Protect Your Nestegg!

New IRS Rules For IRA's You Must Know!

By

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New Rules from IRS for 60 Day Rollovers

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Don't you hate it when you are shopping and see the sign "Limit One Per Customer"? I know that I do. Did you ever buy one, take it to your car and go back to the store and buy another? Maybe use the divide and conquer strategy – your spouse buys one and you buy one? How inconvenient! Now the IRS is instituting that same policy with respect to IRA rollovers.

As we get older, we accumulate stuff. The same is true with financial accounts. Sometimes, a retiree may have several IRA accounts at various financial institutions. For example, Joe Investor may have a $53,000 IRA CD at Chase, an IRA annuity worth $201,000 at Prudential, and a 401(k) from work held at Fidelity worth $147,000. So what would happen if he changed his financial advisor and wanted to transfer his accounts to a new IRA at TD Ameritrade?

The longstanding rule is that there is 20% tax withholding for monies distributed from a 401(k) plan directly to an individual. Because of this rule, it is common practice to perform a "Trustee to Trustee" transfer of these funds. In this instance, Joe would direct Fidelity to write a check for $147,000 to TD Ameritrade for his benefit, and the funds would deposit directly into the new IRA account.

For IRA's, there is no withholding requirement, so Joe could ask Chase and Prudential to write him a check for the balance of his account and deposit those funds in his bank account. He would then have 60 days to roll over those funds into his TD Ameritrade IRA.

Historically, this so called "60 day rollover" was fraught with problems. In one instance that I encountered, Joe had performed a proper 60 day rollover to purchase an annuity. What happened next however, was a tax disaster. In Arizona, there is a rule that investors over the age of 65 are allowed to examine any annuities that they purchase for a 30 day period. If they decide that they don't want to keep it, they can get their money back. This is commonly referred to as the "Free Look Period". Joe exercised his right to rescind the annuity contract and the insurance company refunded the money – to him. He then deposited the check into his bank account. Unbeknownst to him, he had just violated the once per year rule since he had deposited those funds into his bank account twice. I was the bearer of bad news when I informed him that he had to pay tax on the 2nd distribution and it could not be rolled over to another IRA.

It would have been far better for Joe if the advisor who sold him the annuity had simply done a trustee to trustee transfer of these funds. Then when Joe "Free Looked" the annuity, the insurance company would have simply returned the funds to the original IRA custodian and there would have been no unintended tax liability to Joe.

Currently, this 60 day rollover landscape is even more dangerous. In a recent tax court decision, the one rollover per year applied to only one account – not one rollover from each IRA account as was the common practice in years past. Under the new law, Joe could only do a 60 day rollover from the Chase IRA or the Prudential IRA – but not both.

On a prospective basis, what should be done? The easiest answer is to always do a trustee to trustee transfer of IRA's, SEP's and employer qualified plans. This eliminates a lot of problems:

1. The potential of the rollover blowing up and resulting in tax.
2. The form 1099R shows $0 taxable distributions.
3. Sometimes, there is no 1099 issued at all.

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One last note regarding rollovers concerns spousal rollovers. It has always been a rule that a widow or widower can inherit the IRA of their deceased spouse. Oftentimes this was accomplished with the 60 day rollover provisions. Now, to be safe, the surviving spouse needs to take possession of the IRA – which may entail lots of extra paperwork.

Bottom line – when doing a rollover from one provider to another, do not accept a check payable to you – always have it paid to the next custodian of your IRA account.

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Teresa Bear specializes in retirement planning and asset preservation for retirees and their loved ones. Teresa works primarily in the Phoenix Metro area and has offices in Mesa and Chandler.

Teresa has been helping families and retirees reach their financial, tax, retirement planning, and estate planning goals for over 25 years. She is legally bound to uphold the highest level of fiduciary standards when providing investment advice to her clients.

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