

Tax-Free IRA Rollover Tips (and Traps)

By Peter L. Reiss

1. If you execute an IRA rollover (or a rollover from a 401(k) to an IRA) when leaving a job, arrange for a “trustee to trustee” rollover, where the assets are transferred *directly* from the first plan to the custodian or administrator of your personal rollover IRA. If you take a direct distribution and then send the proceeds to your new rollover IRA, the original administrator is *required by law* to withhold 20% of the distribution, regardless of your age, and send it to IRS. In order to do a *complete* rollover, which must be done within 60 days of the distribution, you’ll have to come up with the extra 20% to fund the new rollover IRA. If you don’t, you’ll pay tax on the 20% sent to IRS (and if you’re under 55 you will also be liable for the 10% premature withdrawal penalty) even though you will *eventually* get the 20% back (when you file your tax return for the year in which the rollover occurs).
2. If you are over 55, don’t roll over more than you need. While you’ll pay income tax on the amount you don’t roll over, you will not (if the distribution is a result of leaving a job) pay the 10% penalty tax. If you roll over the entire distribution and then find that you need some of that money, and you are under 59 ½, you will pay regular income tax *and* the 10% penalty or any amounts you then withdraw.
3. If you inherit an IRA or other retirement account from your spouse, roll the assets into *your own* IRA. By doing this and avoiding a direct distribution to yourself, you will escape some complicated tax laws that may require you to begin to take distributions (and pay income taxes on the distributions) immediately. If you roll the IRA or other retirement account into your own separate Inherited IRA, you will continue earning tax-deferred income until you begin withdrawals and you will not be *required* to begin taking distributions until you reach age 70 ½. If you inherit your spouse’s Roth IRA and roll it over into your own Roth IRA, you will not be required to take any distributions for as long as you live.