STIFEL

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ROLLOVERS TO INDIVIDUAL RETIREMENT ACCOUNTS (IRAs)

The Financial Industry Regulatory Authority (FINRA) has increased scrutiny on IRA rollover recommendations. It issued Regulatory Notice 13-45 to remind financial firms of their responsibilities when recommending rollovers to IRAs by employer-sponsored plan participants who are terminating employment.

Rollover considerations

Participants of employer-sponsored retirement plans [401(k), profit sharing, 403(b), etc.] typically have several options when they terminate employment:

- Leave the money in the former employer's plan, if permitted
- Roll over the assets to a new employer's plan, if one is available and rollover contributions are permitted
- Distribute the assets
- Roll over assets to an IRA

Each alternative may have advantages and disadvantages, based on an individual's needs and circumstances, and all of the following issues or items should be carefully considered:

	Employer-Sponsored Retirement Plan	IRA
Investments	Number and type may be restricted by the plan. If mutual funds, less expensive institutional share class may be used.	Usually broader array of products available.
Fees	What are investment expenses? Advisor expenses? Are administration/recordkeeping fees charged to participants, or does the employer pay them? Charge for distributions to an IRA?	Annual Custodial fee. Stifel = $40/year; $30 if multiple accounts in a household. Transaction and/or advisory fees that vary depending on the product and/or program selected.
Services	Do you have access to investment advice, planning tools, telephone help lines, educational materials, and workshops?	Do you have access to planning tools, telephone help lines, and educational materials, or advice, full brokerage services, and financial planning?
Penalty-Free Withdrawals	Age 59 ½. Some penalty exceptions may apply. Age 55 if separated from service with sponsoring employer during the year in which or after attaining age 55.	Age 59½. Some penalty exceptions may apply.
Taxation	Ordinary income tax assessed at distribution (exception for Roth and after-tax contributions).	Ordinary income tax assessed at distribution (exception for Roth and after-tax contributions).
Required Minimum Distributions (RMD)	Generally must begin at age 70 ½, but may be delayed until retirement, if still employed by plan sponsor and the plan allows. RMDs may not be rolled over to an IRA.	Must begin at age 70 ½ (exception for Roth IRAs).
Employer Stock	Tax benefits available for distribution of shares of highly appreciated stock (NUA election).	N/A
Loans	May be available while still employed.	No loans permitted.
Protection from Creditors	Unlimited protection from creditors under federal law.	Protection in bankruptcy proceedings only; state laws vary.
Roth Conversion	Plan may allow for Roth contributions and also in-plan conversions.	Pay tax on conversion, then Roth IRA distributions are tax-free (certain restrictions apply).

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Decisions to roll over or transfer retirement plan or IRA assets should be made with careful consideration of the advantages and disadvantages, including investment options and services, fees and expenses, withdrawal options, required minimum distributions, tax treatment, and each individual's unique financial needs and retirement planning. Individuals should consult with a professional tax advisor to discuss their particular needs and goals before any decisions are made.

LIMIT ON IRA ROLLOVERS

Announcement 2014-15 addresses the application to Individual Retirement Accounts and Individual Retirement Annuities (collectively, "IRAs") of the one-rollover-per-year limitation of § 408(d)(3)(B) of the Internal Revenue Code (IRC) and provides transition relief for owners of IRAs.

IRC Section 408(d)(3)(A)(i) provides generally that any amount distributed from an IRA will not be included in the gross income of the distributee to the extent the amount is paid into an IRA for the benefit of the distributee no later than 60 days after the distributee receives the distribution. Section 408(d)(3)(B) provides that an individual is permitted to make only one rollover in any one-year period. Proposed Regulation § 1.408-4(b)(4)(ii) and IRS Publication 590, Individual Retirement Arrangements (IRAs), state that this limitation is applied on an IRA-by-IRA basis. However, a recent Tax Court opinion, Bobrow v. Commissioner, T.C. Memo. 2014-21, held that the limitation applies on an aggregate basis, meaning that an individual could not make an IRA-to-IRA rollover if he or she had made such a rollover involving any of the individual's IRAs in the preceding one-year period. The IRS anticipates that it will follow the interpretation of § 408(d)(3)(B) in Bobrow and, accordingly, intends to withdraw the proposed regulation and revise Publication 590 to the extent needed to follow this interpretation. These actions by the IRS will not affect the ability of an IRA owner to transfer funds from one IRA trustee directly to another, because such a transfer is not a rollover and, therefore, is not subject to the one-rollover-per-year limitation of § 408(d)(3)(B). See Rev. Rul. 78-406, 1978-2 C.B. 157.

