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Tax Court Holds that One-Per-Year Limit on IRA Rollovers Applies to All of Taxpayer's IRAs

[27894]

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TO: PENSION MEMBERS No. 4-14
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 8-14
BROKER/DEALER ADVISORY COMMITTEE No. 8-14
TRANSFER AGENT ADVISORY COMMITTEE No. 9-14
OPERATIONS COMMITTEE No. 7-14 RE: TAX COURT HOLDS THAT ONE-PER-YEAR LIMIT ON IRA ROLLOVERS APPLIES TO ALL OF TAXPAYER'S IRAS

In Bobrow v. Commissioner, [1] the U.S. Tax Court ruled that the “one rollover per year” rule from Internal Revenue Code (IRC) section 408(d)(3)(B) [2] applies on an aggregated basis to all of a taxpayer’s IRAs and not to each IRA separately. As is discussed further below, this holding appears to conflict with IRS Publication 590, which applies the “one rollover per year” rule separately to each IRA the taxpayer maintains. [3] Given this apparent conflict, the Institute contacted the IRS to discuss the implications of the court’s holding and was informed that the IRS is reviewing the matter.

Background

The taxpayers, Alvan and Elisa Bobrow, maintained several IRAs. Mr. Bobrow maintained a traditional IRA and a rollover IRA and Mrs. Bobrow maintained a traditional IRA. In addition to their IRAs, Mr. and Mrs. Bobrow maintained a joint checking account and Mr. Bobrow maintained an individual checking account with the IRA provider. In 2008, the Bobrows entered into the following transactions involving their IRAs:

- On April 14, 2008, Mr. Bobrow received a $65,064 distribution from his traditional IRA.
- On June 6, 2008, Mr. Bobrow received a $65,064 distribution from his rollover IRA.
- On June 10, 2008, Mr. Bobrow transferred $65,064 from his individual checking account to his traditional IRA.
- On July 31, 2008, Mrs. Bobrow received a $65,064 distribution from her traditional IRA.
- On August 4, 2008, Mr. and Mrs. Bobrow transferred $65,064 from their joint checking account to Mr. Bobrow’s rollover IRA.

- On September 30, 2008, Mrs. Bobrow transferred $40,000 from the Bobrow's joint checking account to her traditional IRA.

The Bobrows maintained that all of the above IRA repayments were qualified repayments and therefore not includable in their gross income. With respect to the $40,000 partial repayment to Mrs. Bobrow's IRA, the Bobrows alleged that the full amount was effectively repaid within 60 days because Mrs. Bobrow requested that the IRA provider transfer $65,064 from the Bobrow's joint checking account to her IRA sometime before September 30, 2008.

The IRS maintained that the case was governed by Martin v. Commissioner. [4] In Martin, the taxpayer withdrew funds from an IRA (IRA-1) and deposited them into a second IRA (IRA-2). Within one year of the first withdrawal, the taxpayer made two separate withdrawals from IRA-2 and redeposited those funds into IRA-2. The tax court held (and the Fifth Circuit affirmed) that multiple distributions from the same IRA that received a tax-free rollover within one year were not eligible to be non-taxable rollovers because IRC section 408(d)(3)(B) limits taxpayers to one nontaxable rollover per year. Following Martin, the IRS argued that the June 6, 2008 distribution from the rollover IRA was a valid non-taxable rollover to the traditional IRA, but the April 14, 2008 distribution from the traditional IRA was taxable because repayment to the rollover IRA occurred within a year of repayment of the June 6, 2008 distribution.

The Tax Court's Holding

The tax court held that IRC section 408(d)(3)(B), previous opinions, and the legislative history [5] limit the frequency with which a taxpayer may elect to make a non-taxable rollover distribution to one per year for all of the taxpayer's IRA's. Specifically, the court found that

The plain language of section 408(d)(3)(B) limits the frequency with which a taxpayer may elect to make a nontaxable rollover contribution. By its terms, the one-year limitation laid out in section 408(d)(3)(B) is not specific to any single IRA maintained by an individual but instead applies to all IRAs maintained by a taxpayer. Section 408(d)(3)(B) speaks in general terms: An individual may not receive a nontaxable rollover from "an individual retirement account or individual retirement annuity" if that individual has already received a tax-free rollover within the past year from "an individual retirement account or an individual retirement annuity."

Accordingly, the court found that the first (April 14, 2008) distribution from Mr. Bobrow's traditional IRA was a tax-free rollover, but because the second distribution was made within a year of the first, it was a taxable distribution. With respect to Mrs. Bobrow's distribution, the court found that (1) the $40,000 transfer was made 61 days after the distribution; and (2) there was no evidence presented to illustrate that the delay in repayment was due to the IRA provider's error. Further, the court held that there was no evidence that Mrs. Bobrow satisfied the requirements for a waiver of the 60-day rule and therefore found the full amount of the distribution from her IRA includable in her gross income. The court also found that the Bobrows were liable for the 10 percent early withdrawal penalty (with respect to Mrs. Bobrow's IRA distribution, as she had not attained age 59½ at the time of the distribution) and a 20 percent penalty for substantially understating their income liability.

Conflict with IRS Publication 590

The court's holding appears to conflict with IRS Publication 590, Individual Retirement Arrangements. [6] Publication 590, which was most recently updated on January 5, 2014, states as follows:

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.

Based on the court's opinion, it does not appear that the Bobrows made reference to or asserted reliance on Publication 590. [7]

We will continue to update you on the status of this matter, and any related future IRS guidance issued as a result of the Bobrow opinion.

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endnotes

[1] A copy of the opinion is available here: http://www.ustaxcourt.gov/InOpHistoric/BobrowMemo.Nega.TCM.WPD.pdf.

[2] Generally, IRC Section 408(d)(1) provides that any amount distributed from an IRA is includable in gross income by the distributee. However, IRC section 408(d)(3)(A) allows a payee or distributee of an IRA distribution to exclude from gross income any amount paid or distributed from an IRA if the entire amount is rolled over into a qualifying IRA or eligible retirement plan not later than 60 days after the date of the distribution. IRC Section 408(d)(3)(B) limits a taxpayer from performing more than one nontaxable rollover in a one-year period.

[3] The court's holding also conflicts with proposed Treasury Regulation section 1.408-4(b)(4), which was issued as a proposal in 1981 but never finalized, which provides that the one-year limitation applies to each separate IRA maintained by an individual. See

also Private Letter Ruling 8731041 (May 6, 1987).

[4] T.C. Memo 1992-331, aff’d 987 F.2d 770 (5th Cir. 1993).

[5] Based on the legislative history, the court concluded that Congress enacted the 408(d)(3)(A) exemption as a way of providing employees with some measure of flexibility with regard to their retirement planning and Congress added the limitation contained in section 408(d)(3)(B) as a way to ensure that taxpayers did not repeatedly shift nontaxable income in and out of retirement accounts.

[6] IRS Publication 590 is available here: http://www.irs.gov/pub/irs-pdf/p590.pdf.

[7] In this respect, IRS publications are intended to explain the law in plain language for taxpayers and their advisors, and, according to the IRS, neither are they binding on the Service, nor should they be cited to sustain a position. See section 4.10.7.2.8 of the Internal Revenue Manual, available here: http://www.irs.gov/irm/part4/irm_04-010-007.html.