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IRS Provides Relief for Late Rollovers with New Self-Certification Procedure

By Michael Byro

An IRA owner or qualified plan participant may avoid the taxation of an IRA or plan distribution by rolling the distribution over to an IRA or qualified plan within 60 days. On Aug. 24, 2016, the Internal Revenue Service (IRS) published Revenue Procedure (Rev. Proc.) 2016-47, 2016-37 I.R.B. 346, establishing a self-certification procedure for rollover contributions that missed the 60-day deadline. The procedure allows a taxpayer to certify that a late rollover is eligible for waiver of the 60-day rollover requirement so that an insurance company acting as a qualified plan administrator or an individual retirement arrangement (IRA) trustee, custodian, or issuer (hereinafter "financial institution") may accept and report the rollover contribution without the necessity of a private letter ruling (PLR) from the IRS. The IRS intends this new procedure to provide taxpayers who inadvertently miss the 60-day deadline an easier method to complete a desired rollover.[1] But, as is common with even the best-intentioned solutions, the new IRS guidance leaves some open questions and concerns for financial institutions accepting late rollover contributions through self-certification.

This article discusses the general rules applicable to rollovers and the self-certification procedure outlined in Rev. Proc. 2016-47. It concludes with a consideration of the implications this new procedure has for taxpayers and financial institutions.

THE ROLLOVER RULES

The Internal Revenue Code (the Code) provides that a distribution from a qualified plan or IRA can be excluded from income if it is rolled over to another qualified plan or IRA within 60 days of the date it was received.[2] A financial institution must report rollover contributions to an IRA on IRS Form 5498.[3]

In 2001, the Economic Growth and Tax Reconciliation Act amended the Code, giving the IRS the authority to grant hardship waivers of the 60-day rollover requirement "where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control" of a taxpayer.[4] As this Code provision did not include sufficient explanation of the circumstances constituting a qualifying hardship or the means that a taxpayer could seek a waiver, the IRS published Rev. Proc. 2003-16, 2003-1 C.B. 359, to provide clarification. Rev. Proc. 2003-16 requires a taxpayer to apply for a hardship exception through the PLR procedure.[5] To determine whether a waiver is appropriate the IRS will consider all relevant facts and circumstances, including: "(1) errors committed by a financial institution; (2) inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error; (3) the use of the amount distributed (for example, in the case of payment by check, whether the check was cashed); and (4) the time elapsed since the distribution occurred."[6] In addition, Rev. Proc. 2003-16 provides an automatic waiver of the 60-day rollover requirement without a letter ruling if (1) the rollover contribution is deposited into an eligible retirement plan[7] within one year from receipt of the funds, and (2) if not for a financial institution error, the rollover would have been valid.[8]

> [S]elf-certification may be completed at no cost, unlike a PLR, and provided to the receiving qualified plan or IRA instead of the IRS.

In conjunction with the guidance in Rev. Proc. 2003-16, the IRS established a reduced filing fee schedule for taxpayers requesting a hardship waiver of the 60-day rollover requirement.[9] In 2016, however, these reduced fees were eliminated and a taxpayer requesting a 60-day rollover requirement waiver must now pay the general $10,000 fee for a letter ruling.[10]

NEW SELF-CERTIFICATION PROCEDURE

Rev. Proc. 2016-47 establishes a self-certification procedure for plan participants and IRA owners to make late rollover contributions to a qualified plan or IRA. If a taxpayer meets the necessary conditions below, the self-certification may be completed at no cost, unlike a PLR, and provided to the receiving qualified plan or IRA instead of the IRS. A financial institution may choose to, but is not required to accept a late rollover through self-certification.

Conditions for Eligibility

To be eligible for self-certification, a late rollover contribution must satisfy three requirements. First, the IRS must not have

previously denied a waiver request for the rollover. Second, the 60-day deadline must have been missed for one or more of the following reasons:

- An error was committed by the financial institution receiving the contribution or making the distribution to which the contribution relates;
- The distribution, having been made in the form of a check, was misplaced and never cashed;
- The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan;
- The taxpayer's principal residence was severely damaged;
- A member of the taxpayer's family died;
- The taxpayer or a member of the taxpayer's family was seriously ill;
- The taxpayer was incarcerated;
- Restrictions were imposed by a foreign country;
- A postal error occurred;
- The distribution was made on account of a levy under § 6331 and the proceeds of the levy have been returned to the taxpayer; or
- The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information.

