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Qualified Plan and IRA Rollovers

Most qualified retirement plans and IRAs can be "rolled over" (transferred) to another qualified retirement plan or IRA. The term IRA includes SEP, SIMPLE, Roth, and traditional IRAs. The rollover rules for each type of IRA and qualified plans vary slightly so make sure you check the rules prior to making a move.

Why roll over?

An individual may choose to rollover from one IRA to another IRA for several reasons, including the following:

- Simplify administration and recordkeeping
- Access to different investment options
- Different fee structure
- Consolidate accounts for planning clarity

An individual with a qualified retirement plan, such as a 401k or profit sharing plan, may also choose to rollover funds from the qualified retirement plan to an IRA to achieve certain benefits, including the following:

- Simplify administration and recordkeeping
- Access to different investment options
- Avoid 10% penalty on pre-59.5 distributions for education, first time homebuyer, unemployed health insurance premiums (these penalty-free distributions are allowed from IRAs but not from qualified plans)

Before rolling over from a qualified plan to IRA the following should be considered:

- Potentially less protection from creditors
- Mandatory 20% tax withholding may be required
- Loss of net unrealized appreciation (NUA) treatment
- Loss of ability to access funds penalty free upon retirement between age 55 and 59.5[1]
- Loss of ability to borrow
- Loss of ability for non-spouse beneficiary to convert to Roth IRA upon death of IRA owner

Planning Tip

Make sure you work with the qualified plan or IRA custodian and let them know what you are trying to do with the rollover. There are times when the IRS allows the transaction, but the custodian is more restrictive and will not allow it.

Which distributions can be rolled over?

IRAs: Any distribution from an IRA can be rolled over except:[2]

- Required minimum distributions, or
- Distribution of excess contributions and related earnings.

Qualified retirement plans: Any permitted distribution from a qualified retirement plan can be rolled over except:[3]

[1] Distributions from qualified plans are penalty free for those age 55 or older who leave employment. IRA distributions are penalty free after age 59.5, regardless of employment.
[2] §408(d).
[3] §402(c).

- Required minimum distributions,
- Loans treated as a distribution,
- Hardship distributions,
- Distributions of excess contributions and related earnings,
- Substantially equal periodic payments,
- Withdrawals electing out of automatic contribution arrangements,
- Distributions to pay for accident, health or life insurance,
- Dividends on employer securities, or
- S corporation allocations treated as deemed distributions.

Of course, to get a distribution from a retirement plan, the plan's conditions for a distribution must be met, such as termination of employment.

How do I complete a rollover?

Rollovers must be completed properly to avoid treatment as a distribution (possibly triggering tax and penalties) and contribution (possibly triggering penalties for excess contributions). There are three methods for completing a rollover:

1. Direct rollover – A plan administrator makes the distribution payment directly to another retirement plan or to an IRA. The administrator may issue a check made payable to the qualified plan or IRA custodian or trustee and not to the individual.
2. Trustee-to-trustee transfer – A plan administrator transfers funds directly to another IRA or qualified plan.
3. 60-day rollover – A plan administrator issues a check payable to the participant, who deposits the full distribution amount into an IRA or qualified plan no later than the 60th day following the day the participant received the check. The IRS may waive the 60-day rollover requirement if the deadline is missed because of certain hardships or financial institution errors.[4] Taxes are withheld from a distribution from a retirement plan, so outside funds may be required to roll over the full amount of the distribution.

When are taxes withheld?

No taxes are withheld from either direct rollovers or trustee to trustee rollovers.

An IRA distribution paid to a participant is subject to 10% withholding, even if the participant intends to roll it over later, unless the participant elects out of withholding or chooses to have a different amount withheld.

A retirement plan distribution paid to the participant pursuant to a 60-day rollover is subject to mandatory withholding of 20%, even if the participant intends to roll it over later.

If taxes are withheld and the distribution is rolled over within 60 days, other funds must be used to make up for the amount withheld or else the withheld amount will be treated as a taxable distribution.

What is the one-rollover-per-year rule?

Only one 60-day rollover from an IRA to another (or the same) IRA is permitted during any 12-month period.[5] This limit applies to all IRAs in the aggregate, so if an individual owns several IRAs (including SEP, SIMPLE, Roth) a rollover of one

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[4] See Rev. Proc. 2016-47.
[5] §408(d)(3)(B).

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IRA precludes rollovers from the individual's other IRAs during the same one-year period. The one-year period begins on the date the first IRA distribution is received. The one-per year limit does not apply to:

- rollovers from traditional IRAs to Roth IRAs (conversions),
- trustee-to-trustee transfers between IRAs, or
- rollovers to or from a qualified retirement plan.

Which retirement accounts can accept rollovers?

