Our First Subscriber!

This is the 100th issue of our newsletter, but it began with a single subscriber. So who was our first subscriber? It was Trow Trowbridge, president of Dominion Wealth Management, Inc. Reston, Virginia. In fact, he subscribed even before there was an *"Ed Slott's IRA Advisor"*.

"Back in the 1990s," recalls Trow, "the IRA rules were much more complicated than they are now. If you made the wrong choice, your beneficiaries could be hamstrung. Once Mom or Dad made that irrevocable decision at age 70½, the stretchout opportunities were severely curtailed. The tax implications for beneficiaries of large IRAs were horrendous. Our firm works with affluent individuals and I wanted the edge that would come from knowing how to handle large IRAs for my clients and their heirs."

"I called Ed and found out that he was thinking of doing a newsletter. I sent him a check (for $49) and told him that he'd have to put out a newsletter, now that he had a paid subscriber." Trow was right. Now I had this $49 check so I had to put out something and I published the first issue of *"Ed Slott's IRA Advisor"*. Once I saw how much would have to go into each issue, I realized that I just gave Trow the deal of the century and immediately increased the annual subscription price.

Our First Subscriber!

Trow Trowbridge, President of Dominion Wealth Management, Inc.

Eight-plus years later, Trow is still a paid subscriber. "Even though I was the first, I still pay the higher rate, and it's worth it", he notes. "I keep all the issues archived in PDF format so I can refer to them, when necessary."

Although the IRA rules have been simplified, account owners and advisors can't assume they're universally understood. The rules are still among the most complicated in the tax code and continue to baffle advisors and consumers who make key decisions based on their understanding of the complex provisions. "You still have to know more than the custodian," Trow says, "if you're going to advise clients. Ed's newsletter, with all the expert commentary, gives me the confidence I need."

There has been a personal payoff for Trow, too. Based on a strategy endorsed in several issues of the newsletter, Trow's mother had created a Roth IRA, naming her sons as beneficiaries. The ultimate goal was to provide for her grandchildren's education funding.

"When my mother died in 2004," says Trow, "the custodian of her Roth IRA told the beneficiaries that we didn't have to take to take minimum required distributions." Trow knew from the newsletter and other research that distributions aren't required from a Roth IRA during the account owner's lifetime but that's not the case for an inherited Roth IRA. "I was right," he says. "We took the required distributions and avoided a penalty."

What's more, due to the advance planning, Trow and his brothers easily divided all the inherited IRAs. Because the brothers' ages are spread by eleven years, each now has his own account and, as per the IRS guidelines, distributions can be stretched out over each beneficiary's life expectancy for maximum tax deferral. "The newsletter gives me the comfort that the advice I'm giving to clients is based on the truth" says Trowbridge. "Clients value this kind of guidance."

So that is the E! True Hollywood story of how *"Ed Slott's IRA Advisor"* began and I thank Trow and the thousands of other financial advisors, attorneys, CPAs and other professional advisors who, over time, followed his lead by subscribing and providing top notch retirement distribution advice to their clients. ■

Rollover Relief Denied in Recent IRS Rulings

Even though there are now hundreds of IRS Private Letter Rulings (PLRs) in addition to numerous articles and warnings, botched rollovers are still a major problem. When you withdraw funds from a plan or IRA, you have only 60 days from the date you received the funds to transfer them back to a plan or IRA, otherwise the distribution will be subject to tax and, if you are under age 59½, a 10% penalty on the taxable amount if no exceptions apply.

Of course the best way to avoid the rollover problem is not to do a rollover and move retirement money by using trustee-to-trustee transfers, or what the tax law calls "direct rollovers," where the funds are transferred directly from one plan or IRA to another without you touching the money in between. This way you cannot get into any trouble because the funds never leave the plan or IRA.

If you must do rollovers, then make sure the funds go back to another plan or IRA within the required 60 days. In cases where the funds are not transferred to another plan or IRA within 60 days, relief may be available by requesting a PLR from IRS, but that is now very expensive. IRS PLR fees can be as high as $3,000 plus professional fees and even then, there is no guarantee that IRS will rule in your favor.