Lastly, the rollover contribution must be made to the plan or IRA as soon as practicable after the reason or reasons listed above no longer prevent the taxpayer from making the contribution. Rev. Proc. 2016-47 includes a safe-harbor, deeming this final condition satisfied if the rollover contribution is made within 30 days after the reason or reasons no longer impede the rollover.

If the aforementioned conditions are satisfied, a taxpayer may provide a written certification to the financial institution. A model letter that may be used for self-certification is included in the Appendix of Rev. Proc. 2016-47. The self-certification procedure is effective as of Aug. 24, 2016. The IRS modified Form 5498 and its instructions to require financial institutions with IRAs to specifically report rollovers accepted after the 60-day deadline.[11]

Effect of Self-Certification

The self-certification procedure cannot be used for any purposes other than determining if a late rollover satisfies the conditions for waiver of the 60-day deadline. A financial institution may rely on a taxpayer's self-certification, but is not required to accept a late rollover.[12] A financial institution is explicitly prohibited from relying on a self-certification if it has actual knowledge that is contrary to the self-certification.

While a self-certification may be used by a taxpayer to report a late rollover contribution as a valid rollover, it does not constitute a hardship waiver. The IRS may verify whether a rollover meets the requirements for a waiver in the course of an audit. If the IRS determines that the rollover does not qualify for a waiver, a taxpayer may be subject to additional income tax and penalties.[13] Because self-certification is not a waiver of the 60-day rollover requirement, Rev. Proc. 2016-47 provides that the IRS may grant a waiver during an audit of a taxpayer's return pursuant to its authority under the Code.

DISCUSSION

Impact on Taxpayers

The elimination of the reduced filing fee for ruling requests seeking hardship exceptions to the 60-day rollover requirement appeared to be an attempt by the IRS to reduce the abundance of these PLR requests by making such applications cost prohibitive, forcing taxpayers to exercise more prudence when executing rollovers. With the publication of Rev. Proc. 2016-17, however, the IRS showed its intent was not to create barriers to hardship waivers, but rather to create an easier, cost-free self-certification procedure for taxpayers who unintentionally miss the 60-day deadline to complete a late rollover and retain the tax-deferred status of their funds.

The reasons for missing the 60-day rollover deadline that qualify for self-certification under Rev. Proc. 2016-47 comprise many, but not all, of the facts and circumstances considered by the IRS for hardship waiver enumerated in Rev. Proc. 2003-16. The list in Rev. Proc. 2016-47 includes factors that have commonly led to the grant of a hardship exception in prior PLRs, such as a death in the taxpayer's family and the illness of the taxpayer or a member of the taxpayer's family.[14] Perhaps the most lenient reason provided, and the most common justification for granting a hardship waiver, is that the deadline was missed because of errors by a financial institution associated with the rollover.[15] Taxpayers and practitioners should note that the list does not contain other common circumstances for waiver, such as the death of the taxpayer,[16] the mental condition or incapacity of the taxpayer,[17] or the erroneous advice of a financial advisor not associated with a financial institution.[18] If these reasons caused the 60-day deadline to be missed, the taxpayer must undertake the normal private letter ruling process pursuant to Rev. Proc. 2003-16 and pay the general $10,000 fee.

Impact on Financial Institutions

Financial institutions administering qualified plans or IRAs will likely view the self-certification procedure as a means to get more money in the door. But, as the acceptance of self-certified late rollover contributions is voluntary, financial institutions should consider a number of potential concerns and open questions. A financial institution should be conservative in promoting the use of self-certification. The IRS has blessed a financial institution distributing the model certification directly to clients,[19] but providing such direction could potentially be viewed as tax or legal advice by a client. If a late rollover contribution is deemed by the IRS upon audit to not meet the requirements of Rev. Proc. 2016-47, a client could seek recompense from the financial institution.

