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Q & A on IRA rollovers

A recent report from the GAO suggests that IRAs are becoming an increasingly important element of retirement security. An estimated 43 million taxpayers have IRAs, worth an estimated $5.2 trillion. Some 42.3 million of these IRAs are worth less than $1 million each, and 800,000 are worth more. 314 taxpayers have IRAs worth $25 million or more.

One doesn't accumulate IRA balances that large simply by making a maximum contribution each year and getting lucky with investments. Larger IRAs are nearly always the result of a rollover from an employer's qualified retirement plan, one that has long had much higher contribution caps than IRAs.

The IRA rollover is a critical tool for preserving retirement capital. Here are some questions that we've heard regarding this area.

Mixed distribution

Q. I've made both pre-tax and after-tax contributions to my employer's retirement plan. Are there special considerations for my IRA rollover?

A. The IRS has provided helpful guidance for taxpayers who have both pre-tax and after-tax balances in their employer-provided retirement plans (Notice 2014-54). In most cases the taxpayer will have the flexibility to achieve an optimum tax result.

The IRS provided the following fact pattern. Taxpayer's 401(k) account consists of $200,000 of pre-tax money and $50,000 of after-tax contributions. Upon a separation from service, Taxpayer has requested a distribution of $100,000. Those funds must come proportionately from each pot, so that the distribution will be $80,000 pre-tax, $20,000 after-tax.

From this setup, the IRS explores several scenarios for the Taxpayer. First, Taxpayer may order that the money be paid directly to IRAs, the pre-tax money to a traditional IRA and the balance to a Roth IRA. That approach preserves all the favorable tax attributes of the distribution for the future.

Next, the Service posits that Taxpayer wants to roll $70,000 of his distribution into a successor employer plan. Because that amount is less than the pre-tax portion of the distribution, the entire amount will be assumed to be of pre-tax money. If the new employer plan allows for separate accounting of after-tax contributions, Taxpayer has the option of so designating a portion of the rollover. However, Taxpayer does not have that choice if the new plan does not provide the separate accounting, the IRS warned.

Missed deadline

Q. I received a big retirement plan distribution which I meant to roll over to an IRA, but I didn't get to it within 60 days. What can I do now?

A. The best way to handle a rollover is a trustee-to-trustee transfer. Are you certain that you received a distribution? That is, if the distribution check is made out to the recipient plan, instead of to you, this may still be a trustee-to-trustee transfer. Such a check may be delivered to the payee plan after the 60-day deadline has passed, even after the death of the participant.

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If that solution is not available, the next question is whether an exception to the 60-day rule might apply. These exceptions are:

First-time homebuyer. Let's say that your withdrawal was a "first-time homebuyer" distribution. If there is a delay or cancellation of the purchase or construction of the home, the amount withdrawn may be recontributed back into the IRA without penalty. The time limit on this is 120 days, instead of 60 days.

Disaster-based extensions. If a federal disaster has been declared in your area, the IRS may issue a pronouncement on the availability of automatic extensions for various filings, which may include your rollover.

Financial institution errors. If you took action within 60 days, but the deposit to the IRA happened after 60 days solely due to an error by your financial institution, you can get an automatic waiver of the 60-day rule. This works, provided the funds are deposited in the eligible plan within a year of the original distribution.

Frozen deposits. If a bank becomes insolvent, so that a participant can't get the money out in time to meet the 60-day rule, the rule is suspended. The time during which the money has been frozen doesn't count toward the 60 days, and the participant has 10 days after the assets are unfrozen to complete the rollover.

Do you have a question?

We specialize in two areas of personal financial management:

• Helping clients to *achieve* financial independence, using tax-sensitive techniques as appropriate.

• Helping clients to *maintain* financial independence by providing unbiased investment advice and trusteeship.

For specifics on how we might help you, see our asset-management specialists

(March 2016)