

# FYI<sup>®</sup> Alert

## For Your Information<sup>®</sup>

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## New Safe Harbor Explanations for Eligible Rollover Distributions

On November 24, 2014, the IRS issued guidance amending the safe harbor explanations for notices that plans must provide to recipients of eligible rollover distributions. These amendments reflect recent updates to the rules governing the allocation of pretax and after-tax amounts and distributions in the form of in-plan Roth rollovers. They also remove redundant and out-of-date language and make other clarifications. Employers can use the updated explanations to satisfy their 402(f) notice obligations.

### Background

A written explanation known as an IRC section 402(f) notice must be provided to recipients of eligible rollover distributions from qualified plans, 403(b) plans, and governmental 457(b) plans. This safe harbor notice describes options to roll over the amounts to defer taxation and the tax implications of taking a taxable distribution. Previously, under Notice [2009-68](#), the 402(f) notice provided that if a distribution included after-tax contributions and only a portion of the distribution was directly rolled over, the rollover amount and the amount paid to the participant would each include a pro rata share of pre- and post-tax amounts. This language seemed to conflict with the Code language indicating that if a distribution is partially rolled over, the amount rolled over would be considered to consist of taxable amounts first. With the enactment of provisions to add in-plan Roth rollovers (conversion to Roth of just distributable amounts), sample language to communicate to participants was provided, but not formally incorporated into 402(f) notices. The subsequent expansion of the in-plan Roth conversion option (in-plan conversion of *all* contributions) confirmed that if the conversion was only related to amounts not otherwise distributable, a participant did not need to receive a 402(f) notice. See our *For Your Information* of [December 14, 2010](#) and [December 17, 2013](#)

Last month, the IRS confirmed in [Notice 2014-54](#) that, for purposes of determining the proration of a distribution that consists of both pretax and after-tax (including Roth) amounts, multiple distributions made at the same time (or within a reasonable timeframe due to administrative delays), whether or not to multiple destinations, are treated as a single distribution. This guidance resolved the confusion surrounding the 2009 safe harbor language. See our *For Your Information* of [October 7, 2014](#). In the notice, the IRS indicated that it intended to revise the safe harbor explanations to reflect these new allocation rules.

**Comment.** Many plan administrators had already removed the faulty basis recovery language from their customized notices in light of the Code language.

## Amendments Updating the Safe Harbor Explanations

[Notice 2014-74](#) amends the safe harbor explanations that must be provided to plan participants receiving eligible rollover distributions to add new language about in-plan rollovers, clarify certain provisions, and remove redundant and out-of-date language. The guidance is divided into two sections, with Part A amending the explanation for payments not from a designated Roth account and Part B amending payments from a designated Roth account. A sample notice incorporating all the changes is included in the guidance. Highlights of the changes include:

### **New section added in Part A: “If you do a rollover to a designated Roth account in the plan”**

Language is added to describe the in-plan Roth rollover scenario, situations when the 10% excise tax will apply, and how to count the five-year rule for qualifying a Roth distribution. The five-year rule for qualification is counted from the January 1 of the year of conversion, but is tracked differently from a direct rollover from a designated Roth account. Payments that do not meet the criteria for a qualified distribution are taxed on the earnings and subject to the 10% excise tax (unless an exception to the penalty applies).

### **“How much may I roll over?” (Parts A and B)**

Refunds of automatic contributions under an eligible automatic contributions arrangement are not eligible for rollover. Clarification is provided that the refund period is 90 days from date of the first contribution, not enrollment.

### **“If I do a rollover to an IRA, will the 10% additional income tax apply to early distributions from the IRA?” (Parts A and B)**

Clarification is provided that the exception to the 10% excise tax for payments after a participant has received unemployment compensation for 12 weeks is limited to payments for health insurance premiums rather than all payments.

### **“If your payment includes after-tax contributions” (Part A)**

Language is added reiterating that one cannot take a payment of only after-tax contributions unless there are pre-1987 after-tax contributions maintained in a separate account. This section also confirms that amounts rolled over consist first of the taxable portion of the distribution.

### **“If you roll over your payment to a Roth IRA” (Part A)**

Amendments to this section remove out-of-date language about:

- Income limitations prior to 2010 for contributions to a Roth IRA as a conversion
- Two-year tax reporting special rule for 2010-2011
- Inability to roll over a payment from a plan to a designated Roth account in the employer plan

## In closing

Now that this anticipated guidance has been issued, employers should update their 402(f) notices accordingly.

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