

## **IRA and Retirement Plan Rollovers and the 12-Month Rule**

Most taxpayers are familiar with the general requirements of an IRA or retirement plan rollover and the 60-day rule. Given the current rates of return on investments, taxpayers may be interested in moving their IRA funds in search of better returns or more safety for their investments. Meeting the requirements for a successful rollover of retirement assets is vital in protecting these assets from potential taxes and penalties. Making a mistake in the the rollover process can be costly.

Let's start with a review of some terms involved.

A Rollover is a distribution from an IRA or other eligible retirement plan to the participant/taxpayer, followed by a contribution of all or part of those assets to another IRA or eligible retirement plan. During the rollover period, a maximum of 60 days, the taxpayer has access to the assets.

A Direct Rollover is when the assets are moved directly from an IRA or eligible retirement plan to a Traditional IRA. A Direct Rollover is similar to a transfer, but in the case of a Direct Rollover, the taxpayer may direct where the distribution is to go and may even deliver the check.

A Transfer occurs when IRA or other retirement plan assets are moved directly from one trustee or custodian to another trustee or custodian. The key feature that distinguishes a transfer from a rollover is that in a transfer the taxpayer never receives direct access to the assets being moved. At the direction of the IRA owner, the current trustee sends the IRA assets directly to the new trustee. If a check is issued, the check is made payable to the trustee for the individual's IRA. That procedure is significant. The reporting and tax rules imposed on transfers is more lenient because the assets are never within the control of the taxpayer.

A Rollover is preferable when the IRA owner wants access to the assets during the 60 days immediately after the distribution or wants to transfer the funds as quickly as possible, because the Direct Rollover or Transfer requires too much time for trustees to administer.

A taxpayer may roll over a distribution on a tax-free basis if the taxpayer meets the following requirements:

1. The taxpayer receives a distribution from an IRA or other eligible retirement plan.
2. The distribution is an eligible rollover distribution.
3. The distribution is rolled over within 60 days after the date of the distribution.
4. The distribution is rolled over into an IRA or other eligible retirement plan.
5. The same property is rolled over.
6. No more than one rollover is made during any 12-month period.
7. The taxpayer irrevocably designates the contribution to the new IRA as an rollover contribution.
8. The distribution is rolled over into an IRA in the name of the taxpayer.
9. The property rolled over is eligible rollover property.
10. The person making the rollover is one of the persons eligible to make a rollover contribution.
11. The rollover complies with the special rules and requirements for each type of IRA.

While most rollovers are straightforward, and the taxpayers need only be concerned about the 60-day rule, the sixth requirement is lesser known and can result in a costly mistake. The remainder of this discussion focuses on the once-per-12-month rule.

Generally, if you make a tax-free rollover of any part of a distribution from a traditional IRA, you cannot, within a 1-year period, make a tax-free rollover of any later distribution from that same IRA. You also cannot make a tax-free rollover of any amount distributed, within the same 1-year period, from the IRA into which you made the tax-free rollover. The 1-year period begins on the date you receive the IRA distribution, not on the date you roll it over into an IRA. If the taxpayer makes more than one rollover during a twelve-month period, then the first rollover contribution is a qualified rollover contribution, and

subsequent rollover contributions during the 12-month period are disqualified rollover contributions. The subsequent rollover contributions are taxable and may also be subject to the 10 percent tax on premature distributions.

### **For Example.**

You have two traditional IRAs, IRA-1 and IRA-2. You make a tax-free rollover of a distribution from IRA-1 into a new traditional IRA (IRA-3). You cannot, within 1 year of the distribution from IRA-1, make a tax-free rollover of any distribution from either IRA-1 or IRA-3 into another traditional IRA.

However, the rollover from IRA-1 into IRA-3 does not prevent you from making a tax-free rollover from IRA-2 into any other traditional IRA. This is because you have not, within the last year, rolled over, tax-free, any distribution from IRA-2 or made a tax-free rollover into IRA-2.

As with any rule, there are exceptions. The one year waiting period does not apply in the following cases:

#### **Qualified Employer Plans**

A taxpayer can make more than one rollover from an employer plan to an IRA within the same year. The once-a-year limit on IRA-to-IRA rollovers does not apply to these distributions. For example, the taxpayer may roll-over a distribution from an employer plan to an IRA and then roll over a distribution from an IRA to another IRA within the same 12-month period. The taxpayer may also rollover a distribution from a qualified employer plan into multiple IRAs within the same 12-month period if the rollovers are made within 60 days after the date of the distribution.

#### **Rollovers from an IRA to Other Plans**

Rollovers from an IRA to a qualified employer plan, Section 457(b) governmental plan, or Section 403(b) tax-sheltered annuity plan are not subject to the one-rollover-per-year rule. Such rollovers do not prevent a taxpayer from making another IRA rollover within the same 12-month period.

#### **Inherited IRAs**

A surviving spouse may rollover a distribution from an IRA inherited from a deceased spouse, even if the surviving spouse has made another IRA rollover during the same 12-month period. The rollover is not considered in determining whether the surviving spouse may make another rollover during the same 12-month period.

A nonspouse beneficiary may not roll over a distribution from an inherited IRA to an IRA in the beneficiary's name. However, a nonspouse beneficiary may transfer an inherited IRA into another IRA in the name of the deceased IRA owner for the benefit of the nonsposue beneficiary. The transfer of the account does not constitute a rollover for purposes of the one-rollover-per-year rule.

#### **Failed Financial Institutions**

There is an exception to the rule for distributions made from a failed financial institution by the Federal Deposit Insurance Corporation (FDIC) as receiver for the institution. To qualify for the exception, the distribution 1) must not be initiated by either the custodial institution or the depositor, and 2) must be made because: the custodial institution is insolvent, and the receiver is unable to find a buyer for the institution.

#### **First-Time Home Purchase**

There is an exception to the rule if the taxpayer withdraws frunds from an IRA to acquire or build a first-time home, and then recontributes the money back into the IRA within 120 days or receipt as a result of a

delay or cancellation of the purchase or construction. The recontribution is not taken into account in determining whether the 12-month limitation applies to any other rollover amount.

#### Roth IRAs

The taxpayer may make more than one rollover from a Traditional IRA to a Roth IRA during a 12-month period. However, only one rollover from a Roth IRA to another Roth IRA may be made during a 12-month period. A recharacterization of a Traditional IRA contribution as a Roth IRA contribution, or a Roth IRA contribution to a Traditional IRA contribution, is not treated as a rollover for purposes of the one-rollover-per-year rule.

#### Distributions on the Same Day

The taxpayer may receive two distributions from the same IRA on the same day, and roll over both distributions to another IRA without violating the one-rollover-per-year rule. Two separate checks from the same IRA trustee on the same day do not constitute two separate distributions for the purposes of this rule. A taxpayer may want to receive separate checks in order to avoid signature guarantees or other bank requirements.

#### Best Solution

One of the benefits of the trustee-to-trustee transfer is that there is no possibility of noncompliance with the 60-day rule or the 12-month rule. Taxpayers are better served by having their IRA or retirement plan assets transferred directly via trustee-to-trustee transfers rather than by a rollover.

#### References:

Cartano, David J. 2005. Taxation of individual Retirement Accounts, 2005 Edition, Chicago, IL: CCH Incorporated, 2005.

Steven G. Lockwood, Martin Fleisher, and Donald R. Levy. 2005. Individual Retirement Account Answer Book, 11<sup>th</sup> edition, New York, NY: Aspen Publishers, 2005.

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