To receive a favorable ruling allowing you more time to complete the rollover (beyond the 60 days), you will have to show that you truly intended to do a rollover and the delay was due to either errors made by your advisors

ED SLOTT'S IRA ADVISOR

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April 2006

Tax & Estate Planning For Your Retirement Savings

"When I was young, I used to think that money was the most important thing in life; now that I am old, I know it is."
-Oscar Wilde (1854-1900) playwright and novelist

This is our 100th issue!

"Ed. How are you going to write eight pages a month just on how to take money out of an IRA?" That's what almost everyone asked me when I came up with the idea of a monthly newsletter dedicated to the distribution side of retirement planning. Now you know.

Those of you that have been reading the newsletter from the beginning, for a few years, or even for a few months now see how deep this topic really is and why we can easily fill another 100 issues with a seemingly never ending supply of IRA distribution strategies and advice, not to mention keeping you up to the minute each month on the steady flow of IRA related tax law changes, rulings and cases.

Our 100th issue is a proud milestone for us, but that is not the big story here. The real story is the exponentially increasing number of consumers who are now realizing (sometimes the hard way, through costly mistakes and advisor errors) how much of the retirement distribution planning issues that we highlight here each month applies directly to the fate of their retirement savings.

This month's feature article is also our Guest IRA Expert column. We wanted this landmark issue to feature someone equally special and of course we chose IRA expert Marvin R. Rotenberg, Director of Individual Retirement Services, Retirement Solutions Group, Bank of America in Boston, MA. Marvin was featured in our first issue as our first guest IRA expert so we thought it would be perfect to feature him once again in our 100th issue.

Marvin's article ***"Exit Strategies for Your Retirement Savings"*** is especially timely given the number of people reaching retirement or changing jobs, not to mention the rash of companies ending or freezing their retirement plans. Employees and advisors need this information and can use this article to help them make the right decisions with their accumulated retirement savings.

For more IRA information, visit our website at ***www.irahelp.com***.

Ed Slott, CPA
100 Merrick Road
Rockville Centre, NY 11570

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Guest IRA Expert

Marvin R. Rotenberg
Director of Individual Retirement Services
Retirement Solutions Group
Bank of America
Boston, MA

Exit Strategies for Your Retirement Savings

When you leave a job, you'll probably have to make several decisions about how you're going to get on with your life. Among the most important issues you'll face will be the handling of your retirement account. What should you do with the money you've accumulated in your employer's 401(k) or some other qualified plan?

Take the Money and Pay the Tax

One appealing scenario might be to simply take the money. Now you can buy that second home you've been eyeing, or join a golf club.

Usually, though, that's not a good idea. Taking a lump-sum distribution, as it's known in the tax code, means that all the money you withdraw will be subject to income tax, at ordinary rates that now reach 35%. In fact, taking a large withdrawal probably will move you into a higher tax bracket and increase your chances of paying tax at a 35% rate.

Your state, and maybe even your city, might tax this income too. What's more, if you leave your job before age 55, you'll probably owe a 10% penalty tax on top of ordinary income tax.

Perhaps most important, withdrawing all the money in your plan moves your retirement fund out of tax-deferred territory. You'll reduce your chances of accumulating substantial wealth for yourself, your spouse, and your descendants. That said, there may be times when taking a cash distribution makes sense. For example:

Financial distress. Large medical bills might be due. Paying those bills may be your top financial priority.

Heavy debt. If you owe a significant amount on credit cards, paying off the balance is a unique opportunity to effectively enjoy a return of, say, 15% (if that's the interest rate on your credit cards), risk-free.

Low tax rates. If you were born before 1936, you qualify for special tax provisions (10-year income averaging and/or capital gains treatment) that can result in a lower overall tax liability. You must withdraw your entire retirement account balance within one taxable year in order to qualify.

The 10-year income averaging option results in a distribution being taxed as if it had been received over a 10-year period. Thus, you're effectively taxed on lower amounts but at higher tax rates (those applicable to 1986). In addition, you may claim capital gains treatment on balances relating to pre-1974 plan participation. Such gains will be taxed at 20%, not the current 15% rate on long-term gains.

In order to qualify for the special 10-year income averaging and the capital gains treatment, the employee must have actively participated in the plan at least 5 taxable years before the year in which the distribution is made. This 5-year participation rule does not apply to payments made to beneficiaries on account of the participant's death.

