Conduit IRAs
What are they?
Why are they important?

What is a conduit IRA?

A conduit IRA is a holding tank for funds that originally came from a qualified plan and are or may be on their way to another qualified plan. An example of a qualified plan is a 401(k) plan. A conduit IRA is beneficial for those leaving one employer with a qualified plan, who need a temporary fund shelter as they seek reemployment. If the new company you join has a qualified plan, then you can roll the funds from your conduit IRA to the new employer's qualified plan. (Ex. Qualified plan (QP)-IRA-QP).

The purpose of the conduit IRA is to allow a participant who was paid a distribution from the qualified plan of the old employer to roll it over temporarily to a conduit IRA. Since the accountholder may not be reemployed within the allowable 60-day rollover period, the tax rules allow for a conduit IRA. When the individual is rehired, the person may move these funds to the new employer's qualified plan.

An example: Todd leaves the service of Toyco, and receives a lump-sum distribution of $10,000 from Toyco's qualified, noncontributory plan. Todd puts all of the $10,000 into a conduit IRA. Five years later, Todd goes to work for Rivaltoy. Todd can receive the assets of his conduit IRA tax-free and transfer part or all of them to Rivaltoy's qualified plan if he does so within 60 days after receiving them and Rivaltoy's plan accepts the assets. If Todd wants to contribute to an IRA during the years after Toyco and before Rivaltoy, he can set up a separate IRA account.

You may also wish to use your conduit IRA as a way to restore a prior distribution from a qualified plan so that you would regain rights in your nonvested account balance. The situation where this normally arises is – you quit working for an employer and then later return to work for that same employer. At the time you quit you had an account balance $16,000. Since you were only 40% vested, you were paid (or deemed paid if you did a direct rollover to an IRA) the amount of $6,400. The other 60% or $9,600 will be forfeited after you have incurred five consecutive breaks in service or if you do not repay the $6,400 within 5 years from the date you were reemployed. If you had rolled over the $6,400 from the qualified plan into a conduit IRA, then you could roll over the $6,400 from the IRA back to the qualified plan. That is, you can use the funds within a conduit IRA for the repayment and then you would regain your rights to the $9,600. Note, however, the conduit IRA could arise from a different employer and still be used to restore a prior distribution.

May 403(b) funds also constitute a conduit IRA?

A conduit IRA is also a holding tank for funds that originally came from a section 403(b) plan or account and are on their way to another section 403(b) plan or account. 403(b) plans and accounts are a special type of retirement plan generally established by schools and hospitals. A conduit IRA is beneficial for those leaving one employer with a 403(b) plan, who need a temporary fund shelter as they seek reemployment. If the new company you join has a 403(b) plan, then you can roll the funds from your conduit IRA to the new employer's 403(b) plan. (Ex: (403(b)-IRA-403(b)).

How is a conduit IRA created?

The individual must establish an IRA by signing an IRA Plan Agreement. It is not required that the IRA be designated a "conduit" IRA as long as the non-commingling rule is met and as long as the funds originated from a qualifying rollover or direct rollover from a qualified plan or section 403(b) plan.

Must I affirmatively elect to call or name my IRA a conduit IRA?

No. As long as there has been no impermissible mixing within the IRA, your IRA established with a rollover contribution from a qualified plan qualifies as a conduit IRA whether or not you expressly informed the IRA custodian or trustee to label the IRA a conduit IRA.

Must all the funds in the qualified plan distribution be rolled over into the IRA?

No. A conduit IRA is created even if the individual does not roll over 100% of the amount eligible to be rolled over.

Example: Erica Peret, age 38, receives a distribution of $42,000 from her former employer's 401(k) plan. She retains $12,000 to pay off some credit card balances and rolls over $30,000. The $30,000 that is rolled over qualifies as a conduit IRA.

What governmental reporting takes place if funds are distributed from a qualified plan to the person, and then he or she recontributes the distribution amount?

If a recipient receives any money from the qualified plan that was eligible to be rolled over, 20% federal withholding will be withheld from the distribution check. The distribution will be reported on Form 1099-R showing the 20% withholding amount and the amount the customer received in check form.

If the recipient decides to roll over the funds after the check is received, they may roll over any portion of the amount of the check received, or they can roll over the entire amount of the withdrawal from the qualified plan.

Example: Tracy Turner had $10,000 in her qualified plan that was eligible for rollover. Because she did not make a direct rollover, $2,000 was withheld for federal taxes; the check she received was for $8,000. Tracy can roll over all or any portion of the $8,000 check she received, or roll over the full $10,000 by replacing the $2,000 with funds from another source (i.e. checking or savings). Tracy will receive a 5498 from the custodian/trustee of the IRA plan showing the rollover contribution.

What records should I maintain with respect to my rollovers?

Before the distribution is made from the qualified plan, the plan administrator for the qualified plan is required by law to give recipients of distributions eligible to be rolled over to IRAs, a general explanation of their rollover rights. Because this rule is found in Internal Revenue Code section 402(f), this is sometimes referred to as a "402(f) Notice." The 402(f) Notice explains what distributions can and cannot be rolled over. This notice should be kept, as well as the annual statements from the conduit IRA. With these documents, you can show proof that the rollover was eligible, and that no other funds were ever combined with the original deposit.

If the funds are later directly rolled to a new qualified plan, then also keep a copy of the request and the receipt received from the qualified plan administrator showing the deposit amount.

What is the non-commingling requirement?

