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If you have questions, please contact your regular Groom attorney or any of the attorneys listed below:

Elizabeth T. Dold
edold@groom.com
(202) 861-5406

David N. Levine
dlevine@groom.com
(202) 861-5436

Louis T. Mazawey
lmazawey@groom.com
(202) 861-6608

David W. Powell
dpowell@groom.com
(202) 861-6600

Kara M. Soderstrom
ksoderstrom@groom.com
(202) 861-0177

Tax Court Takes Restrictive View of One-Year Limitation for Indirect IRA Rollovers

The Tax Court in Bobrow v. Comm'r, recently held that the once-a-year limitation rule under Section 408(d)(3)(B) of the Internal Revenue Code of 1986, as amended (the "Code"), applies to all IRAs maintained by a taxpayer. T.C. Memo 2014-21 (Jan. 28, 2014). As more fully described below, this is in sharp contrast with the long-standing proposed regulations (issued in 1981), and IRS Publication 590, that both apply the once-a-year limitation to each separate IRA.

The Case

The taxpayer, a tax attorney, asserts that he made three tax-free indirect rollovers:

(1) April 14, 2008 distribution from his traditional IRA (IRA-1) that was returned to the same IRA (IRA-1) on June 10, 2008,

(2) June 6, 2008 distribution from his rollover IRA (IRA-2) that was returned to the same IRA (IRA-2) on Aug. 4, 2004, and

(3) July 31, 2008 distribution from his wife's IRA (IRA-3) that was directed to be returned to the same IRA (IRA-3), but was not in fact returned by the 60-day deadline (and for which he requested a waiver of the 60-day requirement).

The IRS took the position that, following Martin v. Comm'r (where the Tax Court held, and the Fifth Circuit summarily affirmed, that multiple distributions from the same IRA that received a tax-free rollover within a year were not eligible for indirect rollover treatment), the distribution from IRA-2 was timely rolled to IRA-1, but the distribution from IRA-1 violated the 1-year rule (as it was repaid to IRA-2 within 12 months of the tax-free rollover distribution from IRA-2).

The Tax Court simply held that the first distribution on April 14, 2008 was a tax-free indirect rollover, but as the second distribution was made within a year of the first, it was a taxable distribution (as was the third distribution that was not even repaid within the 60-day period). Notably, the court did not consider the "guidance" discussed below.

IRS "Guidance"

Proposed Treasury Regulation section 1.408-4(b)(4) expressly provides that:

> This rule [the one-year limitation] 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.

While the current status of this proposed rule is rather murky, IRS Publication 590 has historically provided that "[t]his rule applies separately to each IRA you own." The current language, set forth below, makes this clear:

> **Waiting period between rollovers.** 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.
>
> The 1-year period begins on the date you receive the IRA distribution, not on the date you roll it over into an IRA.
>
> ***Example.*** You have two traditional IRAs, IRA-1 and IRA-2. You make a tax-free rollover of a distribution from IRA-1 into a new traditional IRA (IRA-3). You cannot, within 1 year of the distribution from IRA-1, make a tax-free rollover of any distribution from either IRA-1 or IRA-3 into another traditional IRA. However, the rollover from IRA-1 into IRA-3 does not prevent you from making a tax-free rollover from IRA-2 into any other traditional IRA. This is because you have not, within the last year, rolled over, tax free, any distribution from IRA-2 or made a tax-free rollover into IRA-2.

The court did not consider any of the above "guidance" – nor did it review the private letter rulings in this area that similarly support a per IRA interpretation. Instead, it focused on the plain language of the statute and the broad legislative history intended to limit repeated shifting of nontaxable income in and out of retirement accounts.

What's Next?

The court's more restrictive reading of the statute, if adopted by the IRS, will mandate changes in the processing of indirect IRA rollovers (and related excess contributions), which will take time to implement. We are hopeful that the IRS will clarify its position soon. And if a change is made, we would encourage the IRS to make the change prospective in nature – granting sufficient time for the IRA industry to update its procedures to reflect the more restrictive approach. Stay tuned!