



## **Roth Feature in a 403(b) or Governmental 457(b) Plan—What Every Employer (and Financial Advisor) Needs to Know**

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Adding a Roth salary deferral option to your plan is not as hard as you think. There are a number of valuable benefits for you as the employer and, of course, for your employees when a Roth option is incorporated into your retirement savings plan. And, there is a new tax law change (explained in detail below) that creates new opportunity and interest in permitting employees to select the Roth option for contributions, *and*, potentially, consider converting some of their current pre-tax savings to that option.

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Let's start from scratch with a basic explanation of the Roth option. All Roth employee salary deferral contributions are made on an after-tax basis. While employees pay taxes on their contribution amounts, their distributions, including earnings, are tax-free if they meet the eligibility requirements. That is a deal that is hard to beat. Note: Employer contributions cannot be directed into the Roth option; employer dollars are directed to the traditional account on a pre-tax basis. This option is available for all active and former participants with an account balance and spousal beneficiaries. This does not appear to be eligible for non-spouse beneficiaries.

To be eligible for a non-taxable distribution, a participant must be participating in the Roth plan for more than five years and have a qualifying event. Qualifying events in a 403(b) plan are death, disability and attainment of age 59 ½. 457 plan qualifying events for a non-taxable distribution are attainment of age 70 ½, death and disability.

Aside from the participant benefits, why would you as the employer want to offer this feature in your plan? Roth contributions are fast becoming a standard provision in a retirement plan as an employee retention and recruitment tool. The Roth option also has the potential to increase the participation rate within your existing employee population. Adding this feature demonstrates your ongoing commitment to helping employees achieve their retirement goals.

So, how do you add the Roth feature to the existing retirement plan? Refer to your plan document and see if Roth is an available option. If it is not, simply amend your plan document to include it. Then notify your TPA, check with the providers on their capabilities to support this and announce this great benefit to your employees.

For more details about the benefits of Roth or guidance to implement, contact your financial advisor.

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## **Pre-tax to Roth Plan Conversions—A New Take and a New Reason to Add the Roth in 2013**

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Participants in 403(b) and 457 plans now have an additional option to consider when looking at their retirement savings portfolio. The American Taxpayer Relief Act of 2012 includes a provision that now allows plan participants to convert pre-tax dollars to Roth after-tax dollars without requiring a qualifying event.

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When this option was previously enacted in 2010, the participant had to experience a qualifying event—attaining age 59 ½ [in the 403(b) or 401(k) plan; age 70 ½ in your 457(b) plan] or separation of service. With one swipe of the pen this requirement was removed—which makes it potentially much more attractive. Now, all pre-tax dollars within the plan may be directly rolled over or converted into Roth dollars. This transaction is a distribution that is a taxable and reportable event. However, it is not subject to the 10% premature withdrawal penalty nor is it subject to the 20% mandatory withholding. The distribution is subject to taxation as ordinary income, so a participant should have sufficient dollars saved outside of the plan to pay for the taxes on the conversion.

Who is a likely candidate for this option? This option may appeal to a younger, wealthier individual who will potentially have a higher future income and has the benefit of time to recoup the ordinary taxes paid upon distribution. Another candidate might be a participant who wants to increase the portion of his or her portfolio that is not subject to taxes, which is accomplished by converting and reaping the benefit of tax-free distributions. In addition, Roth accounts are often utilized as legacy accounts, to be left to their heirs. The Roth in-plan conversion would not typically be strategy for a person nearing retirement.

There are some other considerations. A Roth in-plan conversion cannot be reversed. It cannot be revoked like a Traditional IRA to Roth IRA conversion. Also, Roth 403(b), 401(k) or 457(b) dollars are subject to Required Minimum Distributions (RMDs). This can be avoided by rolling the Roth dollars to a Roth IRA, which is not subject to the RMD rules. Also, this option is available for all active and former participants with an account balance and spousal beneficiaries. This does not appear to be available for non-spouse beneficiaries.

How do you include the Roth option and in-plan conversion in a plan? Simply amend the plan's document to include the Roth salary deferral and in-plan conversion provision, which can be done retroactively, check with the TPA and providers to see their capability to support these features and announce these great benefits to its employees. And, of course, financial advisors should offer to provide educational workshops and pre-tax vs. after-tax comparative information.

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