



WRMarketplace

An AALU Washington Report

Thursday, April 10 2014

WRM# 14-14

The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

TOPIC: Court and IRS Limit Short-Term Access to IRA Funds Through Rollovers.

MARKET TREND: Despite explicit prohibitions on taking loans from IRAs, some IRA holders have used rules applicable to tax-free rollovers to effectively “borrow” amounts held in their IRAs for short periods – generally, up to 60 days. A recent Tax Court decision and follow-on guidance from the IRS, however, will now limit this method of access to IRA funds.

SYNOPSIS: In *Bobrow v. Commissioner*, the Tax Court recently concluded that the rollover treatment that allows taxpayers to take money out of, and repay money to, IRAs on a tax-free basis is limited to one rollover per 12-month period per taxpayer, regardless of the number of IRAs held by the taxpayer. This ruling differs significantly from the previous IRS position, which applied the tax-free rollover rules on an IRA-by-IRA basis. After the Tax Court's decision, however, the IRS issued Announcement 2014-15, indicating that it now will follow *Bobrow's* interpretation of the IRA rollover rules.

TAKE AWAY: The *Bobrow* decision and the IRS's revised position have significantly restricted an IRA holder's ability to access his or her IRA funds on a short-term, tax-free basis. This, combined with the recent proposal to eliminate “stretch” IRAs found in both the draft “Tax Reform Act of 2014” and the President's FY2015 Budget (see discussion in *WRMarketplace* #14-10), evidence that additional changes to the tax treatment of IRAs may be possible. Regardless, these savings vehicles currently remain important and popular tools for retirement planning. Thus, clients maintaining IRAs (and their advisors) must be aware of the IRS's change in position to avoid inadvertent violations of the rollover rules, which could cause unexpected current taxation of amounts purportedly rolled over after December 31, 2014.

MAJOR REFERENCES: [*Bobrow v. Commissioner, T.C. Memo. 2013-21 \(2014\)*](#); [*Internal Revenue Service Announcement 2014-15*](#).

Some individuals are reluctant to save for retirement in tax-favored vehicles, such as tax-qualified 401(k) plans and individual retirement accounts (“IRAs”), because of their limited ability to access the funds, if needed, before retirement. While 401(k) plans partially address this concern by allowing participants to take loans from their plan accounts, the Internal Revenue

Code (“**Code**”) specifically prohibits IRA holders from borrowing from their IRAs or pledging them as collateral for a loan. Doing so can disqualify the entire IRA and subject the IRA holder to immediate taxation on the IRA balance, plus penalty taxes.

Despite these prohibitions, the rules governing IRA rollovers effectively allow IRA holders to “borrow” from their IRAs on a fairly short-term basis. Under the Code, as a form of rollover, an IRA holder can take a distribution from an IRA and repay that amount within 60 days of withdrawal without immediate tax consequences. Until recently, individuals and/or married couples who maintained multiple IRAs could extend the 60-day period through a series of rollovers – *i.e.*, by taking a distribution from IRA #1, taking the same distribution from IRA #2 and timely repaying IRA #1, taking the same distribution from IRA#3 and timely repaying IRA #2, etc. The IRA holders could continue the series of rollovers for as long as the number of their IRAs permitted.

As described below, however, the recent Tax Court decision in *Bobrow v. Commissioner* and follow-on guidance from the IRS **now limit the ability of IRA holders to implement these short-term rollovers to one time per year per taxpayer**, regardless of how many IRAs the taxpayer owns. Because this approach reflects a departure from the IRS’s previous position, ***the limitation will apply only for IRA distributions made on or after January 1, 2015.***

IRA RULES

Internal Revenue Code § 408 governs IRAs. Under Internal Revenue Code §408(d)(3), an IRA distribution will not be included in the recipient’s gross income to the extent the amount is paid into an IRA for the benefit of that recipient no later than 60 days after the distribution. The Code section restricts this special rollover tax treatment to individuals who had not otherwise received a rollover distribution during that same one-year period.