The bottom line? If you qualify for these tax breaks, pulling out cash might be enticing if you have a small balance in the plan or if you intend to use the money in the short term.

Annuitize – Receive Payments for Life

Some employer-sponsored plans offer departing participants the option of converting an account balance into an annuity. By accepting, you'll receive a stream of cash that can flow for your lifetime, the lives of yourself and your spouse, or perhaps for a maximum number of years. (Such annuity payments probably will be fully taxable, at ordinary rates.)

If you're worried about running short of money as you grow older, this option might seem appealing. However, employers may pay low annuity rates to retirees. Indeed, all annuity rates are at historic low levels these days.

Retirees who want an annuity probably will be better served by rolling over their account balance to an IRA (see below). Then you can shop among insurers for the highest payout on an immediate annuity.

Keep Your Money in the Company Plan

Yet another choice for departing employees is to keep their money in a former employer's plan, even after they depart the company. Under federal law, you are allowed to keep money in a qualified plan if your vested account balance is $5,000 or more. Otherwise, it can be distributed to you without your approval.

Why would you want to keep your money in your old employer's plan?

No management responsibilities. You might be happy with the plan's investment choices and the way your money has grown. If you're pleased with the way things have gone, why change?

Asset protection. Your account balance is protected from creditors as long as it's held in an employer-sponsored plan under federal law. The same protection might not apply if you move your money from a qualified plan to an IRA.

Delayed distributions. In a company plan, required minimum distributions can be delayed until you stop working, if you don't own more than 5% of the company. If you roll the money into an IRA, you must start taking distributions after you reach age 70½.

Handy loans. Many employer-sponsored plans permit you to borrow half your account balance, up to $50,000. Such loans may be easier to get than other types of consumer loans, with less paperwork. Also, repayments (plus interest) go to your retirement account rather than to a financial institution. On the other hand, you can't borrow from an IRA. Any outstanding plan loans must be repaid before an IRA rollover.

Keeping your money in your former employer's plan also may be a smart move if you plan to retire at an age between 55 and 59½ and tap the account.

Life insurance. If your account in an employer-sponsored plan includes life insurance, you might want to keep your money in that plan in order to keep the policy in force. That's because you may find it costly to continue your life insurance after you leave the company plan especially if you're in poor health. Your IRA can't hold life insurance and you might not be able to buy needed coverage at a reasonable price.

Earlier access to the money. Keeping your money in your former employer's plan also may be a smart move if you plan to retire at an age between 55 and 59½ and tap the account. If you quit your job after attaining age 55 and withdraw the money directly from your company's retirement plan, you'll avoid a 10% early-withdrawal penalty. By contrast, IRA withdrawals may be subject to this penalty until age 59½. It's true that you can avoid such a penalty but it will require an effort to comply with the rules on "substantially equal periodic payments."

If you're changing jobs and your new employer sponsors a 401(k), a profit-sharing plan, etc., you may be permitted (by your new employer) to roll over your old plan balance to the new plan. Such a rollover maintains the tax deferral while providing all the benefits of keeping the money in a former employer's plan.

Reasons Not to Keep Your Money in the Company Plan

With all those attractions, why not keep your money in a former employer's plan or roll the account to your new employer?

Lack of control. Whether you roll over your retirement fund into a new employer's plan or keep it where it's been, you won't have control over those funds. You may be limited in terms of investment choices, and you might not enjoy unlimited access to your money.

Snapping the stretchout. Holding your money in any employer-sponsored plan may pose a tax problem for your beneficiaries. That's because many employers force non-spouse beneficiaries to withdraw the inherited balance over a very short period of time following the death of the participant.

Except for your spouse, beneficiaries of employer-sponsored plans are not allowed to rollover the assets to an IRA. Conversely, after you've rolled your retirement funds into an IRA you can arrange for your children to stretch out payments over their lifetimes, providing extended tax deferral and, hopefully, substantial wealth-building.

Flexible estate and investment planning options. You can establish multiple IRAs and name different beneficiaries on each account. You may also have different investment objectives for each IRA. With multiple IRAs you can take withdrawals from one of your accounts, if you wish, while leaving the others intact for ongoing tax deferral.

An edge on expenses. Not only do you have more flexibility with an IRA, you may have more control over expenses.

