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IRS issues final rules for distributions from designated Roth accounts to multiple destinations

On May 18, 2016, the IRS published final rules for distributions from designated Roth account plans to multiple destinations. These rules are basically unchanged from the proposed rules issued in 2014 and generally apply to distributions on or after January 1, 2016.

Background and overview

Prior to the issuance of proposed rules in 2014, if a participant's designated Roth account included both post-tax and pre-tax amounts and was distributed to multiple destinations, each distribution from the account consisted of a pro rata share of post-tax and pre-tax amounts. Therefore, if a participant elected to receive a portion of the distribution to himself and directly rollover the remaining portion to a Roth IRA or another designated Roth account, each portion would be treated as a separate distribution that included a pro rata share of the post-tax and pre-tax amounts.

In September 2014, the IRS issued proposed rules to remove the existing allocation rule for disbursements from designated Roth accounts to multiple destinations. Under the proposed rules, distributions from a Roth account made to multiple destinations are treated as a single distribution. These proposed rules were issued along with Notice 2014-54, which provided guidance on the allocation of post-tax amounts to rollovers. On May 18, the IRS published final rules that generally adopt the proposed rules.

As a result of these rules, if distributions are made to both the participant and to the participant's designated Roth account or Roth IRA in a direct rollover, then pre-tax amounts are allocated first to the direct rollover, rather than being allocated pro rata to each destination. Also, a participant may direct the allocation of pre-tax and post-tax amounts that are included in disbursements from a designated Roth account that are directly rolled over to multiple destinations. Thus, the same allocation rules apply to distributions from designated Roth accounts that apply to distributions from other types of accounts.

Next steps

These final rules are effective for distributions on or after January 1, 2016. For distributions made between September 2014 and January 1, 2016, participants may have chosen not to apply the separate distribution rule by applying a "reasonable interpretation" of the rules. A "reasonable interpretation" includes the rules as described in Notice 2014-54.

The final guidance is consistent with the approach Prudential has taken in processing and tax-reporting distributions from designated Roth accounts. Therefore, no changes are needed for plan sponsors as a result of these final rules.