Sec. 179 Expensing Deduction

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NEW YORK— The 2010 Small Business Jobs Act, enacted on September 27, 2010, provides a new opportunity for Roth 401(k) plan participants to convert their existing 401(k) plan balances into Roth 401(k)s. "The Act also allows participants making the conversion in 2010 to spread the tax hit over a two-year period," said Richard O'Donnell, a senior retirement plan analyst at the Tax & Accounting business of Thomson Reuters.

A Roth 401(k) plan has a "qualified Roth contribution program" that allows participants to make "designated Roth contributions" in lieu of all or some of the elective deferrals that they could otherwise make under a 401K plan. For example, if a participant defers $10,000 to his 401(k) plan that has a Roth program, he can elect to have some (or all) of his $10,000 deferral placed in the Roth portion of the plan. The downside is that amounts contributed to the Roth portion are not made on the pre-tax basis that typically applies to 401(k) contributions. The upside is that when the participant takes a distribution, those contributions, plus their associated earnings, are received free of federal income tax. So, the Roth 401(k) acts similar to a Roth IRA in that there is no tax advantage for contributions made to the plan, however, distributions from the plan are tax-free.

Some limits apply to Roth 401(k)s, for example, employer-matching contributions are not allocated to the Roth portion of a 401(k) plan. Further, once a deferral is contributed to the Roth portion of the plan, it must remain there. Unlike contributions made to regular Roth IRAs, there is no "recharacterization" provision to undo it. Therefore, a contribution to the Roth portion of a 401(k) plan is irrevocable.

O’Donnell notes that the 2010 Small Business Jobs Act provides new rules for Roth

earnings will be tax-free.

- This provision allows participants to “convert” their pre-tax employee deferrals and employer contributions into post-tax Roth contributions, without needing to take a distribution from the plan and then contribute that amount to a Roth IRA.
- However, amounts in a 401(k) plan account subject to distribution restrictions cannot be converted to Roth 401(k) contributions. Therefore, if a plan does not allow for in-service distributions or distributions before normal retirement age, Roth 401(k) conversions cannot be made.
- The 10% tax on early withdrawals (which generally applies to the taxable portion of a plan distribution made before the participant has reached age 59 ½, unless an exception applies) does not apply to distributions that are made as part of a Roth 401(k) conversion. However, “this relief comes with a caveat — a ‘recapture’ rule applies to distributions within a specified five-tax-year holding period,” said O’Donnell. “So, amounts contributed to the Roth portion of the 401(k) plan must remain there for five years to avoid this tax.”
- As an additional benefit, a participant may elect to spread the tax hit from the Roth contribution over two years for conversion distributions made in calendar year 2010. Under this provision, the participant includes one-half of the distribution that is subject to tax in income in 2011 and the other half in 2012. This defers taxes on the conversion and may lower the tax rate that would otherwise apply to the amount converted.
- This two-year tax-deferral tax must be accelerated, however, if the participant receives a distribution from the Roth portion of the 401(k) plan in 2010 or 2011. Acceleration is also required if the participant dies before 2012, unless a surviving spouse acquires the entire account and elects to continue the deferral.
- Instead of electing this two-year deferral, a participant may elect to include the entire taxable amount of the distribution in 2010 gross income. “This may be the best option for those who expect to be in higher tax brackets in 2011 and 2012,”

said O'Donnell. Once made, a participant may not revoke this election after the

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