

“In plan” Roth conversions and new electronic deposit rules for payment of retirement plan withholding taxes

By Marcia S. Wagner, Esq.

In September 2010, President Obama enacted the Small Business Jobs and Credit Act of 2010 (the “Act”). The Act authorizes 401(k), 403(b), and 457(b) plan sponsors to permit Roth conversions within the plan without forcing plan participants to distribute funds from the employer’s retirement plan. In December, the Internal Revenue Service (the “IRS”) provided informal guidance on issues related to “In Plan” Roth conversions. As a result, plan sponsors can now amend their plans to permit such Roth conversions.

In particular, the Roth conversion provision allows plan participants to convert a non-Roth account balance that qualifies as an eligible rollover distribution to a Roth account within the plan. A plan participant’s account may be distributable as an eligible rollover distribution after the occurrence of certain events, such as the termination, disability, or death of the participant or the participant’s attainment of age 59½. Hardship distributions, corrective distributions, and required minimum distributions are not eligible rollover distributions and, therefore, cannot be the basis for a conversion into a Roth account.

Plan sponsors that are considering amending their 401(k) plans to permit Roth conversions should be aware of the following:

- Adoption of the Roth conversion provision is *voluntary* (i.e., plan sponsors are not required to include Roth conversions in their plans).
- A plan that is amended to include a conversion provision also must be amended to provide a Roth feature to accept Roth contributions within the plan.
- The Roth conversion election *only* may be made available to participants who experience a distributable event allowing them to withdraw their accounts from the plan such that they have a right to convert such amounts to Roth.
- Plan sponsors are not required to add new withdrawal types to plans for all participants and instead can tailor new withdrawal types only for participants who wish to make “In Plan” Roth conversions.
- The Roth conversion election *only* can apply to amounts that are treated as eligible rollover distributions.
- All or any part of a participant’s vested account balance that qualifies as an eligible rollover distribution may be converted to a Roth account within the plan.
- Taxable amounts converted into Roth accounts will be taxable to the participant in the tax year in which the conversion takes place.
- Both participants and spousal beneficiaries are permitted to make Roth conversion elections.

As noted, a Roth conversion can result in a significant tax liability in the year of conversion. To avoid an underpayment penalty, a converting taxpayer would be well-advised to begin or increase quarterly estimated tax payments for the year or years in which the income will be recognized. Estimated payments should be coordinated with any withholding that applies to plan distributions. When a Roth IRA is converted, such withholding is unavailable, but this is not necessarily the case with conversions of a plan account for which a participant may elect voluntary withholding. Certain changes with respect to how withholding is implemented, primarily affecting small businesses, were effective beginning January 1, 2011.

The IRS finalized regulations that, in general, require taxes withheld from retirement plan distributions to be deposited using the Electronic Federal Tax Payment System (“EFTPS”).

Under the prior regulations, taxes withheld from retirement plan distributions could be deposited at an authorized financial institution using Form 8109, *Federal Tax Deposit Coupon*. However, effective January 1, 2011, taxes withheld from retirement plan distributions must be deposited using the EFTPS. EFTPS is a free service from the U.S. Department of the Treasury that allows the taxpayer to schedule payments online or by phone.

As under the prior regulations, plans with under \$2,500 in federal tax withholding for a year may continue to make such deposits to the IRS when filing Form 945, but the IRS will assess penalties if the withholding amount eclipses \$2,500. If the deposit will be made with Form 945, the Form 945 and deposit are due by the January 31 following the calendar year of withholding.

The timeframe for depositing taxes withheld from retirement plan distributions remains unchanged; monthly depositors can make such deposits up to 15 days after the close of the calendar month in which the tax was withheld.

Plan sponsors that used Form 8109 between June 2009 and June 2010 were sent letters by the IRS that provided the PIN necessary to effectuate the plan’s enrollment in EFTPS. Plan sponsors that did not receive such a letter can apply for EFTPS by calling (800) 555-4477 or enroll online at www.efpts.com. When enrolling, be sure to use the plan Trust Identification Number (“TIN”) as opposed to the plan sponsor’s Employer Identification Number (“EIN”).

If a plan sponsor cannot deposit the withheld taxes using EFTPS, certain financial institutions, tax professionals, and payroll services are able to make payments on behalf of plan sponsors. Plan sponsors may be charged a fee for using such services.

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If a plan sponsor fails to correctly deposit the withheld taxes, the IRS will assess a 10% penalty. The IRS will also assess interest on late deposits of withheld taxes. Plan sponsors are

not permitted to pay such penalties or interest assessments out of plan assets.

Finally, when preparing any related Forms 1099-R, 1096, and 945 (the "Forms"), plan sponsors must be sure to include on such Forms the Identification Number (i.e., TIN or EIN) that

was used when depositing the retirement plan's withholding. ♦

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