The IRS has received comments about the administrative challenges presented by the Bobrow interpretation of § 408(d)(3)(B). The IRS understands that adoption of the Tax Court's interpretation of the statute will require IRA custodians to make changes in the processing of IRA rollovers and in IRA disclosure documents, which will take time to implement. Accordingly, the IRS will not apply the Bobrow interpretation of § 408(d)(3)(B) to any rollover that involves an IRA distribution occurring before January 1, 2015. Regardless of the ultimate resolution of the Bobrow case, the Treasury Department and the IRS expect to issue a proposed regulation under § 408 that would require the IRA rollover limitation apply on an aggregate basis. However, in no event would the regulation be effective before January 1, 2015.

History on Bobrow v. Commissioner

In 2008, Mr. Bobrow maintained two traditional IRAs (IRA 1 and IRA 2) at Fidelity, his wife maintained a traditional IRA (IRA 3), they maintained a joint checking account (Joint Account), and Mr. Bobrow maintained an individual checking account (Individual Account). Mr. Bobrow received two distributions from IRA 1 in the combined amount of $65,064 on April 14, 2008. Then, on June 6, 2008, he received a $65,064 distribution from IRA 2. On June 10, 2008, he transferred $65,064 from his Individual Account to IRA 1. On July 31, 2008, Mrs. Bobrow received $65,064 from IRA 3. On August 4, 2008, the couple transferred $65,064 from their Joint Account to IRA 2. Finally, on September, 30, 2008, Mrs. Bobrow transferred $40,000 from the Joint Account to IRA 3.

The dispute lies within two parts. The Commissioner contends that the plain language of Section 408(d)(3)(B) limits the frequency with which a taxpayer may elect to make a nontaxable rollover contribution. By its terms, the one-year limitation in Section 408(d)(3)(B) is not specific to any single IRA maintained by an individual but instead applies to all IRAs maintained by a taxpayer. As such, the Commissioner also contends that two of the three repayments are unqualified. The Bobrows maintained that the rollovers were qualified based on a technical advice memo (Tech. Adv. Mem. 9010007), instead of citing case law. Furthermore, the items that were referenced relate to the use of funds between the time a distribution was taken from the IRA and the time repayment occurs. The Commissioner ruled that such defense is irrelevant to determining whether a transaction qualifies as a rollover contribution.

Conclusion

Again, the recent opinion (Memo 2014-21) regarding Bobrow v. Commissioner puts an end to what has historically been an acceptable strategy with IRA rollovers. Prior to this ruling, an IRA owner was able to utilize the 60-day rollover rule per IRA. After reviewing the Bobrows' IRA transactions, the Tax Court cited Revenue Code Section 408(d)(3)(B), which indicates that an individual is permitted to make only one rollover in any one-year period. And, in the latest Memo 2014-21, the opinion holds that the limitation applies on an aggregate basis, meaning that an individual could not make an IRA rollover if he or she had made such a rollover involving any of the individual's IRAs in the preceding one-year period. An individual may still complete a 60-day rollover; however, he or she is purely limited to one per 365-day period, regardless of the number of IRA accounts owned. Remember, this ruling affects IRA to IRA rollovers, and it does not place a limit on the number of direct rollovers from qualified retirement plans (i.e., 401(k) or 403(b)) to IRAs.

QUALIFIED RETIREMENT PLAN DISTRIBUTIONS ELIGIBLE FOR A ROLLOVER?

Retirement plans are all about saving, but at some point, assets accumulated must be distributed. At the time of distribution, funds may be rolled to an IRA or another qualified plan in order to maintain the opportunity for tax-deferred growth. But, will the distribution be eligible for a rollover? One way to know if a distribution is an "eligible rollover distribution" can be to see if it is on the list of distributions that may not be rolled over. This list includes:

- A Required Minimum Distribution: Paid in installments based on life expectancy, these distributions must begin by April 1 following the year the participant turns age 70 ½. Plans may allow these distributions to be delayed until *retirement* if the participant does not own more than 5% of the sponsoring employer.
- A distribution that is one of a series of substantially equal periodic payments (at least annually) made over:
  - o The life or life expectancy of the employee or over the joint lives or joint life expectancy of the employee and the employee's beneficiary, or
  - o A specified period of ten or more years.
- A distribution made upon hardship.
- After-tax contributions not payable to the name of the IRA or retirement plan account.
- Elective contributions (also called "deferrals") and employee "after-tax" (not Roth) contributions that are returned to the employee (together with their allocable income) in order to comply with the annual contribution limitations ($52,000 or $57,500, including a $5,500 "catch-up").
- Corrective distributions of the following, including their allocable income:
  - o Excess contributions: Highly Compensated Employee (HCE) deferrals that exceed the limits of the Actual Deferral Percentage (ADP) test,
  - o Excess deferrals: Deferrals that exceed the individual limits of $17,500 or $23,000 (including a $5,500 "catch-up"), and
  - o Excess aggregate contributions: HCE matching and/or "after-tax" (not Roth) contributions that exceed the limits of the Actual Contribution Percentage (ACP) test.
- Participant loans in default that are deemed distributions.
- Dividends paid on employee stock ownership plan (ESOP) employer securities.
- Distributions of premiums for accident or health insurance.
- The costs of current life insurance protection.
- Prohibited allocations in S corporation ESOPs that are treated as deemed distributions.
- A distribution that is a permissible withdrawal from an eligible automatic contribution arrangement.