With an employer-sponsored plan such as a 401(k), you do not see the extent of the fees you pay because the total return of the fund is reported to you, net of any administrative or money management expenses. The total fees with an employer-sponsored plan might be 2% a year, or even more, which can take a huge bite out of your long-term return.

On the other hand, with an IRA you not only can choose investments, you can choose low-cost investments. Asset management fees levied by IRA custodians and trustees must be disclosed when the account is opened or when the fee schedule changes.

As the IRA owner, you may have the option to pay your trustee fees from another account or by having the

fees deducted from the IRA. When you pay your fee with external (non-IRA) funds, you not only have more money for tax-deferred accumulation, you may be able to count the outlay as an itemized tax deduction.

Heir power. An IRA gives you more opportunity for long-term wealth-building. You can name someone other than a spouse as beneficiary and enable that person or persons to stretch out required distributions over their life expectancy.

Out of the penalty box. You may qualify to take penalty-free withdrawals for first-time home buying (up to $10,000 lifetime) and for higher education expenses, which you can't do with an employer-sponsored plan.

An individual living in Arizona learned this the hard way, after he quit his job and returned to school to obtain a PhD. In 2001, he withdrew $30,369 from his 401(k) account at his former employer and used the money to pay for school expenses and to buy his first home.

He reported the $30,369 as income on his 2001 return but paid only the normal tax on it. The IRS demanded a 10% penalty (more than $3,000) for an early distribution because the taxpayer was not yet 55 years old. The Tax Court sympathized but upheld the law. Penalty-free withdrawals for higher-education expenses and first-time home buying apply only to IRAs, not to 401(k) plans.

An IRA gives you more opportunity for long-term wealth-building.

Roth IRA rewards. An IRA rollover needn't mark the last stop for your retirement funds. Once money has been rolled from an employer-sponsored plan to an IRA, you subsequently can convert all or part of an IRA to a Roth IRA.

Roth IRA conversions are permitted in any year that your modified adjusted gross income doesn't exceed $100,000. You must pay any deferred income tax on the IRA funds you convert to a Roth IRA, to the extent it would have been taxable to you if you had received it as a distribution. Minimum required distributions from your IRA are not eligible for conversion to a Roth IRA, but they do not count towards the $100,000 conversion eligibility threshold.

Once an IRA has been converted to a Roth IRA, all subsequent withdrawals will be tax-free (1) five years after the conversion and (2) as long as you're at least age 59½. Moreover, there are no lifetime required distributions from a Roth IRA.

Rollover Your Plan Funds to an IRA

When you roll your account balance to an IRA the tax deferral is maintained. In addition, you have absolute control over your retirement funds and you can invest practically any way that you'd like.

You might decide against an IRA rollover if:

(1) you need cash right away;
(2) you don't want to manage your own retirement funds;
(3) you live in a state with poor creditor protection for IRAs;
(4) you intend to keep working after age 70½;
(5) you have taken or might take plan loans;
(6) you have vital life insurance inside your employer's plan; or
(7) you're retiring between ages 55 and 59½.

But if none of these reasons apply, a rollover might be your best choice.

Partial IRA Rollovers

You should bear in mind that partial IRA rollovers are permitted, and that they provide the same tax advantages as a full rollover.

Suppose, for example, you change jobs and your 401(k) account has a balance of $300,000. Say you need $60,000 for current expenses, debt repayment, etc. In this situation, you could rollover $200,000 to an IRA, which would be entitled to tax deferral, investment flexibility, and estate planning advantages for non-spouse beneficiaries, as described above. The other $100,000 could be taken as a cash withdrawal from your 401(k) account. Even after paying income tax and possibly a 10% early-withdrawal penalty, you'd likely have the $60,000 you need for immediate use.

A Tax Break for Employer Stock (NUA)

There is one situation in which a partial rollover may be especially savvy and that is when you hold employer stock in your 401(k) plan and that stock has risen significantly since it was acquired. If you move the stock from your 401(k) to a non-retirement brokerage account, you'll owe tax, but only on the price of the stock when it was purchased for your account, not on its current value.