Code section 408(d)(3)(A)(ii) is the statutory authority which authorizes the rolling over of certain funds within an IRA to a section 401(a) qualified plan. The statute reads, "no amount in the account…is attributable to any source other than a rollover contribution (as defined in section 402) from an employee's trust described in section 401(a) which is exempt under section 501(a)…and the entire amount received (including property and other money) is paid (for the benefit of such individual) into another trust not later than the 60th day on which the individual receives the payment or distribution." It is clear that the commingling of any type of IRA funds (regular, spousal, SEP, or SIMPLE) with the funds which originally came from a 401(a) qualified plan will mean that the funds within this IRA are no longer eligible to be rolled to another 401(a) qualified plan or 403(b) plan. It is not as clear whether funds from multiple section 401(a) qualified plans can be combined within the same conduit IRA. We construe this section as NOT imposing a requirement that a conduit IRA cannot receive funds from more than one section 401(a) qualified plan. You must act on the advice of your own attorney for this issue. The most conservative administrative approach would be to establish separate conduit IRAs when you are paid distributions from more than one qualified plan.

Is the determination as to whether an IRA has been commingled determined at the IRA plan agreement level or at the time deposit or investment level?

It is determined at the IRA plan agreement level. For example, a person maintains an IRA #001. Within this IRA she has a CD for $12,000 which arose from annual contributions of $2,000 for four years plus related earnings. Within this IRA there is a second CD which arose from a rollover of $30,000 from a profit sharing plan. This IRA does NOT qualify as a conduit IRA. There has been an impermissible mixing. There needs to be two IRA plan agreements.

Is there a limit on how many times I can roll over funds from a QP plan into a conduit IRA?

No. The rules for IRAs permit only one rollover per IRA per 12-month period. No such rule exists for distributions from qualified plans.

What distributions are eligible to be rolled over?

Generally, the distribution of any portion of your qualified plan or a tax-sheltered annuity will be eligible to be rolled over. Three exceptions are discussed in the following paragraph.

Once you reach age 70½, you must start taking distributions from your account each year. These are not eligible to be rolled over or transferred. Also, you are not eligible to roll over annuities paid over life, or life expectancy (single or joint) or any distribution which is one of a series of substantially equal periodic payments (i.e. installments) for a period spanning ten years or more. Also, a distribution which would not be taxable is not eligible to be rolled over.

How long can an IRA qualify as a conduit IRA?

There is no time limit. For example, in 1988 you rolled over $10,000 into an IRA from your former employer's profit sharing plan. The $10,000 has increased to $33,000 in 1999. Your present employer has a 401(k) plan which is written to accept rollover contributions from conduit IRAs. Even though 11 years have elapsed, you could roll over the $33,000 from the conduit IRA to the 401(k) plan. You could do so even if 30 years had elapsed.

Is there a minimum time restriction?

No. Funds can sit in a conduit IRA for 8 days, 35 days, 75 days or 9 months and still qualify to be rolled over to another qualified plan or section 403(b) plan as applicable. That is, funds can sit in a conduit IRA for a very short period of time before being withdrawn from the IRA and recontributed to the qualified plan (i.e. a rollover) or section 403(b) plan.

Can a person set up multiple conduit IRAs with regard to one or more distributions from a qualified plan?

Yes. There is no limit on how many conduit IRAs may be established. For example, a person receiving a distribution of $160,000 could roll over $20,000 to eight different conduit IRAs.

Is there any limit on the number of conduit IRAs a person may maintain?

No.

Why might a person want to move funds from his or her IRA to a qualified plan or section 403(b) plan?

There can be a number of reasons.

1. A distribution from a qualified plan may qualify for 10-year averaging. A distribution from an IRA will never qualify for 10-year averaging.
2. By combining your conduit IRA funds with other qualified plan funds you may maximize your investment return.
3. Funds within a qualified plan are more secure from creditors than assets within an IRA.
4. Funds within a qualified plan may be borrowed if the plan permits loans to participants. IRA funds may not be borrowed.

Must the entire distribution from a conduit IRA be rolled over, or may a partial amount of a distribution be rolled over?

The entire portion of a distribution from a conduit IRA must be rolled over. It is not permissible to roll over only a portion of the distribution and retain the rest.

Must a person withdraw the entire amount within his or her conduit IRA?

No. A person may withdraw just a portion of the balance in his or her conduit IRA. Whatever portion is withdrawn must be totally rolled over or not rolled over at all.

What governmental reporting takes place if the funds in the qualified plan are directly rolled over?

Funds that are directly rolled over are handled like a transfer, but reported like a rollover. A 1099-R will be generated for the distribution from the qualified plan using reason code "G." A form 5498 will be generated for the rollover contribution into the IRA.

What government reporting takes place if the funds are withdrawn from the conduit IRA and rolled over (or transferred) to a qualified plan?

A 1099-R will be generated from the IRA custodian/trustee. The reason code used will be "H." The administrator of the qualified plan will issue no tax form 5498, but they will give a receipt for the contribution. The accountholder should attach a copy of the receipt to their 1040 tax form for verification that the amount was actually deposited into the qualified plan.

Can a person decide to terminate a conduit IRA?

Yes. An IRA ceases to be a conduit IRA if any impermissible commingling occurs. A person might wish to do this if there are fees associated with maintaining the IRA and the person knows he or she will never move the funds to another qualified plan or section 403(b).

Should I consult with my tax advisor before deciding to roll over or directly roll over a distribution?

Yes. Because of the complexity of the tax rules, you are strongly advised to consult with your tax advisor to determine the most favorable course of action for you with respect to your distribution. What is right for you may not be right for another person or vice versa.

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