

## **DO CHANGES TO IRA ROLLOVERS IMPLICATE 529 PLANS, COVERDELL ESAs, AND HSAs?**

**BACKGROUND:** As outlined in more detail in the attached Appendix, the tax code contains several nearly identical “one rollover per year” rules for tax-advantaged accounts, such as IRAs, 529 plans, Coverdell ESAs, and HSAs. These provisions all generally limit account holders to one tax-free rollover distribution every 12 months (although so-called trustee-to-trustee transfers are not counted as rollovers for this purpose). The IRS has not provided final regulations on exactly how each of these “one rollover per year” rules would be applied in cases where an individual maintains multiple accounts of the same type.

**RECENT TAX COURT DECISION RE: IRA ROLLOVERS:** In *Bobrow v. Commissioner*, the Tax Court held that the “one rollover per year” rule applies across all IRAs that a taxpayer owns, rather than on a per-IRA basis. In this ruling, the Tax Court applied a much more rigid interpretation of the IRA “one rollover per year” rule than previous IRS proposed regulations and publications would appear to have required. Essentially, the Tax Court deemed those contrary IRS pronouncements as irrelevant to the statutory interpretation.

**IRS RESPONSE:** In March, the IRS (in Announcement 2014-15) stated that it will be changing its application of the “one rollover per year” rule for IRAs from a per-IRA basis to an aggregate account basis consistent with the *Bobrow* decision. Traditional IRAs would not, however, be aggregated with Roth IRAs. The IRS further provided that it will not apply the IRA change retroactively, stating that it will publish future regulations which will not be effective before January 1, 2015.

**POTENTIAL IMPLICATIONS FOR 529 PLAN, ESA, AND HSA ROLLOVERS:** As the comparisons across account types shown in the Appendix make clear, the logic of the *Bobrow* court’s IRA decision could easily (and arguably appropriately) be applied in interpreting the almost identical “one rollover per year” rules for 529 plans, ESAs, and HSAs. If the *Bobrow* ruling were applied to these other account types, then (without IRS relief) many past rollovers might theoretically be tainted and all future rollovers from those accounts could plausibly be limited to one per year on an aggregate basis with respect to a particular account holder.<sup>1</sup> [Note that special account aggregation rules apply to 529 plans for purposes of determining the taxable portion of a nonqualified distribution, but these rules do not technically apply to the section 529 plan “one rollover per year” rule.]

### **POSSIBLE ACTIONS**

- Request that the IRS either (1) clarify that the *Bobrow* ruling does not apply to 529 plans, ESAs, and HSAs or (2) provide that Announcement 2014-15’s temporary delay in the application of the *Bobrow* court’s “one rollover per year” IRA interpretation would extend to rollovers from 529 plans, ESAs, and HSAs until further, more specific, guidance is issued.

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<sup>1</sup> As noted in the Appendix, IRS Publication 970 with respect to ESAs and IRS Publication 969 with respect to HSAs indicate that the IRS would apply the rollover limitation on an account-by-account basis, just as it did for IRAs prior to *Bobrow*. However, the Tax Court specifically rejected similar language in a comparable IRS Publication 590 for IRAs in reaching its decision, stating in an Order that the “[IRS’s] published guidance is not binding precedent,” and that “taxpayers rely on IRS guidance at their own peril.”

- If the IRS ultimately determines that 529 plan, ESA, and HSA rollovers are affected by *Bobrow*:
  - Propose specific rules on how the Tax Court decision will be applied to multiple 529 plan accounts. One approach might be to request that rules similar to the existing 529 plan aggregation rules (as shown in the Appendix and as have been expressed by the IRS) used for computing the taxable portion of nonqualified distributions also be used for purposes of applying the “one rollover per year” rule. That is, in applying the 529 plan “one rollover per year” rule, (1) only accounts with identical owners and identical beneficiaries would be aggregated, (2) accounts in different state programs would never be aggregated, (3) and 529 pre-paid and 529 savings plan accounts within the same state program would not be aggregated.
  - Propose specific rules for the treatment of ESA rollovers, including clarification of the treatment of multiple accounts maintained by (1) different individuals for the same designated beneficiary or (2) the same individual for different designated beneficiaries.
  - Propose specific rules for the treatment of HSA rollovers, if there are any reasons they should differ from the general IRA rules being developed by the IRS.
- Determine whether any changes are needed in 529 plan, ESA, or HSA disclosures regarding permitted rollovers in light of the application of the *Bobrow* decision.

