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NEW RULES IN 2015 AFFECT IRA ROLLOVERS

Retirement savers can realize significant tax savings through the use of employer qualified plans (such as a 401(k) or 403(b)) and Individual Retirement Accounts ("IRAs"). After all, these plans are designed to incentivize workers to save for retirement. Tax advisors and financial planners will tell you that it's important to devise a sound strategy to maximize the benefits these plans offer. And they're right; the rules are complex, and the consequences of breaking them could lead to penalties, unintended income recognition or simply missing out on the full extent of tax savings possible.

Knowing the contribution and rollover rules and executing transactions appropriately is the key to success when it comes to taking advantage of retirement accounts. Two significant changes to IRA rollovers, one pertaining to qualified plan-to-IRA rollovers and one regarding IRA-to-IRA, developed in 2014 and take effect in 2015. It's important to understand the rule changes before implementing your retirement savings strategy.

A NEW DOOR OPENS FOR ROTH IRA ROLLOVERS

Do you have after-tax contributions in your employer-sponsored retirement plan? You now have a clear path to getting that money into a Roth IRA.

IRS Notice 2014-54 clarifies split rollovers of pre- and after-tax funds, allowing split rollovers to be aggregated disbursements treated as a single distribution. The recipient can select how pre- and after-tax amounts are allocated among split rollovers by informing the plan administrator of the allocation prior to direct rollovers. This removes the forced pro-rata rules that apply to Roth IRA conversions and allows after-tax dollars to rollover into a Roth IRA tax free.

For example, say you have $100,000 in your 401(k), and the balance consists of pre-tax contributions and investment growth of $85,000 (85%) and after-tax contributions (not from a designated Roth 401(k) account) of $15,000 (15%). Under the new rules, when you execute a rollover from your 401(k) you can put 85% of the rollover into a traditional IRA and 15% of the rollover into a Roth IRA. The rollovers, as long as they are direct between custodians and not distributions to you, are tax free.

So what could this mean for your strategy? Well, many 401(k) plans allow after-tax contributions above the annual pre-tax and Roth IRA account contribution limits. If you choose to make after-tax contributions to your 401(k), you now have a clear option to later convert the after-tax basis (but not the investment growth on the after-tax contributions) directly to a Roth IRA, tax free. This has the potential to be a powerful retirement planning strategy that offers current tax-deferred investment growth and future tax-free growth through a direct Roth IRA rollover.

While this new rule makes after-tax contributions to a retirement plan more attractive than ever, it is important to understand the implications of employing such a strategy.

A Roth rollover of after-tax qualified plan contributions has the potential to be a powerful retirement planning strategy that offers current tax-deferred investment growth and future tax-free growth.

The rules still require that funds leaving a qualified plan must leave pro-rata before the recipient selects the pre- and after-tax allocation. For example, and back to the case of an 85/15 split of pre- and after-tax dollars, any partial distribution rollover must also be split 85/15, with 85% of the partial distribution being pre-tax dollars (rolling to a traditional IRA) and 15% after-tax dollars (which you would roll to a Roth IRA). The rules still allow for a tax-free Roth IRA rollover in a partial distribution, but in order to get the full amount of after-tax funds out of a qualified plan and into a Roth IRA you would need to make a total distribution of the entire qualified plan. This would generally not be an issue for those who retire or separate from service from their employer, but may affect those looking to make in-service distributions from plans that allow them.

Other retirement planning strategies could be affected by qualified plan rollovers, such as the ability to withdraw funds without penalty after age 55 but before age 59 ½ when separating from service, or the ability to take advantage of net unrealized appreciation (NUA) rules for employer stock held in a qualified plan. Careful consideration should be given to your investment allocations and tax planning strategies before deciding if after-tax contributions and Roth IRA rollovers are right for you.

CAREFUL WITH THAT ROLLOVER!

The 60-day IRA rollover rules have changed for 2015.

As the result of a US Tax Court case, *Dobrow v. Commissioner*, a loophole in the IRA 60-day rollover rule has been closed. The 60-day rollover rule applies to IRA distributions: any amount distributed from an IRA is not included in the taxpayer's gross income to the extent that the amount is deposited into another IRA for the taxpayer's benefit (i.e., rolled over). Essentially, you can remove money from your IRA without income tax and penalty consequences if you put the money back into another IRA in your name within 60 days. 60-day rollovers are limited to one nontaxable rollover in any one-year period. Prior to *Dobrow v. Commissioner,* the 60-day rollover rule was applied on an account-by-account basis; for example, if you have five different IRAs, you could execute five different 60-day rollovers, one for each account, in any one-year period. Not so anymore. The Tax Court ruled that the one-rollover-per-year limitation applies on an *aggregate* basis, meaning that no matter how many separate IRA accounts an individual has, including SEP, SIMPLE, traditional, and Roth IRAs, *each taxpayer gets only one 60-day rollover in any one-year period*. The IRS announced that enforcement of the change applies to distributions that occur on or after January 1, 2015. A transition rule applies to distributions made in 2015 that ignores 2014 distributions as long as they are not from the same accounts. The transition rule will not prevent a 2015 distribution from being eligible for a 60-day rollover if a distribution was made late in 2014 and rolled over in early 2015, as long as the 2015 distribution is from an IRA not involved in the 2014 distribution and subsequent rollover. The IRS provides an example on their website:

> ***Example****: If you have three traditional IRAs, IRA-1, IRA-2 and IRA-3, and in 2014 you took a distribution from IRA-1 and rolled it into IRA-2, you could not roll over a distribution from IRA-1 or IRA-2 within a year of the 2014 distribution but you could roll over a distribution from IRA-3. This transition rule applies only to 2014 distributions and only if different IRAs are involved. So if you took a distribution from IRA-1 on January 1, 2015, and rolled it over into IRA-2 the same day, you could not roll over any other 2015 IRA distribution (unless it's a conversion).*

How does this affect you? Many folks have multiple IRAs for different reasons, whether it's to gain access to different types of investments that are offered at different custodians, to keep rollovers from qualified plans at former employers separate from IRA contributions, or to isolate after-tax basis in traditional IRAs, people have the need to transfer funds between different IRAs for investment or tracking purposes. It's also no secret that some people took advantage of the old 60-day rollover rules to meet cash flow crunches by "floating" loans to themselves through a string of 60-day rollovers between different IRA accounts. That will not work anymore. You now must be more careful to track the timing of rollovers to ensure compliance with the one-per-year limitation on 60-day rollovers of distributions made directly to you. If the rollover rules are broken, distributions could be included in gross income and subject to a 10% early withdrawal penalty when applicable. Rollover deposits that violate the rules may be treated as excess contributions and taxed at 6% per year as long as they remain in the IRA. The penalties for botching a rollover are steep.

The good news is that these rules do not apply to direct trustee-to-trustee transfers. As long as the money movement is directly between custodians, bypassing any distributions to the taxpayer, there is no limit on transfers.

NEED MORE INFORMATION?

Be sure to speak with the experts at WithumSmith+Brown before executing any distributions or rollovers from your employer qualified plan or IRAs. A little planning ahead of time can save you from big headaches in the future when it comes to the complex rules that govern IRAs. Let our experts help you keep your retirement goals on the right track.
