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Subject: **In-Plan Roth Conversions and Partial Annuitization of Nonqualified Annuity Contracts Permitted Under the Small Business Jobs Act of 2010**

Major References: [*Sections 2111, 2112 and 2113 of the Small Business Jobs Action of 2010; Section II\(B\) of the Joint Committee on Taxation Report JCX-47-10 \(September 16, 2010\)*](#)

Prior AALU Washington Reports: 10-77; 10-15

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On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 (the Act). Under sections 2111, 2112 and 2113 of this new legislation, effective for distributions made after September 27, 2010, 401(k), 403(b) and governmental 457(b) plans under the Revenue Code may now permit participants to make in-plan Roth conversions of their pre-tax employee contributions. Additionally, partial annuitization of nonqualified annuity contracts will be permitted beginning in 2011.

The in-plan Roth conversion provision was included in the Act because it is expected to raise more than \$5.5 billion over the next ten years from participants who perform in-plan rollovers to designated Roth programs. The implementation of this feature is discretionary; however, in order for participants to take advantage of the special rule relating to income inclusion for in-plan Roth conversions in 2010, sponsors of 401(k) and 403(b) plans have a short period of time to set up this option in a plan.

Roth Plan Provisions

The ability to make in-plan Roth conversions is conditioned upon the following:

- The plan must permit participants to make their own designated Roth contributions. In other words, the designated Roth account under a plan cannot be designed solely for in-plan Roth conversions. Although in-plan rollovers to Roth programs are limited to plans that provide for designated Roth contributions, the amount that may be rolled into the designated Roth program is not restricted to employee pre-tax elective deferrals. For example, if a 401(k) plan has a profit-sharing feature, the portion of the account attributable to profit-sharing contributions can also be included in the in-plan Roth conversion.
- The distribution must be otherwise permitted under the plan. In other words, an in-plan Roth conversion can only occur after the participant has experienced a distributable event. According to the report by the Joint Committee, if a plan sponsor expands in-service distribution options so that participants may take advantage of this opportunity, the sponsor can limit such options only to those participants who elect to have the distribution rolled over directly to the designated Roth program within the plan.
- The distribution must be an eligible rollover distribution.
- The participant is required to include the fair market value of the distribution into gross income in the year of the rollover. However, a special rule applies for in-plan Roth conversions performed during 2010. Unless the participant elects otherwise, the taxable amount resulting from an in-plan Roth conversion made in 2010 will be included in gross income in equal parts during 2011 and 2012. It is important to note that this special rule will not be available to participants in governmental 457(b) plans since such plans cannot permit designated Roth contributions until January 1, 2011.

Although the statutory language does not provide for one, the Joint Committee's report indicates that it is intended that the IRS will provide a remedial amendment period for plan sponsors that implement this option during 2010.

In conjunction with the new in-plan Roth rollover option, effective for tax years beginning after December 31, 2010, governmental 457(b) plans may permit participants to make designated Roth contributions. This option is available to governmental 457(b) plans regardless of whether the plans include the in-plan Roth rollover option.

Partial Annuitization of Non-Qualified Annuity Contracts

The Act now permits, effective for tax years beginning after December 31, 2010, the partial annuitization of annuity, endowment or life insurance contracts, provided the annuitization period is for ten (10) years or more, or is for the lives of one or more individuals. Any amount received pursuant to an annuity meeting the annuitization period requirements will be treated as a separate contract for purposes of section 72. For purposes of applying rules relating to the exclusion ratio, the determination of the investment in the contract, the expected return, the annuity starting date, and amounts not received as an annuity, the investment in the contract will be allocated on a pro rata basis between the portion of the contract from which annuity payments are made, and the portion of the contract from which amounts are not received as an annuity. A separate annuity starting date will be applied with respect to each portion of the contract from which amounts are received as an annuity.

This new rule, which was included in the President's FY 2011 budget, and in a previous version of the Jobs bill offered by Senator Baucus (D-MT), is not intended to change rules relating to amounts received as an annuity (or not received as an annuity) from qualified 401(a) and 403(a) plans, 403(b) plans and individual retirement plans. (See our Bulletins Nos. 10-15 and 10-77.)

Any AALU member who wishes to obtain a copy of sections 2111- 2113 of the Small Business Jobs Act or section II(B) of the Joint Committee on Taxation Report CX-47-10 may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your last name and birth date and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

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