

The Interplay of RMDs and Rollovers

A person is never eligible to roll over a distribution that is a required distribution. It does not matter if the distribution is coming from an IRA or a 401(k) plan or similar plan, if the distribution is a required distribution it is ineligible to be rolled over. What distributions are required distributions? Does the IRA grantor or the 401(k) participant have the right to decide which distribution is a required distribution and which distribution is not? Common sense says that the person does not have this right and the IRS has written a regulation providing such. A distribution from the IRA or 401(k) plan is considered to be a required distribution and ineligible to be rolled over until 100% of the required distributions have been withdrawn. The problem is, the IRS has done a poor job of informing the public (and 401(k) administrators) of this governing rule set forth in Regulation 1.402(c)-2. The following statement is made in IRS Publication 590A, Contributions to IRAs,

Required distributions. Amounts that must be distributed during a particular year under the required distribution rules (discussed in Publication 590-B) are not eligible for rollover treatment.

The following statement is made in IRS Publication 590B, Distributions from IRAs,
Distributions not eligible for rollover. Amounts that must be distributed (required minimum distributions) during a particular year are not eligible for rollover treatment.

In Notice 2014-74, the IRS furnished a Safe Harbor Explanation - Eligible Rollover Distributions which an employer can use to satisfy its statutory requirement to explain the rollover rules to a terminating participant before the participant instructs how he or she wishes to have the distribution processed. In this Notice, the IRS fails to explain the rule that since a required distribution is required to be distributed from a 401(k) or other employer plan before any non-required distribution, any required distribution is ineligible to be rolled over. We will suggest to the IRS that this additional explanation be made; sometimes they adopt our suggestions, but many times they do not. Fewer invalid rollovers (i.e. excess contributions) would be made and fewer corrections would need to be made if the IRS made clear the rule, no rollover is possible until the person's RMD has been satisfied