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THE SPECIALIST

ANSWERS TO TOUGH QUESTIONS ABOUT TAXES AND INVESTING

IRA Rollovers: Tax Court Decides Once Is Enough

By Ed Slott, CPA

A 2014 U.S. Tax Court ruling caught IRA owners and experts by surprise. In the case of *Bobrow v. Commissioner*, the court's new interpretation of a key rule contradicted the position that the IRS has long taken — and that was clearly stated in Publication 590 and certain private-letter rulings.[1]

With a rollover, an investor can move money from one IRA to another without losing the tax-deferred status of the funds or incurring the 10% federal income tax penalty for early withdrawals. To keep the rollover from becoming a taxable distribution, the money must be deposited into another IRA within 60 days. However, the investor cannot take advantage of another 60-day rollover for 365 days (with certain exceptions).

A simple way to avoid a costly mistake and keep your retirement savings intact is to use trustee-to-trustee transfers when moving funds between any of your IRAs.

IRA owners should be aware that the tax court ruling has resulted in a significant change in how the IRS plans to implement the "once per year" rule going forward.

New Read on Old Rule

In the past, the rule was applied separately to each IRA, so a person with multiple IRAs might be allowed more than one rollover in a 12-month period. Now the IRS has announced that it will follow the court's decision and apply the rule on an aggregate basis. As of January 2015, a taxpayer can perform only one tax-free rollover each year, regardless of how many IRAs are owned. The clock starts ticking on the day the IRA distribution is received.

Each additional rollover would be considered a taxable distribution, which is subject to ordinary income taxes plus the 10% early-withdrawal penalty for those younger than 59½. And when an IRA owner contributes more than allowed by law in a given year, whether by exceeding the contribution limit or making more

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If you have any questions about the topics in this newsletter or about your financial future, call us. We are available to help.

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File and Suspend: A Flexible Social Security Strategy

The Social Security system may seem complex, but understanding your claiming options could help increase your benefits. One strategy to consider is "file and suspend" (sometimes referred to as "voluntary suspension").

The basic concept is to file for benefits at full retirement age (66 to 67, depending on year of birth) and immediately suspend benefits before receiving any payments. This allows your spouse to be eligible for spousal benefits; meanwhile, you earn delayed retirement credits (up to age 70), which increases your future benefit. It also provides flexibility for retroactive benefits regardless of marital status.

Options for Married Couples

The following hypothetical examples are used for illustrative purposes only and assume a full retirement age of 66 for both spouses. Actual benefit amounts and results will vary.

Jeff is eligible for a $2,000 monthly Social Security benefit at age 66 but wants to continue working until age 70. His wife, Meg, is eligible for a $700 benefit at age 66 based on her own earnings. If Jeff files and suspends his benefits upon reaching full retirement age, Meg would be eligible for a $1,000 spousal benefit at age 66 (50% of Jeff's full retirement benefit). Jeff could continue accruing delayed retirement credits, increasing his benefit at an 8% annual rate, and at age 70 his monthly benefit could reach $2,640. (See chart for benefit percentages.)

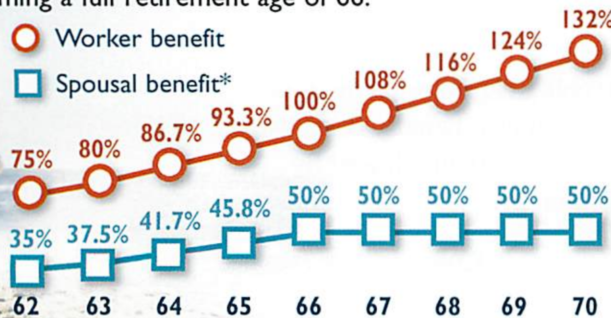
If Meg is younger than Jeff, she could claim a spousal benefit as early as age 62 (assuming Jeff has filed and suspended his benefits). However, her spousal benefit would be permanently reduced. For example, at age 62 her spousal benefit would be only $700 (35% of Jeff's full benefit).

