Caution: New IRA Rules (Part 1)

(Contributed by Justin Fundalinski)

In the world of IRAs, IRA Custodians (financial intuitions that are approved by the IRS to hold such retirement accounts) have lots of responsibilities that they must uphold. However, it is not their responsibility to assure you know the differences among all the confusing terminology that revolves around IRA withdrawals/transfers and the tax consequences behind them (for example: direct transfers, indirect transfers, and distributions are all ways to take money out of an IRA and all have different tax rules). It is up to the account holder to sign off on the reason IRA funds are leaving an account, and if you are not educated on the rules that just changed in 2015, unintended tax consequences may occur.

To illustrate this point, recently at the office we saw IRA withdrawal paperwork from a bank custodian that clearly stated above the signature line, "… no tax advice has been given to me by the Custodian" and, "I assume the responsibility for any adverse consequences which may arise from this withdrawal and that the Custodian is not responsible". The sad thing is that a bank employee filled out the paperwork, checked the incorrect distribution type, never went over this with their client, and the client signed off unknowingly. With all the confusing terminology as well as changing tax laws this article is intended to inspire a bit of caution to those who move IRA funds – especially those who have multiple IRAs or move their accounts frequently (i.e. IRA CD/Interest rate shoppers).

Common Withdrawal Types:

Before we get into the depths of the topic at hand, a quick overview of three common withdrawal types is necessary.

A ***distribution*** is the easiest to explain of the various withdrawal types and is when an IRA owner takes money out of their IRA. The reason someone may want to do this varies, but typically they either *have to* remove funds because of Required Minimum Distributions (the IRS wants their cut) or they *want to* remove funds because they need the money. Any money that is withdrawn is subject to taxes as ordinary income (just as one's wages or interest income is) and may be subject to a 10% penalty if they are under age 59½ when they take the withdrawal.

A ***direct transfer*** is a withdrawal from one Custodian directly to another Custodian. This is a very common way of moving an IRA to another financial institution. Most times a direct transfer is completed electronically, however if a check is issued, it is made payable to the new Custodian for the benefit of the IRA owner and not to the IRA owner themselves. For instance, if I were transferring my IRA to ABC Custodian the check would be made payable as: ABC Custodian IRA FBO Justin Fundalinski. Under current rules there are no limits on how many direct transfers an IRA owner can complete in a year.

An ***indirect transfer*** (aka 60-day rollover) is actually a distribution (as described above) from an IRA where the check is made payable to the IRA owner so that they can then turn around and redeposit the funds into a different IRA. With indirect transfers, the IRA owner becomes the "middleman" between the retirement account custodians; hence, it is "indirect" and they become responsible for ensuring the check makes it to next custodian. The indirect transfer is a tax and penalty free distribution of assets as long as one adheres to the 60-day rollover rules set forth by the IRS (in short – recontribute the funds to an IRA within 60-days of receiving the original distribution). Unfortunately the 60-day rollover rule was refined in 2015 and became much more restrictive with the one rollover per year rule.

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.

So what are the consequences? 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. This rule change will undoubtedly have negative consequences on many people, but knowing how the rule works and the distribution types discussed above it will be business as usual.

Proceed with Caution:

Since there are so many possible scenarios that this new IRA rule change could wreak havoc on, getting into such detail is beyond the constraints of this month's article. However, because it is something that IRA owners should understand, consider this a "to be continued," and the following paragraph a spoiler of what you can expect next month.

Coming from many years of working at a national bank and understanding more banking and IRA jargon than I like to admit to, I can assure you that the majority of IRA owners that will be affected by the new *one rollover per year rule* will be IRA CD/bank savings owners. So, if you need to move around IRA funds at your local bank before you can read next month's article please make sure you understand the rules and terminology discussed above and don't hesitate to give us a call if you have any questions.

Questions, comments and critiques on this article can be sent to justin@jimhelps.com and our office can be reached at 970-530-0556