## Appendix

“One Rollover Per Year” Rule for IRAs	
<b>STATUTE CODE</b> § 408(d)(3)(B)	A rollover does not qualify for tax-free treatment “if at any time during the 1-year period ending on the day of such receipt such individual received any other amount described in [section 408(d)(3)(A)(i)] from an [IRA] which was not includible in his gross income because of the application of” the tax-free rollover provision of section 408(d)(3).
<b>ORIGINAL IRS VIEW</b> PUBLICATION 590 AND PROP. TREAS. REG. § 1.408-4(b)(4)(ii)	<p>For many years, the IRS has applied the “one rollover per year” rule on a per-IRA basis, so that a taxpayer is only precluded from making a tax-free rollover from a particular IRA if he already made a tax-free rollover from or into that same IRA within the 1-year period.</p> <p><b>Example:</b> An individual has two traditional IRAs (IRA-1 and IRA-2) and makes a tax-free rollover of a distribution from IRA-1 into a new traditional IRA (IRA-3). The individual 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.</p> <p style="text-align: right;">IRS PUBLICATION 590 (2013).</p>
<b>TAX COURT VIEW</b> <i>BOBROW</i> 2014	The Tax Court ruled that the “one rollover per year” rule applies across all IRAs that a taxpayer owns, rather than on a per-IRA basis. In the example above, the rollover from IRA-1 to IRA-3 would also prevent the individual from making a tax-free rollover from IRA-2 into any other traditional IRA. Taxpayer had no right to rely on IRS Publication or proposed regulation.
<b>NEW IRS VIEW</b> ANNOUNCEMENT 2014-15	The IRS announced that it will follow the Tax Court’s interpretation of the rule as stated in <i>Bobrow</i> . The IRS will revise Publication 590, withdraw Prop. Treas. Reg. § 1.408-4(b)(4)(ii), and issue new proposed regulations. This change will be applied to rollovers <i>no sooner than</i> those involving a distribution occurring on January 1, 2015.

## “One Rollover Per Year” Rules for 529 Plans, Coverdell ESAs, and HSAs

	STATUTE	IRS STATEMENTS TO DATE
<b>529 PLANS</b>	<p>The provision for tax-free rollovers to another qualified tuition program for the benefit of the designated beneficiary “shall not apply to any transfer if such transfer occurs within 12 months from the date of a previous transfer to any qualified tuition program for the benefit of the designated beneficiary.”</p> <p style="text-align: right;">Code § 529(c)(3)(C)(iii)</p>	<p>“If the rollover is to another [qualified tuition program (QTP)] for the same beneficiary, only one rollover is allowed within 12 months of a previous transfer to any QTP for that designated beneficiary.”</p> <p style="text-align: right;">IRS PUBLICATION 970 (2013)</p> <p><i>Account Aggregation Guidance:</i></p> <p>“If an individual is a designated beneficiary of more than one account <u>under a [qualified State tuition program (QSTP)]</u>, the QSTP shall treat all contributions and earnings as allocable to a single account for purposes of calculating the earnings portion of any distribution from that QSTP.”</p> <p style="text-align: right;">Prop. Treas. Reg. § 1.529-3(d)[Emphasis added]</p> <p>The IRS has said that final regulations are expected to provide that only accounts maintained by a 529 program with the same owner and same beneficiary must be aggregated for purposes of computing the earnings portion of a distribution. A state’s prepaid and savings programs would not be aggregated.</p> <p style="text-align: right;">IRS Notice 2001-81</p>
<b>COVERDELL ESAS</b>	<p>The provision for tax-free rollovers “shall not apply to any payment or distribution if it applied to any prior payment or distribution during the 12-month period ending on the date of the payment or distribution.”</p> <p style="text-align: right;">Code § 530(d)(5)</p>	<p>“Only one rollover per Coverdell ESA is allowed during the 12-month period ending on the date of the payment or distribution. This rule does not apply to the rollover of a military death gratuity or payment from Service members' Group Life Insurance (SGLI).”</p> <p style="text-align: right;">IRS PUBLICATION 970 (2013)</p>
<b>HSAS</b>	<p>The provision excluding amounts that qualify as a rollover contribution shall not apply “if, at any time during the 1-year period ending on the day of such receipt, such individual received any other amount [that qualified as a rollover contribution] from a health savings account which was not includible in the individual’s gross income because of the application of [the rollover contribution provision].”</p> <p style="text-align: right;">Code § 223(f)(5)(B)</p>	<p>“You can make only one rollover contribution to an HSA during a 1-year period.”</p> <p style="text-align: right;">IRS PUBLICATION 969 (2013)</p>

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