finalized and are effective for distributions on and after January 1, 2016. The final rules do not change the tax treatment of rollovers that were made between September 18, 2014 and January 1, 2016 or the notices provided with respect to those distributions. In fact, the revised notices will be able to continue to be used under the final rules because the proposed changes were adopted substantially without any changes other than clarifying changes.

Thus, the changes plans made to participant education materials on the distribution alternatives and tax consequences and a reminder of the reason individuals should consider keeping Roth funds in Roth accounts via direct rollovers to preserve the years of participation toward the 5 year participation and age 59 and ½ requirement for the current tax-free nature of distribution of earnings on Roth funds remain the same for distributions after January 1, 2016 as they were before that date under the rules as explained in Notice 2014-54 which first permitted the individual to make a direct rollover of a 401(k) account that included a Roth 401(k) account and preserve the separate treatment of the Roth funds from other funds in the account even when distributed to multiple destinations permitting the allocation of the Roth and pre-tax amounts to different destinations.

For example, the new rule would apply if an employee terminated employment with \$12,000 of pre-tax and \$8,000 of Roth amounts and his new employer's plan did not have a Roth account feature so he could not rollover the full account to his new employer's plan. Under the final rule he could direct the former employer's plan to roll the \$12,000 of pre-tax funds to his new employer's plan and the \$8,000 of Roth funds to his Roth IRA in one distribution and would not be required to follow the prior rules which allocated funds sent to each destination a set manner between pre and post-tax with no election or direction provided or which required that the distributions be done in stages separated to be different rollovers. This simplifies the rollover process for employees with Roth 401(k) accounts and the administration for employers by permitting preservation of the tax treatment with a single rollover transaction, even if it has multiple destinations.

This is new guidance that makes permanent the rules that plans with Roth 401(k) accounts were already operating and will probably require few if any changes.

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