IRA Transfers vs. Rollovers: What Is The Difference?

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Learn the simple differences between IRA transfers and IRA rollovers.

Individual retirement accounts (IRA's) are required to be held at financial institutions. These institutions are referred to as the custodian. When an individual moves and individual retirement account from one custodian directly to another custodian this is considered a transfer.

When you transfer an IRA, there are no tax consequences and you are not required to report anything on your income tax return. An individual is permitted to make as many transfers a year as they would like.

A rollover may appear similar to a transfer with respect to the mechanics, but it is a very different operation. Rollovers have strict rules which need to be adhered to or the consequences could be very costly.

Rollovers are a tax-free distribution from a retirement plan that is paid directly to you and then you contribute those funds into another qualified retirement plan.

When Are Roth IRA Withdrawals Taxed

This is where it can become a bit dicey; there is a rigid timeline of 60 days to complete the process. If the distributed assets are not contributed back into a qualified retirement account within the allotted timeframe, a cascade of negative consequences is what follows. First, the distribution is considered a withdrawal and becomes taxable. Additionally, If you are under age 59 ½, then you can tack on a 10% penalty for a premature withdrawal on top of the tax burden.

Another distinction of the rollover is that you are only allowed to have one rollover during a 12 month period per IRA. There will also be a paper trail you will need to be aware of so that you do not incur a tax liability. At the end of the year you will be furnished with a 1099-R from the institution who distributed the funds and this distribution will be reported to the IRS. You would use IRS form 5498 when you file your taxes to document the contribution into the new retirement account.

Lastly, if the rollover is paid directly to you, 20% is withheld by the payor for tax. This money may be credited back when filing your taxes.

A direct rollover shares some characteristics of both a transfer and a rollover. Direct rollover assets are made payable to the qualified plan or IRA Custodian/Trustee, never to the individual.

A direct rollover is reportable but not taxable and there is no 60 day window to be concerned about.