

May 28, 2009 – Rollover Mistakes

The recent collapse of the world financial markets have forced many companies into survival mode. They are cutting costs in response to falling product demand and this has led to many good people losing their employment. With many people being forced to take early retirements, this is a prudent time to review rollover blunders. Doing it wrong is incredibly expensive for the participant.

IRA's have many estate planning advantages over 401(k) plans so it is prudent to process the rollover as soon as someone is eligible. Rollovers can only occur once a year and for a rollover to occur there must be a distributable event: retirement, disability, and some plans (GM) allow in-service rollovers.

Blunders

- 1) IRS guidelines require rollovers to be completed within 60 days. The rollover must be complete by the date the new custodian receives the check not the date on the check. IRS Publication 590 states there is a procedure for waiver of the 60 day rule. The IRS will want a good sob story: death, disabled, incarceration, postal error, error by financial institution, hospitalization, etc.
- 2) IRS rule 72(t) allows IRA owners to start withdrawals prior to age 59 ½. Withdrawals must be based on one of three life expectancy calculations. Distributions must be taken until age 59 ½ or five years, whichever is longer. The distributions cannot be modified once they start. One exception: the IRS will allow the participant to change the payment – once – within the distribution timeframe to the lower of the three payment options that are calculated. The person will have to continue this new payment with no opportunity to change it. Also, there are no additions, or transfers/rollovers allowed from the IRA other than the 72(t) distributions.
- 3) Required Minimum Distributions (RMD) are required when the IRA owner turns 70 ½. The IRS wants their share of your retirement savings so they put into law an IRA owner must start taking money from their IRA when they turn 70 ½. Nothing the IRS does is ever simple; the rule states, if you are going to turn age 70 ½ in 2009, then you must take the 1st distribution in 2009 or by April 1 of the following year...in this case 2010. Failure to take the RMD and you'll owe a 50% penalty.

*Note the required minimum distribution has been suspended for the 2009 tax year for all IRA owners over age 70 ½. This is in response to the substantial losses incurred by most IRA owners... the IRS does seem to have a heart after all. Let's see if they extend this benefit to 2010 and beyond if the stock market continues to decline...and there are many headwinds facing the world economies so I would expect the market to continue to struggle for many years. It is my assessment, we will need good money management strategies in place to make much headway in our accounts for many years to come. Buy and hold is simply dead until the next secular bull market begins.

- 4) If an IRA owner dies, the spouse can take over the IRA and receive withdrawals at the life expectancy of the decedent or wait until the IRA owner would have turned 70 ½. This way the survivor can get the money sooner or delay it depending on life circumstances. The beneficiary can assume ownership of the IRA or leave it in the decedent's name. A 10% penalty will be applied if the beneficiary is under 59 ½ and the IRA is rolled over and they need to take money out. If the decedent was over age 59 ½ the money could be left in their name with no penalty to remove it even if the beneficiary is under age 59 ½.

If you or someone you know has a rollover issue and wants to avoid a costly mistake, drop me a line.

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