

The Fatal Rollover Oversight

... and how to avoid it.

Special Report

Do You Have More
than One Financial
Advisor?

You could be in
for serious
trouble with the
I.R.S.

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**THE INDEPENDENT FINANCIAL
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A Registered Investment Advisor
Planning and Wealth Management

The Fatal Rollover Oversight

If you have more than one financial advisor, you could end-up shooting yourself in the foot and getting yourself in trouble with the I.R.S.

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If you have more than one financial advisor, be careful. Some people using multiple advisors under the erroneous impression they're pursuing a form of diversification, can find themselves in serious trouble with the I.R.S.

When an investor does this, the danger is that the right hand may not know what the left hand is doing; and the investor, who is in the middle, won't possess the requisite knowledge to avoid potential landmines buried in the I.R.S. codes.

The Once-Per-Year Rule

Only one 60-day IRA-to-IRA rollover can be done per year by an individual, regardless of how many IRAs the individual has. This rule, which has been in effect since January 1, 2015, but some advisors are making costly errors for their clients simply because (a) the advisor may not be aware of the ruling, or (b) the client hasn't provided full disclosure about all IRAs and other advisors who may be involved.

The problem with violating this rule is it can't be fixed.

According to IRA and tax guru Ed Slott, who is a practicing CPA in addition to his frequent appearances on PBS, the I.R.S. does not have the authority to provide any relief for this error, and now a stricter interpretation of the rule applies as the result of a tax court ruling [Alvan L. Bobrow, et ux. V. Commissioner, TC Memo 2014021] and follow-up guidance from the I.R.S. Announcement 2014-32.



The I.R.S. had believed in the past that the rule applied separately to each IRA, but apparently that's no longer the case. It's now apparent the ruling applies to all IRAs.

Direct transfers not involved.

Direct IRA to IRA transfers are not involved; nor are rollovers from other types of plans to IRAs, to rollovers from IRAs back to other plans or to Roth conversions. It also does not apply to nonspouse IRA beneficiaries because they can never do a 60-day rollover anyway and can only use direct transfers.

Indirect rollovers are the issue.

These are often called the "60-day" rollovers, the type of rollovers most advisors advise against. The 60-day rollover occurs when an investor withdraws the funds with a check made out to the investor personally—different from a trustee-to-trustee transfer where the investor never takes possession of the funds.

When an investor withdraws the funds from an IRA and deposits the funds into another IRA within 60 days, there's no problem; but, s/he can't do another one for another year without causing problems with the I.R.S. The second indirect rollover, if done within 12 months, would be ineligible and all pretax funds withdrawn will become immediately taxable, not to mention a 10% early distribution penalty if the investor is under age 59-1/2. There could also be a 6% excess IRA contribution penalty if the

rollover is not removed in a timely manner. According to Mr. Slott, this would also require filing Form 5329 to report the excess IRA contribution if the action is not removed by October 15th of the year after the year for which the IRA contribution was made.



When do these errors happen?

Take the example of the investor who takes withdrawals from several IRAs at the same time in order to use the money as a short-term loan for the down payment on a house while waiting for another house to close.

Besides the fact not many homes close inside of 60 days, the problem arises with the second withdrawal (assuming no other withdrawals had been made during the previous 365 days) because it and any others were no longer eligible.

A better strategy would have been to do a direct transfer of the IRAs in to a single IRA and then take a single withdrawal—but, again, the landmine goes off if the rollover isn't completed within 60 days.

The person in our example would have ended-up being taxed on all succeeding rollovers, even if completed, plus a 10% penalty for being under age 59-1/2. And, if all the funds were spent, there may have been no money left at tax time to pay

Uncle Sam all the taxes and penalties due.

The multiple advisor problem

This you can readily see: Two advisors each allowing an indirect rollover, not knowing about the other and the investor not knowing about the landmine.

The multiple advisor mindset is one some investors still have—a leftover from the days when they were dealing with stockbrokers, each offering different investment ideas. A different world I'm not sure even exists anymore.

CDs: A different problem

This one's can present a real problem for the unaware investor. When an IRA CD comes due, the bank will often simply renew it as a rollover to a new IRA. Guess what? That's a rollover. If the IRA owner isn't aware of what's happened, any other rollover done from another IRA or Roth IRA at any other financial institution will be no good—and taxable. Sometimes, the owner will do the rollover right at the bank window with a clerk who doesn't even know to ask about any prior rollovers during the previous 12 months.

Even a small rollover at a bank or credit union affects all other IRAs.

The moral: Use direct transfers whenever possible.

Note: Annuity companies do not do direct transfers. They will send the client a check—and that counts as a rollover.



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Jim Lorenzen is a *CERTIFIED FINANCIAL PLANNER®* professional and an *ACCREDITED INVESTMENT FIDUCIARY®* serving private clients' wealth management needs since 1991. Jim is Founding Principal of **The Independent Financial Group**, a Registered Investment Advisor providing wealth management, retirement planning and investment advisory services. He is also licensed for insurance as an independent agent under California license 0C00742. Jim's background includes founding, building, and selling five successful businesses and international consulting. He has been the headline speaker at more than 500 national and international association and corporate conventions for clients such as Foster Grant, Hobie Cat, CapCities/ABC, H.R. Textron, Hearst Corporation, The National Management Association, the National Newspaper Association, and Cox Communications, as well as scores of state, regional, and national conventions. Jim has also been featured on American Airlines' *Sky Radio* heard on more than 19,000 flights, as well as in *The Wall Street Journal's SmartMoney* magazine, *The Profit Sharing Council of America's Insights*, and has been published in the *Journal of Compensation and Benefits*, *NASDAQ*, and in scores of national and international association trade publications.



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