IRA Rollover as a Qualified Plan Conduit

Retirement
IRA

When an employee leaves a job or a qualified plan is terminated, a special IRA – called a rollover or conduit IRA - can be used to hold a qualified plan distribution until it is either transferred into a new qualified retirement plan or is later distributed to the employee.[1] Tax-sheltered annuity and IRC Sec. 457 governmental plan distributions may also be transferred to an IRA rollover.

If the distribution is transferred to an IRA rollover[2] (or another qualified plan) in a direct rollover, no income tax is withheld and the employee avoids current income tax on the distribution.

If the distribution is first paid to the employee before being rolled over (it must be rolled over within 60 days) the plan administrator will withhold 20% of the distribution. In order to roll over the entire distribution and avoid current taxation (and a possible 10% penalty tax on the 20% of the distribution that was withheld), the employee will have to make up the 20% withholding from his or her separate funds.

Distributions from a traditional IRA, Roth IRA, or SIMPLE IRA are not subject to the mandatory 20% tax withholding. However, if the distribution is not rolled to a plan of the same kind within 60 days, the entire distribution is generally taxable.[3]

Two Options

A qualified plan participant has two options when leaving a job:

- Participant may retain funds in an IRA until age 70½ and then begin distributions.
- Participant may roll the funds over from the conduit IRA into another qualified plan (if permitted). This will requalify the funds for 10-year[4] averaging as long as no regular IRA contributions have been made to the conduit IRA.

[1] Based on federal law. State or local law may differ.

[2] The IRA referred to here is a traditional IRA, not a Roth IRA.

[3] If a SIMPLE IRA is rolled to any other type of IRA within two years of the SIMPLE IRA being established, a 25% penalty tax is assessed.

[4] Those born before 1936 may be able to elect 10-year income averaging or capital gain treatment; these strategies are not available to those born after 1935.

Other Considerations

- Partial distributions can also qualify as eligible rollover distributions and can be tax deferred.
- Both deductible and nondeductible employee contributions may be rolled to the IRA.
- Noncash assets which are distributed can be sold and the cash proceeds transferred to the rollover IRA without realizing a current tax on any gain.
- Amounts received but not rolled over are generally included in gross income in the year received. If the employee is under age 59½ when the funds are distributed, an additional 10% income tax penalty may apply, unless one of the exceptions in IRC Sec. 72(t) applies. Amounts withheld and remitted as tax withholding are considered to be amounts received.
- Following the decision of the U.S. Tax Court in *Bobrow v. Commissioner*, T.C. Memo. 2014-21, beginning January 1, 2015, the IRS intends to apply the IRC Sec. 408(d)(3)(B) one-rollover-per year limitation for IRAs on an *aggregate* basis, regardless of the number of separate IRA accounts that an individual may hold. Under prior IRS guidance, the one-rollover-per-year limitation applied on a *per-account* basis.
- The IRA conduit rollover should be distinguished from a direct trustee to trustee transfer. In a direct transfer, the funds are transferred directly from one plan to another without going through a conduit rollover or being distributed to the participant.
- Federal bankruptcy law provides significant protection from creditors to participant accounts or accrued benefits in tax-exempt retirement plans. Generally, assets in IRA accounts are protected for amounts up to $1,245,475.[1] However, funds rolled over from qualified plans are protected without limit.

[1] Effective April 1, 2013. The limit is indexed for inflation every three years.