Most retirement plans and IRAs can accept a rollover. See the chart below for options.[6]

ROLL FROM \ ROLL TO	Roth IRA	Traditional IRA	SIMPLE IRA	SEP-IRA	Governmental 457(b)	Qualified Plan (pre-tax)	403(b) (pre-tax)	Designated Roth Account (401(k), 403(b) or 457(b))
Roth IRA	Yes	No	No	No	No	No	No	No
Traditional IRA	Yes	Yes	Yes, after 2 years	Yes	Yes	Yes	Yes	No
SIMPLE IRA	Yes, after 2 years	Yes, after 2 years	Yes	Yes, after 2 years	Yes, after 2 years	Yes, after 2 years	Yes, after 2 years	No
SEP-IRA	Yes	Yes	Yes, after 2 years	Yes	Yes	Yes	Yes	No
Governmental 457(b)	Yes	Yes	Yes, after 2 years	Yes	Yes	Yes	Yes	Yes
Qualified Plan (pre-tax)	Yes	Yes	Yes, after 2 years	Yes	Yes	Yes	Yes	Yes
403(b) (pre-tax)	Yes	Yes	Yes, after 2 years	Yes	Yes	Yes	Yes	Yes
Designated Roth Account (401(k), 403(b) or 457(b))	Yes	No	No	No	No	No	No	Yes

[6] This is based on an IRS chart, which has additional information in footnotes.

Rollovers and RMDs

A qualified plan or IRA can be rolled over even after an individual has commenced taking RMDs. If so, the RMD for the year should be distributed before the rollover, as RMDs cannot be rolled over.

If an individual converts a traditional IRA to a Roth before all RMDs are taken for the year, it is treated as if the first dollars out satisfy the RMD. Those dollars are treated as a regular taxable distribution from the traditional IRA and contribution to the Roth IRA, which may cause a penalty for excess contributions.

For purposes of calculating RMDs, the year end account balance may be adjusted to include rollovers occurring near year end.[7]

Pre-tax and after-tax money

If a qualified plan has both pre-tax and after-tax money, a rollover of all or part of the account generally carries out a pro rata share of pre- and after-tax money. The pre-tax and after-tax amounts can be allocated separately in a rollover from a qualified plan. For example, pre-tax dollars can be rolled to a traditional IRA, and post-tax dollars can be rolled to a Roth IRA. This is favorable because it allows for a tax-free conversion of after-tax money to a Roth IRA.[8]

This allocation is not available for rollovers from IRAs, because a pro rata portion of pre-tax and after-tax dollars would be rolled into each account. For example, a complete or partial rollover of pre- and after-tax money from an IRA to another traditional IRA and Roth would result in a pro rata portion of pre- and post-tax money transferred to the traditional IRA and a pro rata portion of pre- and post-tax money transferred to the Roth IRA. The pre-tax money transferred to the Roth IRA would be treated as a taxable conversion.

Transfers to foreign plans

In general, it is not permitted to rollover from a foreign retirement plan to a qualified plan or IRA in the United States or vice versa. If someone moves to a foreign country and transfers money from a U.S.-based qualified plan or IRA to a foreign retirement account (referred to as a foreign trust), it is generally treated as a taxable distribution subject to tax in the United States. There may be exceptions if the foreign trust satisfies all US qualified plan rules, or if there is a treaty between the countries that reduces the tax burden.

Designated Roth accounts

If a qualified plan has a designated Roth account (DRAC), it can be rolled over to another DRAC or a Roth IRA. Benefits of rolling from a DRAC to a Roth IRA include the following:

- the rollover is tax free,
- DRACs are subject to lifetime RMDs, while Roth IRAs are not, and

[7] §1.401(a)(9)-7.
[8] IRS Notice 2014-54.

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- Roth distributions are first treated as tax-free distributions of contributions, whereas nonqualified[9] distributions from a DRAC are partially taxable because distributions are deemed to carry out a proportionate amount of earnings.

Plan loans

If a participant takes out a loan from a qualified plan and then rolls over the qualified plan to an IRA without paying off the loan first, the amount of the loan (known as a plan loan offset) will be treated as a taxable distribution. Participants may use outside funds equal to the loan amount (plus taxes withheld) to "roll over" to the IRA by the due date of their tax return and avoid a taxable distribution.

Employer Stock and NUA

A complete rollover may not be the most tax efficient strategy if there is employer stock inside a qualified retirement plan. The difference between the price paid for the stock (its cost basis) and its current market value is called "net unrealized appreciation" (NUA). If the stock is rolled over to an IRA, the NUA will ultimately be subject to ordinary income tax upon distribution. Alternatively, if the requirements for NUA treatment are met, the stock could be distributed outright and the remaining assets could be rolled to an IRA, in which case only the cost basis is subject to ordinary income tax and the NUA will be subject to long term capital gain tax upon later sale.[10]

Divorce

As part of a divorce, an individual can transfer all or part of a qualified plan or IRA to a former spouse tax free. For qualified plans the document that specifies the transfer amount is called a qualified domestic relations order (QDRO). For IRAs, the transfer amount should be specified in the divorce decree or similar instrument. Subsequent to the divorce, distributions from the IRA are subject to normal rules regarding taxation.[11]

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[9] A nonqualified distribution is one that does not meet the following requirements: (1) it is at least 5 years from the beginning of the year in which the taxpayer first made a contribution to a DRAC in that particular plan; and (2) either (a) the owner has reached age 59 ½; (b) the owner has died, or (b) it is attributable to the owner's disability. §402A(d)(2)(A).

[10] See Net Unrealized Appreciation for more information.

[11] See Divorce and Retirement Accounts for more information.