A Game Change for the 60-day Rollover Rule

Tax Court's Unexpected Interpretation Changes the Game

A recent Tax Court case, Bobrow v. Commissioner, shut down an IRA strategy often utilized by advisors and clients to provide temporary liquidity (similar to a loan) by accessing IRA funds without triggering tax consequences and penalties. It challenged what the financial professionals and even the Internal Revenue Service long thought and understood. In light of this development, it's important to understand what has changed and how the rules will be applied going forward.

Indirect Rollover or '60-day Magic'

The IRS allows an individual to avoid tax consequences from taking a distribution from an IRA if the funds are deposited back to an IRA or a qualified retirement plan within 60 days. This transaction has become known by many as an indirect rollover. To avoid abuse, this 'indirect rollover' opportunity is extended once in a 12-month period; traditionally, the IRS has historically applied this limit on an account-by-account basis. This interpretation allowed individuals to string together multiple IRA rollovers and gain use of IRA funds for an extended period of time thus 'magically' avoiding the once-in-year rule and tax exposure associated with a distribution out of an IRA.

It's important to note that this one-per-year rule applies only to rollovers where the individual actually receives the money. In a trustee-to-trustee transfer, the funds are never received by the individual, therefore the once-per-year limit does not apply to these transactions.

What Happened

The Bobrow v. Commissioner involved a chain-rollover strategy. Unfortunately for Bobrow, the transaction went off-track when one of the rollovers was a day late and only included 2/3 of the amount originally withdrawn; this resulted in that rollover being reported as a taxable distribution. The tax payers, Alvan and Elisa Bobrow, blamed the financial institution for the mistake. The dispute drew attention of the IRS which ruled that the failed indirect rollover distribution was taxable and the chain of distributions was to be treated as one transaction spanning a period of several months. Finally, the fight reached the Tax Court, which ruled that not only the failed distribution was taxable but also, unexpected to all, interpreted that the 12-month limitation applies to all of an individual's IRAs in aggregate, i.e. as if they were one single account. This interpretation contradicts examples given by the IRS in Publication 590 which illustrates multiple IRA rollovers happening across separate accounts.

IRS Responds

In response to ruling, the IRS published an Announcement 2014-15, stating that it will soon issue new Proposed Regulations and update Publication 590 to align itself with the Tax Court's decision. The update will apply the once-per-year indirect IRA rollover rule on an aggregated basis. To allow time for transition, the IRS provided a grace period stating that the pre-decision rule (i.e. the old interpretation) will be allowed through the end of 2014. The new rule allowing only one 'indirect' IRA rollover in a twelve-month period will become effective January 1, 2015.

What It Means Going Forward

In light of Bobrow v. Commissioner ruling, starting in 2015, this basically means that the one-year rollover limitation is now applied on a per tax payer basis, i.e. an individual can only do one rollover across any/all of his/her IRAs in a single year. Any distribution from any IRA will invalidate subsequent IRA rollovers within the one-year period beginning on the date that the first distribution occurs. The multiple-separate-IRAs approach will no longer offer 'protection' from tax consequences and potential early withdrawal penalties.

It bears repeating that trustee-to-trustee transfers are not limited by this rule since the amounts are not actually received by the individual and consequently aren't treated as distributions.

First Allied Retirement Services developed a variety of tools, reports, and materials to assist you in effective communication about these and other important retirement topics. The rules are complex and to succeed you need to either become an expert or align yourself with the right partner. We are available to be an extension of your team. Retirement Services consultants are ready to partner with you in presenting solutions to your clients and prospects. But we don't stop there; we help you implement and maintain the plan in partnership with nationally-recognized recordkeeping vendors to offer a complete plan solution. You can reach us at (888) 926-0600 or via email to pensions@firstallied.com .