THE WHITE PAPER

Your Retirement Planning Newsletter

May 2015

Tori Patrick
President
Progressive Strategies Financial Group
27201 Puerta Real Suite 300
Mission Viejo, CA 92691
949.204.3800 702.893.1500
Fax: 702.549.1900
Tori@psfgwealth.com
www.psfgwealth.com
CA Insurance Lic#

The IRS Clarifies Rules on Rollovers of Retirement Plan Monies

After years of ambiguity around what is and is not allowed regarding the disbursement of after-tax contributions to an employer-sponsored retirement plan, the IRS ruled in September of 2014 that plan participants can roll those dollars into a Roth IRA tax free.

IRS Notice 2014-54, Guidance on Allocation of After-Tax Amounts to Rollovers, "provides rules for allocating pretax and after-tax amounts among disbursements that are made to multiple destinations from a qualified plan."[1] Importantly, the Notice states that all disbursements from a retirement plan made at the same time will be treated as a single distribution even if they are sent to multiple new accounts. Prior to this ruling, the IRS treated distributions from a retirement plan that were rolled over to multiple new accounts as separate distributions, each requiring that a proportional share of pretax and after-tax monies be disbursed.[2]

A Simplified Process

Now individuals holding both pretax and after-tax amounts in their plan can transfer -- through direct, trustee-to-trustee rollovers -- the pretax portion of the distribution (including earnings on after-tax amounts) to a traditional IRA and the after-tax portion of the distribution to a Roth IRA. In the past, this could only be accomplished through indirect 60-day rollovers, not through simplified direct rollovers.[2]

More Clarification, Please

As with many IRS rulings, Notice 2014-54 raised many questions with taxpayers. In response, the IRS recently issued some answers to those commonly asked.

Q: If I have both pretax and after-tax monies in my retirement account, can I roll over just the after-tax monies to a Roth IRA, leaving all of the pretax monies intact?

A: No, the new rule does not change the requirement that each distribution from a plan -- including partial distributions -- must include a "proportional share" of the pretax and after-tax amounts.

Example: If your account balance is $100,000 and consists of $80,000 in pretax amounts and $20,000 in after-tax amounts, and you request a distribution of $50,000, your distribution would consist of $40,000 of pretax amounts and $10,000 of after-tax amounts.[2]

In order to roll over all of your after-tax contributions to a Roth IRA, you could take a full distribution (all pretax and after-tax amounts), roll over all the pretax amounts directly to a traditional IRA or another eligible retirement plan, and roll over all the after-tax amounts directly to a Roth IRA.

Q: Can I roll over my after-tax contributions to a Roth IRA and the earnings on my after-tax contributions to a traditional IRA?

Yes, since earnings on after-tax contributions are considered pretax monies, after-tax contributions can be rolled over to a Roth IRA while the earnings on those contributions can be directed to a separate traditional IRA and avoid being taxed until they are distributed.

Plan Sponsors: A New Opportunity

The new guidelines present an opportunity for plan sponsors to reach out to participants to determine which individuals have after-tax money in their plans and explain the new rules -- and the new opportunity -- to them. Further, for those participants who are not currently making after-tax contributions, advisors may want to encourage them to do so, if their employer plan allows.

With the current annual pretax contribution limit of $18,000 -- or $24,000 for individuals age 50 or older -- high-earning employees who are not making after-tax contributions are missing out on the chance to sock away significantly more (the annual total contribution cap on defined contribution plans is $53,000 in 2015) while benefitting from tax-deferred investment growth.

[1]*The Internal Revenue Service, Notice 2014-54, Guidance on Allocation of After-Tax Amounts to Rollovers, September 18, 2014.*

[2]The Internal Revenue Service, *Employee Plans News*, December 23, 2014.

1-360690