For example, when you leave your job you have $300,000 in your 401(k) including $100,000 of employer stock. The employer stock cost a total of $40,000 (the basis) when it was purchased in your 401(k). The $100,000 of employer stock can be moved directly into a taxable (non-IRA) brokerage account. You can roll the other $200,000 from your 401(k) to your IRA. You'll owe income tax on the $40,000 basis amount, not on the $100,000 market value. You also may owe a 10% ($4,000) early distribution penalty if you're under age 55.

Disadvantages of IRA Rollovers

- You can't borrow from an IRA.
- You can't hold life insurance in an IRA.
- Minimum distributions must begin at age 70½, even if you're still working.
- An early-withdrawal penalty is in effect until 59½ with an IRA, vs. age 55 with an employer's qualified plan.
- Creditor protection for IRAs may not be as expansive as it is with a qualified plan.
- Ten-year income averaging is not available at any time.

Whenever you sell the stock, the other $60,000 (the net unrealized appreciation or NUA) will be taxed as a long-term capital gain. Any further appreciation will be taxed as long term gain, after more than one year from the time that the stock was distributed from the plan.

In order to take advantage of this tax break, the distribution from the 401(k) plan must be a lump-sum distribution and must be paid in one taxable year. If you roll any company shares into an IRA or into a new employer's plan, you lose the opportunity for long-term capital gains treatment of those shares.

Spousal Consent Required

If you're going to do a full IRA rollover, a partial IRA rollover, or a rollover from one employer plan to another, you'll probably need your spouse's consent (assuming you're married). That's not the case, though, if you select an annuity covering both spouses.

Use Direct Rollovers

Moreover, for any type of rollover, you shouldn't take personal possession of your funds. Instead, ask for a direct ("trustee-to-trustee") rollover to an IRA or your new employer's plan. Without a direct rollover, your former employer will be forced to withhold 20% of the distribution. Unless you make up the difference from your own funds, you'll owe income tax on that amount and perhaps a 10% penalty as well.

[This article does not constitute legal, accounting or other professional advice. Although it is intended to be accurate, neither the author nor any other party assumes liability for loss or damage due to reliance on this material.] ■

Advantages of IRA Rollovers

- The investment portfolio can be structured to meet your objectives.
- Trustee fees paid using money outside the IRA may qualify as an itemized income tax deduction.
- After a rollover, no spousal consent will be needed on naming other beneficiaries (this might depend on state law).
- You'll have unlimited options on naming beneficiaries.
- You can convert a traditional IRA to a Roth IRA if income eligibility requirements are satisfied.
- IRA beneficiaries can disclaim; many qualified plans will not honor a disclaimer.
- Distributions are not limited to a set number of years, which might be the case with a qualified plan.
- An IRA may be more easily integrated into an estate plan.
- Assets can be split into multiple IRAs, with different beneficiaries and investment objectives.

Marvin R. Rotenberg is the Director of Individual Retirement Services, Retirement Solutions Group at Bank of America. Widely recognized for his knowledge and expertise on qualified retirement plan distributions, Marvin has given numerous lectures to organizations in the law and accounting professions on this subject. Creative visuals and concise case studies help Marvin introduce novel approaches to complex planning issues. His lectures are accredited in many states, providing participant continuing professional education credit.

Marvin R. Rotenberg has authored several articles appearing in the CPA Journal and The Journal of Retirement Planning. He has also been quoted in numerous financial publications including: The Wall Street Journal, Forbes, Time, Fortune, Newsweek, Money Magazine, Kiplinger's and others. He is listed in the International Who's Who Among Professionals.

At Bank of America, Marvin is responsible for creating distribution strategies from qualified plans and IRAs for clients with substantial net worth. He is an expert at maximizing the options available to clients while taking full advantage of tax and estate planning strategies.

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Of course the best way to avoid the rollover problem is not to do a rollover and move retirement money by using trustee-to-trustee transfers, or what the tax law calls "direct rollovers," where the funds are transferred directly from one plan or IRA to another without you touching the money in between. This way you cannot get into any trouble because the funds never leave the plan or IRA.

If you must do rollovers, then make sure the funds go back to another plan or IRA within the required 60 days. In cases where the funds are not transferred to another plan or IRA within 60 days, relief may be available by requesting a PLR from IRS, but that is now very expensive. IRS PLR fees can be as high as $3,000 plus professional fees and even then, there is no guarantee that IRS will rule in your favor.

