Relaxing the 60-Day Rollover Rules

THERE ARE TWO WAYS FOR A PERSON TO transfer funds between qualified plans and IRAs: rollover and direct rollover (i.e., direct transfer). Rollovers and direct transfers have simple and basic rules. A rollover is one where the taxpayer takes control of the assets in the first plan and personally transfers them to the second plan. A direct transfer is one where the trustee of the first plan transfers the assets to the trustee of the second plan. In this case, the owner initiates the transfer but does not take possession of the funds as they are transferred between trustees.

Which transfer method is better? It depends. One advantage to a direct transfer is that the taxpayer is not required to report the transfer on his tax return and can do a transfer as often as the trustees will permit. Moreover, a direct transfer, unlike a rollover, has the added advantage that the trustee of the first plan is not required to withhold any taxes from the transferred assets (IRC §401(a)(31)). A rollover has the advantage that the owner or taxpayer can have use of the assets for up to 60 days following the day the funds are received. The earnings during this period are generally taxable and cannot be rolled over to the new plan or IRA. A rollover, however, can only be accomplished once every 365 days.

If a rollover is not completed by the 60th day, the funds are considered distributed and therefore included in gross income and, finally, cannot be reinvested as a rollover into an IRA or any other qualified plan. Furthermore, if the taxpayer transfers the funds into another IRA or a qualified plan after the 60-day period, the taxpayer would be making a contribution (likely an excess contribution), which is subject to the excess contribution excise tax rules unless a proper remedy is not timely done (IRC §402(c)(3)).

On the surface, the 60-day rule is straightforward and should provide more than enough time to complete the rollover transfer. Events can, and do, occur in everyday life that may interfere with the completion of the transfer in a timely manner. As a result, situations have arisen because of this rule. The IRS has maintained that they do not have the authority to waive or relax the 60-day rule, however, regardless of extenuating circumstances.

Act §644 of the Economic Growth and Tax Relief Reconciliation Act of 2001 provides the IRS with the authority to waive or relax the 60-day rollover rule under special situations.

The courts have generally upheld the IRS position, but there have been a few occasions when they have sided with the taxpayer. In those rare cases, the courts made an allowance when the transfer was not completed for reasons beyond the taxpayer's control and, more importantly, the taxpayer knew and meticulously followed the law.

In both the Wood and Childs cases (Good v. Comm., 93 T.C. 114 (1989) and Childs v. Comm. T.C. Memo 1996-267), the tax court held that the financial institution's bookkeeping errors did not preclude rollover treatment because, in substance, the taxpayer knew and followed the law and as such had satisfied the statutory requirements. Following the same logic, the court held in Orgera (TC Memo 1995-575) that a misunderstanding of the IRA rollover rules by the taxpayer does not provide a waiver or an extension.

Act §644 of the Economic Growth and Tax Relief Reconciliation Act of 2001 provides the IRS with the authority to waive or relax the 60-day rollover rule under special situations. That is, the secretary is permitted to waive the 60-day rule when the failure to waive would be against equity or good conscience (e.g., casualty, disaster, or other events beyond the reasonable control of the individual).

Although the legislation provides the IRS with the authority, the legislation is vague. Fortunately, the conference committee report provided some additional insight as to the intent of the tax provision. The committee stated that the secretary might issue guidance that includes objective standards for a waiver of the 60-day rollover period:

- Waiving the rule due to military service in a combat zone or during a Presidentially declared disaster (both of which are provided for under present law (e.g., see IRC §7508 and §7508A)),
- For a period during which the participant has received payment in the form of a check but has not cashed the check,
- For errors committed by a financial institution, and
- In cases of inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error.

The Service responded to the legislation by providing some guidance to taxpayers for distributions that have occurred *after* December 31, 2001. Interestingly, the guidance seems to follow the court holdings. Specifically, Rev. Proc. 2003-16 (January 8, 2003) provides that the 60-day rollover requirement is *waived automatically* only if:

- The financial institution receives the funds on behalf of the taxpayer before the end of the 60-day rollover period,
- The taxpayer follows all the procedures set by the financial institution for depositing the funds into an eligible retirement plan within the 60-day period (including giving instructions to deposit the funds into an eligible retirement plan),
- The funds are not deposited into an eligible retirement plan within the 60-day rollover period solely because of an error on the part of the financial institution,
- The funds are deposited into an eligible retirement plan within one year from the beginning of the 60-day rollover period, and
- It would have been a valid rollover if the financial institution had deposited the funds as instructed.

If one of the above exceptions applies, then no private letter ruling is necessary because the 60-day time limit is automatically waived in the eyes of the IRS. These rules can be seen to provide objective standards. But they seem to be limited to errors caused by the financial institution. What happens in the more common situation where the taxpayer is unable to complete the rollover due to death, disability, hospitalization, incarceration, foreign country restrictions, or postal error?

If the taxpayer fails to satisfy the conditions set forth for the automatic waiver of the 60-day rollover provision, then the taxpayer needs to apply for a letter ruling from the Service. The procedures for requesting a private letter ruling are provided in Rev. Proc. 2003-4, 2003-1 IRB 123 (January 6, 2003), which state that the IRS will consider all relevant facts and circumstances in determining whether to grant a waiver, including:

- Whether errors were made by the financial institution (other than those for an automatic waiver, as described above);
- Whether the taxpayer was unable to complete the rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error;
- Whether the taxpayer used the amount distributed (e.g., was the check cashed by the taxpayer); and
- How much time has passed since the date of distribution.

A special fee of $90 is set when applying for a waiver to the 60-day rollover rule (Rev. Proc. 2003-8, 2003-1 IRB 236 (January 6, 2002)).

In conclusion, the Service provides two forms of relief to the 60-day rollover provision. The first is an automatic waiver, which generally is limited to errors caused by the financial institution. The second is a letter ruling requesting relief, which generally applies to situations where the taxpayer is unable to complete the rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error. The former situation does not require a letter ruling, but the latter situation does require the taxpayer to seek a letter ruling. ■

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