When considering future distributions or when the time for a distribution arises, the above list can help participants determine whether the continuation of tax-deferred growth via a rollover will be available.

PLAN DISTRIBUTIONS WHILE EMPLOYED?

Unbeknownst to many participants, their plan allows them to take distributions from their profit sharing / 401(k) plan while still employed, and they can elect to roll their assets to an IRA (see Rollover considerations on page 1). However, whereas the law allows for in-service distributions, as detailed in the list below, the plan's document must include the provisions for them to be available.

In-service distribution opportunities vary per plan contribution type, as noted below:

Profit Sharing Contributions

Contributed funds that have aged in the plan for at least two years are eligible for a distribution, and all funds, contributions and earnings, may be available for a distribution after five years.

Elective Contributions (Deferrals)

Participant salary deferrals (pre-tax or Roth) are available for distribution once the participant reaches age 59 ½.

Matching Contributions

Employer matching contributions generally have the same availability as profit sharing contributions noted above. However, qualified matching contributions (100% vested) made to pass or avoid (via a Safe Harbor 401(k) plan) the ADP Test have the same availability as employee deferrals noted above.

Rollover Contributions

Funds that have been rolled into the plan from another qualified plan or an IRA may be available for distribution immediately or whenever desired by the participant.

When available, in-service distributions can offer additional flexibility in financial planning. Participants should check with their plan administrator to find out if in-service distributions are available and if there are any plan-specific limitations, for example, based on age or service.

ROLLOVERS TO QUALIFIED PLANS MADE EASIER

The government is attempting to make it easier for participants in qualified retirement plans to move their assets from one employer's plan to another. On April 3, 2014, the IRS issued Revenue Ruling 2014-9 which provides a "safe harbor" due diligence method of concluding whether or not a check received is a rollover from a qualified plan. The ruling also provides a safe harbor method of determining whether a traditional IRA may be rolled into a qualified plan. In both the case of the IRA and qualified plan, if there is no evidence to the contrary, the plan administrator may use the new procedures to reasonably and safely make the decision to determine a rollover's eligibility.

Previously, participants who wished to roll their accounts into their new employer's plan were sometimes required by the new employer to get a letter from their prior employer stating the assets were, in fact, coming from a qualified plan. Since the two employers are almost always unrelated, this often forces the participant to act as go-between for the two companies. The process can become overly frustrating to the participant and, in some cases, push them into taking a cash distribution where there is no need to juggle the requirements of two different employers.

The IRS ruling hopes to alleviate the burden on both employers and participants by allowing the plan administrator of the new plan to verify online the former plan's qualified status. The Department of Labor's web site, www.efast.dol.gov, contains electronic records of the Annual Return/Reports of Employee Benefit Plans, more commonly known as the Form 5500. Listed on the Form 5500 are codes that indicate whether or not a plan is qualified. Specifically, if line 8a of the Form 5500 does not include code "3C," which designates a nonqualified plan under IRS Code Sections 401, 403, or 408, the plan is deemed to be a qualified plan. This information is publicly available and easily obtained by plan administrators with web access.

One downside of this method is that certain plans are not required to file 5500s such as specific governmental retirement plans or individual 401(k) plans with assets of less than $250,000. These plans would not show up in the database, which would require the plan administrator to get confirmation of the plan's qualified status through the traditional method of requiring the participant to produce a letter from the prior employer.

Hoping to also ease the burden of rolling traditional IRAs into qualified plans, the IRS provided some safe harbor guidelines on IRA rollovers as well. In this situation, the employee requests an IRA distribution and that the check is made payable to the trustee of the new employer's plan. The employee receives the check and then delivers it to the plan administrator of the new plan. At that point, the employee must certify that there are no after-tax amounts included and that he/she will not reach age 70 ½ by the end of the year that the check is transferred in. If the check stub identifies the IRA as the source of funds, the employer can reasonably conclude that the distribution can be deposited into the qualified plan. This process will not apply to rollovers from a Roth IRA, SIMPLE IRA, or an inherited IRA.

While the new procedures will not work in all situations, such as for rollovers from qualified plans that are not found in the DOL's database, this IRS ruling should help most participants seeking to roll over their assets into a new qualified plan for several reasons. One, the ruling eliminates the need for two unrelated companies to communicate via the participant. Two, it reduces the amount of paperwork necessary. Three, it expedites the rollover process. And four, it decreases the time that the retirement assets of the participant are out of market.

The IRS Revenue Ruling 2014-9 can be found at www.irs.gov/pub/irs-drop/rr-14-09.pdf.

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