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IRS Provides Relief For Missing IRA Rollover Deadline, With Some Catches

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Until last month, the only way to get relief for missing the 60-day deadline on IRA rollovers was to apply to the IRS for a private letter ruling. This process required paying the IRS a fee that was recently increased to $10,000, plus the cost of a tax professional to prepare the request.

“The taxpayer had to wait until the IRS ruled on the matter months later,” said Anthony D. Criscuolo, CFP, and enrolled agent with Palisades Hudson Financial Group in Fort Lauderdale, Fla.

But the situation improved in August, after the IRS announced it would allow self-corrections. “This new rule has clearly outlined exemptions as well as a form IRS letter online, making it easier for an advisor to know if a client is eligible, and a faster, less expensive process overall for those who miss the deadline in acceptable scenarios,” said Greg Hammer, a financial advisor with Hammer Financial Group in Lake County, Indiana and Chicago.

The catch is that the hardship waiver is only allowed for one of 11 specific reasons, which include misplacing the check, depositing the funds into an account the client mistakenly believed to be an eligible retirement plan, a postal error or because of restrictions imposed by a foreign country. “If your client qualifies, the contribution of the eligible rollover must be made within 30 days after the reason that originally prevented it no longer exists,” said David Weinstock, CFP, with WeiserMazars Wealth Advisors.

Other qualifying reasons are that the taxpayer’s principal residence was severely damaged, a member of the family died, the taxpayer is seriously ill and incarceration. “If the intent is to do a tax-free transfer from one retirement plan or IRA to another, it should be done by payment directly between the two, but far too often participants receive checks payable to themselves,” said Weinstock.

Hardship waivers are based on the honor system, but the new process is not a free pass to ignore the 60-day rule. “The rollover has to be valid in the first place,” Criscuolo told Financial Advisor. “Taxpayers and advisors should bear in mind that only one IRA-to-IRA rollover is permitted within a 12-month period.”

Dishonesty never pays, especially with the IRS. “If a subsequent audit finds that your client did not meet the requirements, taxes will be due on the rollover funds and a 10 percent penalty added if the [client] is under age 59½, and then there are penalties for the excess contribution that’s been disallowed, and interest plus penalties for underpayment of all the foregoing," said Weinstock.

The option to rollover 401(k) assets into an IRA or another qualified retirement plan account occurs commonly when leaving a job. "Once you receive the rollover funds, you have 60 days in which to complete the transaction and ensure the funds get deposited into the new retirement account," Criscuolo said. "If you miss the window, the money becomes a distribution."

Once the withdrawal is deemed a distribution, the funds become subject to ordinary income taxes and early withdrawal penalties, depending on the account owner's age. "In many cases, taxpayers can avoid any headaches by simply arranging for a direct transfer from one financial institution responsible for the retirement account in question to another trustee," said Criscuolo. "If the assets never pass through the taxpayer's hands, there is less risk of missing the 60-day window."

Under the new rules, the IRA or plan receiving the rollover will process the funds as tax free so long as the contribution is eligible for a rollover and the account owner didn't know that he or she did not meet the requirements.

"The retirement account custodian must report the letter to the IRS, and the IRS can also require proof the taxpayer qualified if he or she is audited," said Criscuolo.

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