While the statutory language is somewhat ambiguous, in Proposed Regulation § 1.408-4(b)(4)(ii) (“**Proposed Regulation**”) and IRS Publication 590 (“*Individual Retirement Arrangements*” or “*IRAs*”), (“**Publication 590**”), the IRS had interpreted the rule to apply on an IRA-by-IRA basis, as follows:

Proposed Regulation: [The tax-free treatment of rollovers] does not apply to any amount received by an individual from an individual retirement account, individual retirement annuity or retirement bond if at any time during the 1-year period ending on the day of receipt, the individual received any other amount from the individual retirement account, individual retirement annuity or retirement bond which was not includible in his gross income because of the application of paragraph (b)(1) of this section. This rule applies to each separate individual retirement account, individual retirement annuity or retirement bond maintained by an individual. ***Thus, if an individual maintains two individual retirement accounts, IRA-1 and IRA-2, and rolls over the assets of IRA-1 into IRA-3, he is not precluded by this subdivision from making a tax-free rollover from IRA-2 to IRA-3 or any other IRA within one year after the rollover from IRA-1 to IRA-3.***

Publication 590: Generally, if you make a tax-free rollover of any part of a distribution from a traditional IRA, you cannot, within a 1-year period, make a tax-free rollover of any later distribution from that same IRA. You also cannot make a tax-free rollover of any amount distributed, within the same 1-year period, from the IRA into which you made the tax-free rollover.

BOBROW v. COMMISSIONER

Notwithstanding the Proposed Regulation and Publication 590, the recent *Bobrow* case arose out of the IRS's denial of tax-free rollover treatment to a husband and wife who took distributions from, and timely repaid them to, several IRAs during the course of a one-year period. Essentially, the IRS took the position that the one-year limit under Internal Revenue Code § 408(d)(3) applied to **all** IRAs held by a taxpayer and not on an IRA-by-IRA basis.

The Tax Court agreed with the IRS, stating flatly that if Congress had intended to allow individuals to take nontaxable distributions from multiple IRAs during a year, it would have worded Internal Revenue Code § 408(d)(3) differently (in what way different, however, the Court did not say.) The Court also stated that its conclusion was “confirmed by the legislative history, which also refers to the limitation as a general limitation that applies across all of a taxpayer’s retirement accounts.”

IRS ANNOUNCEMENT 2014-15

Interestingly, the *Bobrow* decision did not discuss the Proposed Regulation or Publication 590, creating a possible conflict between those pieces of guidance and the text of the opinion. In addition, the Tax Court raised the issue of possible retroactive application of its holding, which could have a significant impact on many IRA holders.

The IRS, however, recently clarified these issues in Announcement 2014-15, which indicates that it will follow the *Bobrow* decision. Accordingly, the IRS intends to withdraw the Proposed Regulation and to revise the language of Publication 590.

However, as the IRS recognized that procedures and forms related to IRA administration and rollovers also must be revised to reflect these changes, ***it will not apply the Bobrow holding to any rollover that involves an IRA distribution occurring before January 1, 2015.***

TAKE AWAY

- The *Bobrow* decision and the IRS's revised position have significantly restricted an IRA holder's ability to access his or her IRA funds on a short-term, tax-free basis.
- This, combined with the recent proposal to eliminate “stretch” IRAs found in both the draft “Tax Reform Act of 2014” and the President’s FY2015 Budget (see discussion in *WRMarketplace* #14-10), evidence that additional changes to the tax treatment of IRAs may be possible.
- Regardless, these savings vehicles currently remain important and popular tools for retirement planning.
- Thus, clients maintaining IRAs and their advisors must be aware of the IRS's change in position to avoid inadvertent violations of the rollover rules, which could cause unexpected current taxation of the amounts purportedly rolled over after December 31, 2014.

DISCLAIMER

In order to comply with requirements imposed by the IRS which may apply to the Washington Report as distributed or as re-circulated by our members, please be advised of the following:

THE ABOVE ADVICE WAS NOT INTENDED OR WRITTEN TO BE USED, AND IT CANNOT BE USED, BY YOU FOR THE PURPOSES OF AVOIDING ANY PENALTY THAT MAY BE IMPOSED BY THE INTERNAL REVENUE SERVICE.

In the event that this Washington Report is also considered to be a “marketed opinion” within the meaning of the IRS guidance, then, as required by the IRS, please be further advised of the following:

THE ABOVE ADVICE WAS NOT WRITTEN TO SUPPORT THE PROMOTIONS OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED BY THE WRITTEN ADVICE, AND, BASED ON THE PARTICULAR CIRCUMSTANCES, YOU SHOULD SEEK ADVICE FROM AN INDEPENDENT TAX ADVISOR.

The AALU *WRNewswire* and *WRMarketplace* are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members—the nation’s most advanced life insurance professionals.

WRM #14-14 was written by Greenberg Traurig, LLP

Jonathan M. Forster

Martin Kalb

Richard A. Sirius

Steven B. Lapidus

Rebecca Manicone

Counsel Emeritus

Gerald H. Sherman 1932-2012

Stuart Lewis 1945-2012