Tax and penalty trap: IRS clamps down on 60-day IRA rollovers

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In 2015, IRA owners are prohibited from doing more than one 60-day rollover per year, for all of their IRAs.

Advisors beware!

IRAs will be lost this year to new restrictive IRA rollover rules. Make sure you know them and are on the lookout for potential retirement disasters. The last thing an advisor needs is to have to tell a client that the attempted IRA rollover has turned what should have been a tax-free rollover into a massive unexpected tax bill.

Beginning January 1, 2015, IRA owners can only do one 60-day rollover per year, for all of their IRAs. The rule no longer applies separately to each IRA. For this rule, IRAs include, traditional IRAs, SEP and SIMPLE IRAs and Roth IRAs.

The one-year period is not a calendar year; its 365 days, or 12 months. If a second rollover is done within the one-year period, it’s ineligible to be rolled over. The distribution will be taxable and subject to a 10 percent early withdrawal penalty if the client is under age 59½.

If a client attempts a second rollover, the problem cannot be fixed. The IRS does not have the authority to help correct the situation. Moving an entire IRA balance to a new custodian or to a new advisor could end a client’s IRA.

It gets worse. If the client does a second 60-day rollover, not knowing it can’t be done, it’s now not only taxable, but also an excess IRA contribution, subject to a 6 percent penalty every year the ineligible rollover funds remain in the account.

There are two ways to move IRA money to another IRA: directly and indirectly. Always move IRA funds directly if you can.

A direct transfer, also called a trustee-to-trustee transfer is when the IRA funds move directly from one IRA to another without the client touching the money in between. These can be done as often as you wish, without worrying about the once-per-year IRA rollover rule.

With the other method of rolling over IRA funds, an indirect transfer, also called a “60-day rollover,” clients receive a check from their IRA made payable to them personally. They then they have 60 days from the date they received it to re-deposit those funds — roll them over — to another IRA, or back to the same IRA.

Avoid this indirect, 60-day rollover, like the plague. This technique surfaced as a result of the now famous "*Bobrow*" tax court case about a year ago. (Alvan L. Bobrow, et ux. v. Commissioner, TC Memo 2014-21, Docket No. 7022-11, January 28, 2014).Before then, the published tax rules (in IRS Publication 590) allowed the once-per-year rule to be applied separately to each IRA.
In the *Bobrow* case, the court believed that Bobrow, who was a tax attorney, was taking advantage of the 60-day rule for each IRA. Bobrow had done a series of rollovers from separate IRAs and had use of his IRA funds for almost 6 months.
The court essentially said, "No more of this nonsense." Bobrow lost his case, and that changed the interpretation of the once-per-year rule for everyone.

The court ruled that the once-per-year rule applies to all IRAs, not separately to each one. The IRS agreed and changed the rules back in March 2014, with IRS announcement 2014-15. But that still left some questions unanswered.

The IRS answered these questions on November 10, 2014 in Announcement 2014-32. The service made it clear that the once-per-year rollover rule applies to all IRAs and Roth IRAs in aggregate. For example, if you do a 60-day IRA rollover from one traditional IRAs to another, you can't do another 60-day rollover from *any* of your IRAs or Roth IRAs for the next 12 months.
The IRS provided relief for 2014 rollovers that would have been legal under the old separate account treatment, but are not anymore. The new rules will be effective prospectively only, beginning January 1, 2015.

In addition, the IRS confirmed that if the IRA custodian makes a check payable to the receiving IRA custodian (*not* to the client personally), then that check will qualify as a trustee-to-trustee transfer and will not be subject to the once-per-year IRA rollover rule.
The once-per-year rule only applies to a 60-day rollover from a traditional IRA to another (or back to the same) traditional IRA or from a Roth IRA to a Roth IRA.

The rule does not apply to direct trustee-to-trustee transfers. The rule also does not apply to rollovers from plans (like 401(k)s or 403(b)s) to IRAs or from IRAs back to plans. Rollovers from IRAs to Roth IRAs (Roth conversions) are also exempt from the once-per-year rollover rule.

Advisors need to be up to speed on the new rule interpretation and let all clients know about it. Be careful taking in new IRA rollovers as a 60-day rollover.

If you do that, you'll have to ask if the client did a 60-day rollover of an IRA or Roth IRA funds within the past year. If so, the client cannot do another 60-day rollover within the one-year period.

Avoid 60-day rollovers and instead insist on direct transfers when taking in new IRA rollovers, or rollovers for existing clients.