Roth Revisited: In-plan conversion versus rollover

Since 2010, 401(k) plan participants have been able to transfer all or part of the non-Roth portion of their 401(k) account into designated Roth account within the same plan rather than rolling those assets into a Roth individual retirement account (IRA). This transaction is called an in-plan Roth conversion or in-plan Roth rollover. Understanding how these transactions work is critical to making intentional, informed decisions about your retirement savings.

In-plan Roth conversions: Know the basics
A few basic rules apply to in-plan Roth conversions:

- A conversion is limited to eligible rollover distributions, which means the account owner must have terminated employment or be older than age 59½, disabled or a qualified reservist. Hardship withdrawals aren't eligible for conversion.
- The amount you convert is subject to federal income tax in the year you convert it.
- You pay no income taxes on qualified distributions from the Roth account in the future.
- The 10% early distribution penalty doesn't apply to the conversion amount.

The American Taxpayer Relief Act of 2012 broadened the in-plan Roth conversion option beginning in 2013. As a result, if permitted by your employer's plan, you can convert an existing 401(k), 403(b) or 457(b) account to a Roth account, even if you aren't eligible to take a distribution.

But an in-plan Roth conversion may not be available to you. Employers aren't required to offer Roth accounts in their retirement plans, and if they do, they aren't required to permit in-plan conversions.

Taxes: Beware the creep
Here's an important question about an in-plan Roth conversion: How will you pay the taxes you'll owe?

Keep in mind that the conversion amount is added to your modified adjusted gross income (MAGI) for the year you make the conversion. That may cause more of your earnings to be taxed at a higher rate – an unwelcome result known as tax-bracket creep.
Conversion or rollover: Consider all options
If you have the choice of doing an in-plan Roth conversion or a rollover to a Roth IRA, which should you choose? Here are four considerations:

- You can undo, or recharacterize, a Roth IRA conversion, but you can't recharacterize in-plan conversions.
- The investment options available to you in an employer 401(k) plan may be limited, while virtually any type of investment is available in an IRA.
- Investments through 401(k) plans may have lower costs.
- Historically, 401(k) plans were more protected from creditors under federal law than IRAs.

Talk with your advisors
Conversions and rollovers can be complex. That's why it's critical to meet with your tax and financial professionals to determine the best choice for your situation. To learn more about strategies for retirement, contact your financial advisor and visit us at invesco.com/RetirementReady.

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