Caution New IRA Rules (Part 2)

(Contributed by Justin Fundalinski, MBA)

Last month I focused our monthly article on helping you understand that it is not an IRA custodian's responsibility to give advice on how to take distributions from an IRA. It was discussed how they dismiss themselves from any responsibility if a distribution is taken incorrectly and you are forced to suffer undue tax consequences. I also defined some common IRA withdrawal types that can cause confusion when taking a distribution as well as outlined the newly implemented One Rollover Per Year Rule that will throw IRA account holders for a loop in 2015. This month's article is a continuation on this subject and is focused on helping IRA owners proceed with caution so that the new rules do not come back to bite them at tax time. If you missed last month's article or have questions on it please feel free to contact me at justin@jimhelps.com.

Quick Review of the One Rollover Per Year Rule:

In 2014 a major Tax Court decision impacted indirect transfers (60-day rollovers) beginning in January 2015. The new rule states that an IRA owner can only make ***one indirect rollover per any 12-month period, regardless of the number of IRA's that they own.*** Prior to 2015, an IRA owner could move ***any*** IRA account that they had once per 12-month period. If you act outside of this rule you will have to include any distributed amounts as income on your tax return and if you are under age 59½ you may be subject to an additional 10% early withdrawal penalty.

Who Is Most Likely to Be Affected?

My first inclination of who is most likely to break the new rule is anyone who maintains IRA bank savings accounts or CDs. I am not intending to knock bank custodians or bank IRAs, the fact of the matter is that we are all used to doing banking business a certain way – ***in person***. Think about it, if you decided to move your checking accounts to a new bank, would you start by going to the new bank and telling them to transfer your funds over from the old bank? **No!** You would go to your old bank, close the account, get a check, walk across the street and open up a new account before the ink on the check dried. So what happens when you do this with two or more IRA CDs? Whoops, you just made too many indirect transfers and you are subject to the consequences of the One Rollover Per Year Rule. If you have any accounts that are IRAs make sure you simply ***avoid this problem by moving funds with direct transfers.***

Another reason why bank CD owners could fall victim to the new rule is because banks have their own lingo for CDs that unfortunately uses one of the same terms as an IRA distribution type – "***rollover***." When you rollover a CD (in banker terms) it means that you reached the end of your original CD term and you want to continue in a CD for the same term but at the new prevailing interest rates. So now we have one word with two definitions that can be used to describe two completely different things that you can do with same IRA CD. It can be the banker term as defined above or it can be the IRA distribution term as defined in the previous article. Are my lexicographers confused yet? To make this problem simple just remember this – **DO NOT ASK YOUR BANKER TO "ROLLOVER" YOUR CDs TO ANOTHER BANK**. You want to ***ask your <u>new bank/custodian</u> to move your funds by means of a direct transfer.***

Unfortunately, mistakes with of the One Rollover Per Year Rule will be ***caused by the errors of other***. As mentioned in last month's article, we recently worked with someone whose IRA was at a local bank custodian. This person was simply trying to **renew** their existing bank IRA CD for a shorter term. Rather than keeping the ***existing*** IRA open and just buying a new shorter term CD in it, the bank's employee completed paperwork that ***closed*** the IRA and took a full distribution! The employee then directed this distribution into a CD in a ***new*** IRA (in effect this mistake is viewed as an indirect rollover in the eyes of the IRS). To add insult to injury three months later the same bank employee made the exact same mistake again! Each "distribution" generated an erroneous 1099 from the bank which was then reported as taxable income to the IRS of nearly $400,000 on an IRA that was valued at $200,000!

The bank's representative completed distribution paperwork for this IRA owner (common practice even though custodians *technically do not give advice* on how to take the distribution) and she marked the distribution type incorrectly. Of course, the IRA owner signed off on the paperwork not knowing it was completed incorrectly and technically the problem lies on the IRA owner's shoulders. Fortunately, as of the writing of this article the bank was attempting to "fix" the problem. We have no doubt in time they will, but it will also most likely result IRA owner receiving a "letter audit" from the IRS in a few years asking her to explain why she didn't declare $400,000 of IRA distributions on her taxes!

In summary, whether you are moving funds from a bank custodian or from any other type of IRA custodian it just isn't as simple as it sounds. If you have any questions or need help with this please remember that we are here to give you guidance. Jim is a member of the Ed Slott Master Elite IRA advisor group and will be able to help with any and all of your IRA questions.

As always, questions, comments and critiques can be sent to justin@jimhelps.com and our office can be reached at 970-530-0556.