To receive a favorable ruling allowing you more time to complete the rollover (beyond the 60 days), you will have to show that you truly intended to do a rollover and the delay was due to either errors made by your advisors

or financial institution, medical reasons or other valid reasons that were beyond your control.

In these recent rulings IRS declined to waive the 60-day rollover rule when distribution mistakes occurred, mainly because the funds were under the control of the taxpayers and they did not take action that they could have to complete the rollovers within the 60 days.

PLR 200601042

Released by IRS January 6, 2006

"Mary" left her job to find another one. She was a participant of her ex-company's plan and was receiving statements from the plan showing the value continuing to decline. She got depressed with the news and stopped opening the statements as they were mailed to her. In one of those envelopes, though, was a check from the company for her entire plan balance cashing out the account. Mary did not expect this distribution and, since she was not opening any letters coming from the company, she did not discover the check until a later date (after the 60 days had passed) when she apparently opened the letter containing the check. She deposited the check in a local bank and requested this ruling asking IRS to allow her to roll the funds over to an IRA even though the 60 days had passed.

IRS denied the ruling because she was in control of the situation and the problem was due to her own actions, or lack of action in this case. She should have opened her mail. IRS stated that "although it was within your reasonable control, you did not pay attention to correspondence from Company C which resulted in your being unaware that a distribution of your retirement benefits had been made by Company C. These circumstances do not justify the granting of a waiver of the 60-day rollover period."

If you are in control of the money, then you cannot blame anyone else or expect any relief from IRS.

PLR 200602051

Released by IRS January 13, 2006

"Joe" withdrew money from his IRA to make another IRA investment. He held on to the check and forgot about it. During the time the funds were withdrawn Joe attended an investment seminar and decided the investment he was considering was too risky and wanted to return the funds to his IRA, but more than 60 days had passed and the bank would not accept the rollover. He requested this ruling from IRS asking for more time to complete the rollover, but as you may have guessed by now, IRS denied the ruling because Joe was in control of the funds and the delay was his own fault. IRS stated "that the ability to deposit Amount D into an IRA within the 60-day rollover period was within the reasonable control of Taxpayer A," ("Joe"), and ruled against him.

PLR 200609023

Released by IRS March 3, 2006

Here, the taxpayer, "George," withdrew money from his IRA and sent it to another financial institution to use to make another investment. He took his time examining the fees on the investment and then decided not to make the investment. The company sent George his money back but he never cashed the check. The company reissued the check and then George contributed the funds to another IRA, but by that time more than 60 days had passed. George requested this ruling asking IRS to allow him more time to complete the rollover since he never cashed the check thinking that not cashing the check meant that it did not count as being out of the IRA.

IRS denied the ruling stating that it was clear that George did not understand the rollover rules and he should have contacted a tax professional who would have explained the consequences of his actions. In denying the ruling request, IRS stated that the "ability to deposit Amount A into a rollover IRA within the requisite 60-day period was at all times within the control of Taxpayer A," ("George"). In other words, George could have done something to avoid this but took no action and he had only himself to blame.

Pay Attention to What You Are Doing

The common thread in these rulings was that the taxpayers could have avoided these mistakes since the funds were in their control and, because of that, their rulings were denied by IRS. The moral here is that these kinds of mistakes will not be forgiven. If you withdraw money from your IRA, you had better keep track of it and keep track of the 60 day clock if you intend to rollover the funds to another IRA or plan, and don't use the money while it is out of the IRA. If you go beyond the 60 days, you will lose the ability to roll these funds over and trigger taxation on the amounts distributed as well as penalties, if they apply. ■

Increased FDIC Coverage for Retirement Accounts

Retirement accounts opened at your local bank branch that are FDIC insured will see an increase in the coverage limit from $100,000 to $250,000 as of April 1st. The Federal Deposit Insurance Reform Act of 2005 was incorporated into the Deficit Reduction Act of 2005 which President Bush signed into law on February 8, 2006. This change will affect IRAs and Roth IRAs, self-directed Keogh and 401(k) accounts, and governmental 457 plans. The coverage limit for other federally insured accounts remains at $100,000 for now. Beginning in 2011, the coverage limit for all federally insured deposits will be increased for inflation every 5 years. ■

ED SLOTT'S IRA Advisor

Ed Slott, CPA
Editor

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