DIRECT TRANSFERS, DIRECT ROLLOVERS, AND 60-DAY ROLLOVERS

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When moving retirement money from IRA to IRA, or from a workplace retirement plan like a 401(k) to an IRA, there are essentially three methods to relocate those dollars. Two of them are similar, and the third opens all kinds of potential problems. Knowing how to properly move retirement dollars is imperative to produce the desired outcome.

Direct Transfer. A direct transfer is the recommended way to move money from one IRA to another. With a direct transfer, (also called a "trustee-to-trustee" transfer), the funds go directly from one IRA custodian to another. Note that if a check is made payable to the new custodian "for the benefit of" (FBO) the account owner, but received by the IRA owner, that will still qualify as a direct transfer.

Example: John has an IRA with Custodian X. He wants to consolidate his accounts with Custodian Z. John requests a direct transfer of his IRA from Custodian X to Custodian Z. John is a bit of a control freak and wants to make sure the transfer is completed, so he asks for the transfer check be mailed to him. Custodian X issues a check made payable to "Custodian Z FBO John, IRA." This qualifies as a direct transfer, and John hand-delivers the check to Custodian Z.

Direct transfers are not reportable to the IRS. As such, no 1099-R is created for the transaction. Additionally, if an IRA owner is subject to required minimum distributions (RMDs), the entire account, including the RMD, can be directly transferred. There is no need to take an RMD prior to a direct transfer (although it must still be taken by the normal deadline).

Direct Rollover. When retirement dollars move from a work plan like a 401(k) to an IRA, the best option is the direct rollover. (A “direct transfer” is not available with a plan-to-IRA transaction.) A direct rollover is similar to a direct transfer, but with a couple of differences. Primarily, a direct rollover is reportable to the IRS and will generate a 1099-R showing the distribution. When the direct rollover is received by the IRA custodian, the custodian will produce a 5498 confirming the rollover and eliminating any possible taxes due. In addition, if the plan participant is subject to RMDs, the RMD must be taken before the remaining funds are directly rolled over.

Direct rollovers also avoid mandatory 20% withholding if plan dollars were paid directly to a plan participant. Note that there is no mandatory withholding on IRA-to-IRA transactions.

60-Day Rollover. When an IRA owner or plan participant takes a distribution that is paid directly to him, he has 60 days to redeposit all or part of those dollars into the same or similar account. Funds can move from plan-to-IRA and from IRA-to-IRA via 60-day rollover. However, this type of transaction opens numerous opportunities for error. If the funds are not timely rolled over, they will be taxable (and subject to potential penalty). Such distributions from a plan require 20% withholding, and any RMDs included in the distribution cannot be redeposited. Also, a person is only permitted one IRA-to-IRA 60-day rollover per 365-day period. (Note that non-spouse beneficiaries cannot do a 60-day rollover with inherited accounts. Inherited IRAs and work plan assets must be moved by either direct transfer or direct rollover.)

Be sure to understand these methods before requesting any retirement account transaction.