BAKER TILLY

Candor. Insight. Results.

More Roth opportunities in the recent Small Business Jobs Act

With the elimination of the adjusted gross income limitations, many taxpayers have started taking advantage of the ability to roll over their IRA and employer-sponsored retirement accounts to Roth IRA accounts in 2010. Now, with the passing of the Small Business Jobs Act of 2010 (the Act), some employees will also have expanded retirement Roth opportunities for funds within their current employers' savings plans.

The Act contains two provisions affecting Roth accounts within retirement plans:

- It permits amounts in 401(k), 403(b), and 457(b) plans to be converted to Roth accounts within the plan if the plan otherwise permits Roth contributions. However, only amounts that are distributable as eligible rollover distributions (ERD) may be converted.
- It will permit Roth contributions to 457(b) plans maintained by state and local governments starting in taxable years beginning after Dec. 31, 2010.

What constitutes an ERD for current employees is determined by the plan documents, but typically it includes your account balance once you reach 59½, or amounts you have rolled into the plan from a prior employer if under 59½. It is possible for companies to expand the definition of an ERD to include employer profit sharing and matching contributions for employees under 59½ if: (1) the amounts have been in the plan for at least two years and (2) the individual has been a plan participant for at least five years.

Roth accounts within company retirement plans have been permitted by the IRS since 2006, but many employers have been slow in adding this option to their plans. A recent study by Hewitt Associates found that only 29 percent of mid- to large-sized businesses offered Roth accounts – we suspect it is an even lower percentage for small businesses. The Act should encourage more businesses to offer Roth accounts.

If you have the ability to take an ERD, you must first decide whether to convert to a Roth account, and then, whether to keep the funds in a company-sponsored plan or convert them to an IRA outside the plan. For a more detailed analysis of converting to a Roth account, please see our prior Baker Tilly tax alert, "Everyone should be aware of opportunities to convert to Roth IRAs in 2010." While every personal situation is different, our experience indicates that nearly all individuals who believe they will not need plan assets in retirement, and who have not selected a charity as the beneficiary, would likely benefit from a Roth conversion.

Once an individual has decided to convert to a Roth account, the next decision is whether to keep those funds in a company plan or convert to an IRA outside the plan. There are advantages to both of these, depending on the circumstances:

Advantages of keeping the funds with a company-sponsored plan might include:

- Assets in a company-sponsored plan receive greater protection from creditors under the federal Bankruptcy Reform Act. Company-sponsored plans are protected without a dollar limit but IRA assets are only covered up to $1 million. However, state law could provide additional protection over $1 million and it is debatable whether funds converted from a company-sponsored plan to an IRA lose the unlimited protection.
- Attractive mix of professionally selected investment options.

Advantages of converting to a Roth IRA outside the company-sponsored plan might include:

- There are no required minimum distributions from Roth IRA accounts. Traditional IRA, 401(k), 403(b), and 457(b) plans generally require distributions to start when the taxpayer turns 70½ or, if later, upon retirement (if not a 5 percent owner of the company sponsoring the plan). However, if your goal is to avoid required minimum distributions altogether, you will be able to convert your 401(k), 403(b), or 457(b) plan funds to an IRA account before the required minimum distributions need to be made from the plan.

- IRAs will always offer a more varied set of investment opportunities which are dictated by the independent trustee. IRAs can invest in most any type of asset except collectibles and life insurance, and they cannot participate in self-dealing with disqualified persons (generally, the account owner, their lineal descendants, and businesses under their control).
- Conversions to Roth IRA accounts can be recharacterized or undone. Taxpayers have until the filing due date of their individual income tax return for the year the conversion takes place to reverse the conversion and put the funds back into a traditional IRA account. This is an attractive feature if the amount converted should decline in value. Conversions to other Roth accounts cannot be recharacterized.

For more information or any questions you might have on these topics, we encourage you to contact your Baker Tilly tax advisor or send an e-mail to tax@bakertilly.com.