THE WALL STREET JOURNAL.

WEDNESDAY, APRIL 22, 2015 © 2015 Dow Jones & Company, Inc. All Rights Reserved.

VOICES

Dean Hedeker, on a Way Around New IRA Rollover Restriction

IRS now restricts individuals to only one IRA rollover a year

Dean Hedeker

Voices is an occasional column that allows wealth managers to address issues of interest to the advisory community. Dean Hedeker is owner and principal at Hedeker Wealth Management Group in Lincolnshire, Ill.

After the recent decision by the IRS to restrict individuals to only one IRA rollover a year, many advisers felt that they had lost one of their most valuable tools. Rollovers allow clients to use funds from their IRA to provide themselves with a short-term, tax-free loan to cover temporary cash-flow emergencies. In some cases, clients may need to use this technique more than once each year.

Fortunately, clients and advisers can now leverage another new rule, this one concerning Roth IRA conversions, to provide a funding solution should they need to make more than one rollover within a 365-day period.

Here's how it works: In the same document that restricts the use of IRA rollovers, IRS publication 590-A, it also states that rollovers from traditional IRAs to Roth IRAs aren't limited. In other words, individuals can use as many of those conversions each year as needed.

Take, for example, a client who needs $50,000 to cover payroll needs for his business. He would begin by taking money out of his IRA and using it to cover cash-flow needs, just as with a traditional rollover. But in this case, rather than putting $50,000 back into the IRA within 60 days, the client would create a new Roth IRA and fund the new account with $50,000. That is what is known as a Roth conversion.

To avoid triggering taxes, the final step is to recharacterize that conversion during the same tax year. That effectively undoes or reverses your Roth conversation and transfers the $50,000 (plus any growth accumulated during that year) back into your traditional IRA. From a tax perspective, it is as if the money never left the account.

Although it requires one more step than the traditional IRA rollover, this strategy has the same result and, most important, it can be used as many times as needed by the individual.

The rollover rule was amended because there were people who abused it. They would borrow money from their account and effectively move it around like a shell game to avoid paying taxes on the loan. They would have multiple IRAs and keep taking the moneys out of one IRA and then putting it back into another one, allowing them to always have IRA cash in their hands. They were following the old rules, but they also were, in effect, abusing the intent of the provision.

The IRA is a tool to put money away for retirement—it shouldn't be used regularly as a way for clients to loan themselves money. But in case of emergencies where clients do need cash, and they know they have the means to pay it back relatively quickly; it is an incredibly valuable resource.

The truth is, you never know when those emergencies will occur and sometimes they can happen more than once in the same year. When they do, this can be an indispensable tool to have in your back pocket as an adviser.

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