IRA Rollovers: A How-To FAQ

Individual retirement accounts, or IRAs, are the most popular savings vehicle in America for a good reason: They represent a flexible, tax-advantaged and (usually) relatively simple-to-manage vehicle in which to set aside money for retirement.

IRAs held about $7.4 trillion in retirement funds as of the end of 2014, more than any other type of retirement account, according to the Investment Company Institute. But alas, IRAs are governed by a sometimes-complex set of tax rules, especially when transferring money to, from and between accounts, moves commonly termed IRA “rollovers.” Running afoul of the rules means potentially losing the flexibility, simplicity and tax-favored status that make IRAs so appealing. Read on to learn how to preserve those advantages and spare yourself major rollover headaches.

What is an IRA rollover? What does the process entail? An IRA rollover is a process by which the owner of a retirement account instructs the custodian or trustee managing that account (such as a mutual fund company) to distribute a specified amount of money from the account for the purpose of rolling that money into another separate account.

There are several general types of rollovers: (1) from one traditional IRA to another traditional IRA; (2) from a traditional IRA to a retirement plan such as a 401(k) or 403(b); (3) from a retirement plan such as a 401(k) or 403(b) to a traditional or Roth IRA.

Before undertaking an IRA rollover, it’s important to get up to speed on IRS rules that govern the process, says Nate Wenner, a certified financial planner™ (CFP®) and certified public accountant with Wipfli Hewins Investment Advisors in Edina, Minn. Those rules specify the process to which rollovers must adhere to avoid triggering a taxable event, along with the types of distributions that can be rolled over (called “eligible rollover distributions”).

Before executing a rollover involving a retirement plan such as a 401(k) or 403(b), also familiarize yourself with the rules and conditions governing distributions to or from that plan (depending on whether you’re rolling funds from the plan, into an IRA, or vice versa).

What are some of the reasons to consider an IRA rollover? Rollovers can happen by choice or be triggered by an event. Here are some of the most common reasons they occur:

- Separation from employment, such as due to job loss or retirement, whereby the person may need to execute a rollover because they’re no longer eligible to participate in their former employer’s plan.
- To take advantage of broader or different investment options and/or lower investment fees with a different IRA or plan provider.
- To consolidate numerous accounts with one custodian/trustee/plan to simplify portfolio management, etc.
- When taking a new job, where it may make sense to rollover an IRA you have from a previous employer, into one offered by your new employer.
- When a current employer that had not previously offered a retirement plan begins offering one.

- To capitalize on the greater flexibility and access to funds that traditional IRAs tend to offer compared to some other types of retirement plans, according to Wenner.

What are the biggest pitfalls associated with IRA rollovers? The foremost concern in undertaking an IRA rollover, says Wenner, is ensuring the maneuver is executed according to IRS rules to avoid triggering a potentially costly taxable event.

The most important rules to know in this context apply to custody of the distribution (the funds) to be used in the rollover. Will that money transfer directly from one account custodian/trustee to the other account custodian/trustee? Or, will the distribution go to the account owner (typically the person in whose name the account is held), for them to eventually deposit in the new account to finalize the rollover?

The safest way to avoid a rollover-triggered taxable event, says Wenner, is to specify a direct custodian/trustee-to-custodian/trustee transfer, where the account holder instructs the custodian/trustee of one account (the one from which the rollover money will come) to directly transfer funds to the custodian/trustee of the account into which the funds will be rolled. Essentially the account owner removes themselves as the middle person by instructing the relevant financial institutions or plan administrators to handle the transfer directly***. In doing so, be sure to contact the relevant institutions and/or administrators so you're clear on how they intend to handle the transfer and what they may require from you to expedite it.***

Since in this case there is no formal distribution to the account owner, there should be no taxable event to worry about — if the transfer is properly executed. The key here is to be sure the account holder specifies to the custodian/trustee that they want the money to be transferred directly to the other custodian/trustee on their behalf. In many cases that's as simple as asking the custodian to make the check payable to the new custodian for the benefit ("FBO") of you.

Otherwise, if the rollover distribution check from a plan or IRA is made payable directly to you, solely in your name, the amount may be subject to a withholding tax of 10% (for distributions from an IRA) or 20% (for distributions from a retirement plan).

Though it's not always advisable given the risk of triggering a taxable event, in some cases the account owner may take custody of the funds earmarked for a rollover (i.e., the custodian makes the distribution check out in the name of the account owner), with the intent of ultimately depositing that money into another account to execute the rollover.

Under IRS rules, when the money from an IRA or retirement plan is distributed to the account owner during the rollover process (rather than transferred directly from custodian to custodian), the account owner has **60 days** to deposit the rollover amount into another eligible plan, without triggering a taxable event. In this case, a distribution sent to the account owner in the form of a check payable to the receiving plan or IRA is not subject to withholding. However, the onus is on the account owner to get that rollover amount deposited into the other account within 60 days. If that doesn't happen, the account owner likely will be on the hook to pay income tax on the amount of the distribution, in addition to a penalty if they're under age 59½.

Three key takeaways:

1. Take the direct transfer route and know the transfer rules that apply to the specific type of rollover — those of the IRS as well as those of the specific custodians/trustees/plans involved in the transfer.
2. In the case of a direct transfer, be sure you're clear whether the custodian/trustee/plan intends to send you a check made payable to the other custodian/trustee/plan, for you to forward, or if they will directly transfer your funds to the new custodian/trustee/plan.
3. If they're sending you a check in your name (again, not the optimal route in most cases), be sure to deposit that amount promptly into the other retirement plan or IRA account — and absolutely within the 60-day IRS limit.

Where can I go for help executing an IRA rollover? Begin by visiting the IRA/retirement plan rollover page of the IRS website at: http://www.irs.gov/Retirement-Plans/Plan-Participant,-Employee/Rollovers-of-Retirement-Plan-and-IRA-Distributions. Then consult a financial professional to help walk you through the process. To find a Certified Financial Planner™ (CFP®) professional in your area, check out the Financial Planning Association's national database at www.PlannerSearch.org.

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