Todd and Jill both want to continue working past full retirement age to earn their maximum benefits. If Todd files and suspends at age 66, Jill can file a restricted application for a spousal benefit at age 66, and both can continue working and earning delayed retirement credits, up to age 70.

Of course, the roles could be reversed in all these examples. However, the spouse who files and suspends cannot later apply for spousal benefits.

Should You Wait for Higher Benefits?

This chart shows the percentage of the full retirement benefit someone would receive at various filing ages, assuming a full retirement age of 66.



*The percentages for the spousal benefit are based on the primary worker's full benefit amount.
Source: Social Security Administration, 2014

Retroactive Benefits

Under standard filing rules, an individual who files for Social Security after reaching full retirement age can request a lump-sum payment for up to six months of retroactive benefits. For example, if you file at age 66½, you could request a lump sum equal to the benefits you would have received had you filed at age 66; if you filed at 67, the payments would go back to 66½. Future benefits would be based on the lower monthly benefit that would have been set at the earlier date.

If you file and suspend benefits and later request to reinstate them, you could request a lump-sum payment equal to the benefits you would have received since the time you filed. For example, if you filed and suspended at age 66, you could receive two years of retroactive payments at age 68. This might be helpful for someone who faces a change in health or other situation that makes it more important to claim a lump sum than to receive higher monthly benefits going forward.

Medicare and HSAs

When considering the file and suspend strategy, you should be aware that the act of filing — even if immediately suspending benefits — triggers automatic enrollment in Medicare Part A. Because Part A hospital insurance is premium-free for most people, this may not be an issue. However, if you have a high-deductible health plan with a health savings account (HSA), you can no longer contribute to the HSA once you sign up for Medicare.

Social Security decisions can have a lasting impact on your financial situation, so you may want to seek professional guidance before taking action.

Source: Social Security Administration, 2014

Guarding Against Fraud

In a survey of American adults aged 40 and older, 84% revealed that they had been solicited to participate in a potentially fraudulent offer, and 11% had lost money after engaging in such an offer.[1]

The root of this problem — besides the endless efforts of criminals — seems to be naiveté and unwarranted trust on the part of those who are deceived. A large percentage of respondents were unable to spot fraudulent sales pitches and found the unrealistic promises appealing. Although people of any age can be victims of fraud, criminals are more likely to target those who are 65 and older; this age group is also more likely to lose money when they are targeted.[2]

Fraud is complex, and a list of fraudulent schemes could fill many pages. Here are three basic principles to keep in mind.

If an investment sounds too good to be true, it probably is. Investing is a long-term process that requires research, patience, and rational decision making. Investments with the potential for higher rates of return typically have a higher degree of risk and the potential for loss of principal.

Never send money based on the promise of getting money. This type of scam may take many forms. Common examples include: (1) an email or letter promising a large amount of money in return for a small up-front fee; and (2) an authentic-looking check that you are asked to deposit in your account, keep a percentage as a fee, and wire the balance to an address. Even if your bank initially credits your account, you could be liable for the money if the check is found to be fraudulent.

Just because it looks official doesn't mean it is. You might receive a letter, email, or phone call that appears to be from the IRS or a federal, state, or local government agency, either demanding a payment or seeking personal information. You might even be directed to an official-looking website. If you have any doubt, contact the agency directly. Never provide personal information until you're satisfied that you're dealing with a legitimate agency that needs the information.

Regardless of how a fraudulent scheme is presented, your best defense may be a good dose of skepticism and common sense.

1–2) FINRA Investor Education Foundation, 2013

IRA Rollovers (Continued from page 1)

than one 60-day rollover, a 6% excise tax penalty is assessed for each year the excess contribution remains in the account.

Take Hands-Off Approach

The updated guidelines are meant to keep IRA owners from repeatedly using rollovers to give themselves short-term loans — taking withdrawals and using the money as they wish, then returning it to a different IRA within 60 days.

