3 Ways to Decimate a Retirement Account in a Flash

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ED SLOTT'S MASTER ELITE IRA ADVISOR GROUP™

1) Missing the 60-day Rollover Window

If you want to move your retirement account from one institution to another, you can do it one of two ways; directly or indirectly. Moving your account directly is the preferred way because it avoids a lot of headaches, but for various reasons, sometimes people choose to use the indirect method. When using the indirect method you receive a check from the distributing account payable to you. From the time you receive those funds, you have 60 days to get the money back into another retirement account. If you miss the 60-day window the distribution is taxable and, if you're under 59 ½, it would also generally be subject to the 10% early distribution penalty.

Depending upon the reason you missed the window, you may be able to get some relief. Qualifying reasons include illness, severe damage to your primary residence and accidentally depositing the funds in the wrong account. But counting on relief to get you out of the instant taxation of what could be your life's savings is like playing with fire, you may come out ok, but it's a dangerous game.

2) Making Too Many Rollovers Within a Year

If you're moving money indirectly between IRAs or between Roth IRAs, there is another pitfall you must avoid; making too many rollovers within a one-year period. The one-year window starts when you receive the first distribution that you rollover and ends 365 days later. It is not a calendar year. If you move money between retirement accounts directly you don't have to worry about this problem, but again, for a variety of reasons, sometimes people choose the more troublesome, indirect method.

Here's the *really* bad part. Unlike mistakes that involve the 60-day window, there's generally no way to fix once-per-year rollover mistakes. The IRS has the explicit authority to grant relief for 60-day window violations (provided certain conditions are met), but it has no similar authority when it comes to the once-per-year rollover rule for IRA-to-IRA or Roth IRA-to-Roth IRA rollovers. If you accidentally "roll over" a second IRA-to-IRA distribution within the one-year timeframe, your second distribution will be taxable. In many instances, for both IRA and Roth IRA rollovers you'd also be subject to the 6% excess contribution penalty if you did not timely remove that amount from the receiving account.

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3) Committing a Prohibited Transaction

Another surefire way to destroy your retirement account – in one fell swoop no less – is to commit a prohibited transaction. The tax code gives IRAs and other retirement accounts special tax treatment, but if you want that tax treatment, you have to play by the rules. Some of those rules prevent you from engaging in certain transactions. These forbidden transactions are known as prohibited transactions, and engaging in one, either purposefully or by accident, carries a steep penalty.

If you commit a prohibited transaction in your IRA or Roth IRA, the entire IRA is deemed distributed on January 1 of the year you engage in the transaction. As a result, even a mistake with a small amount of money in your IRA or Roth IRA can completely decimate your entire retirement savings. Every IRA owner should be aware of the prohibited transaction rules, but those investors who choose to use self-directed IRAs or Roth IRAs should pay extra close attention, as they are at the greatest risk of running afoul of the rules.

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