A simple way to avoid a costly mistake and keep your retirement savings intact is to use trustee-to-trustee transfers when moving funds between any of your IRAs. A trustee-to-trustee transfer (sometimes called a direct rollover) is when money is sent from one IRA directly to another, so the funds never touch the owner's hands. There is no limit on the number of direct transfers that can be made because they aren't considered distributions or rollover contributions.

It may also be helpful to know that the once-per-year rule does not apply to rollovers made from or to an employer-sponsored retirement plan such as a 401(k), or to conversions of traditional IRAs to Roth IRAs. However, it does apply to Roth-to-Roth 60-day rollovers.

1) *InvestmentNews*, March 16, 2014

Ed Slott is a professional speaker and the creator of several public television specials, including "Ed Slott's Retirement Rescue!" He is the author of *The Retirement Savings Time Bomb...And How to Defuse It* and many other books about IRA planning.

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Rules for Inherited IRAs

In a June 2014 decision, the U.S. Supreme Court ruled that inherited IRAs are not considered protected retirement assets under federal law. This means these assets won't be protected from creditors in the event of bankruptcy. (The court did not address IRAs inherited by spouses.) Though this decision is unlikely to affect a large number of people, it reinforces the importance of understanding IRA rules, whether you inherit assets or bequeath them to your heirs.

Managing Taxes and Distributions

An individual who inherits a traditional IRA can take all or part of the funds as taxable distributions, or stretch out withdrawals by taking annual required minimum distributions (RMDs), which are also taxed as ordinary income. The rules on RMDs depend on the beneficiary's relationship to the original owner; minimum distributions are generally based on the beneficiary's life expectancy.

A **surviving spouse** who is the sole beneficiary can retitle the IRA in his or her own name or roll the assets into an IRA (in the survivor's name). As a result, it's possible that the IRA may not be considered an "inherited IRA" and the assets may be protected in bankruptcy. RMDs would not have to start until age 70½; however, distributions prior to age 59½ could be subject to a 10% early-withdrawal penalty. Spousal beneficiaries who don't retitle the IRA in their own names must start taking RMDs for the year in which the original owner would have turned 70½.

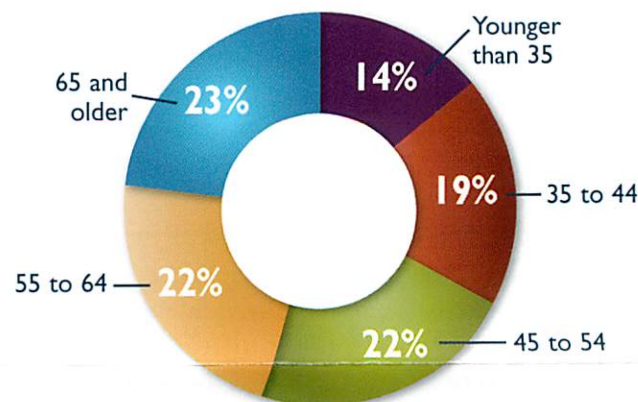
A **nonspouse beneficiary** who doesn't cash out should properly retitle the account as an inherited IRA — such as "Joe Smith (deceased) for the benefit of Mary Smith (beneficiary)." Inherited IRAs are not subject to early-withdrawal penalties, but they are subject to RMDs, which must begin no later than December 31 of the year after the original owner's death. However, if the original owner died after age 70½ and failed to take an RMD in the year of death, the beneficiary must take it by December 31 of that year. Any annual required minimum distributions not taken are subject to a 50% tax penalty.

If you foresee leaving an IRA to someone who is not your spouse and are concerned about creditor protection, you could name a "spendthrift trust" as the IRA beneficiary. This type of trust limits access to the trust principal.

The use of trusts involves complex tax rules as well as additional costs. Be sure to consult a qualified tax and estate planning professional before implementing a trust strategy.

Accounts for All Ages

More than 46 million American households have at least one IRA. Account ownership is spread among the following age groups.



*Age group is based on age of the sole or co-decision maker for household saving and investing. Accounts include traditional, Roth, and employer-sponsored IRAs.

Source: Investment Company Institute, 2013