Another consideration is the administrative burden associated with the acceptance of late rollovers through self-certification. A financial institution has the responsibility of reporting self-certified late rollover contributions to an IRA on IRS Form 5498. A company must establish a procedure to track self-certified late rollovers in order to comply with this obligation and determine if it wants to bear the cost of updating system capabilities for a most likely rare tax reporting requirement. If the tracking process remains manual, the company must take on the inherent risk of human error. A financial institution must

also decide how to report late rollover contributions accepted through self-certification between the effective date of Rev. Proc. 2016-47, Aug. 24, 2016, and Jan. 1, 2017. The IRS updated its 2017 Form 5498 with a new code for late rollovers applied through self-certification, but has neither updated its 2016 Form 5498 with this code, nor provided guidance on how late rollovers accepted before 2017 should be reported.

Perhaps the most important consideration is compliance with the prohibition of accepting a self-certified late rollover contribution when the financial institution has actual knowledge that is contrary to the certification. This rule is the only protection besides IRS audit against a taxpayer's abuse of the self-certification procedure. Rev. Proc. 2016-47 is silent, however, on if a financial institution with multiple businesses must investigate across all business units, or if "actual knowledge" would only apply to the business accepting the self-certification. If the IRS deems that a waiver is not appropriate upon audit, it is also not clear what penalties, if any, may be imposed on a financial institution if the IRS determines that the company had actual knowledge that the self-certification was not valid.

The requirement that a financial institution reject late rollover contributions when it has knowledge contrary to the facts of the certification will also create conflict where the financial institution and the client do not see eye-to-eye on the existence of financial institution error. One example is where a client certifies that a rollover contribution is late because of an error on the part of the receiving institution, but the receiving institution does not agree that it committed an error. In such situations, the financial institution should reject reporting the contribution as a self-certified late rollover. A client has the option of taking a different position on the client's tax return. Upon examination, the IRS could agree with the client, and exercise its authority to grant a hardship waiver in the course of an audit.

One final uncertainty is how far back in time a financial institution may look to accept late rollover contributions. Rev. Proc. 2016-47 has an effective date of Aug. 24, 2016, but does not provide a cut-off date for the original distribution that is being applied as a late rollover. A conservative approach would be to not accept rollovers of distributions occurring before Jan. 1, 2016, to prevent potential abuse.

CONCLUSION

The self-certification procedure is a positive solution for taxpayers that inadvertently miss the 60-day rollover deadline. It provides a free and simple method for taxpayers to contribute late rollovers to qualified plans and IRAs and avoids the prolonged waiting period for a PLR. The self-certification procedure should also decrease the amount of resources the IRS must spend on reviewing 60-day rollover requirement waiver requests. However, Rev. Proc. 2016-47 places much faith in the veracity of taxpayers, and relies solely on audit and financial institutions receiving late rollover contributions to prevent potential abuse. Financial institutions should carefully consider the open questions and concerns discussed above when adopting policies to accept late rollover contributions through the self-certification procedure. ■

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ENDNOTES

1 IRS News Release IR-2016-113 (Aug. 24, 2016).

2 IRC §§ 402(c)(3)(A), 403(a)(4)(B), 403(b)(8)(B), 408(d)(3)(A), 408A(e)(1)(B) and 457(e)(16)(B). Unless otherwise noted, references to the Code or "section" are to the Internal Revenue Code of 1986, as amended.

3 *Id.* § 408(i); Treas. Reg. § 1.408-5; I*nstructions for Forms 1099-R and 5498 (Jan. 8, 2016).*

4 IRC §§ 402(c)(3)(B), 408(d)(3)(I).

5 Rev. Proc. 2003-16, 2003-1 C.B. 359 § 3.01.

6 *Id.* § 3.02.

7 An eligible retirement plan as defined in the Code is an IRA, a § 401(a) qualified plan, a § 403(a) annuity plan, a § 403(b) tax-sheltered annuity, or a § 457 eligible governmental plan. IRC § 402(c)(8)(B).

8 Rev. Proc. 2003-16, 2003-1 C.B. 359 § 3.03.

9 Rev. Proc. 2003-8, 2003-1 C.B. 236 § 6.01(3).

10 Rev. Proc. 2016-8, 2016-1 I.R.B. 246 § 6.01.

11 IRS Form 5498 (2017); Instructions for Forms 1099-R and 5498 (2017).

12 *Retirement Plans FAQs relating to Waivers of the 60-Day Rollover Requirement*, Question 8, IRS.GOV, https://www.irs.gov/retirement-plans/retirement-plans-faqs-relating-to-waivers-of-the-60-day-rollover-requirement#8 (last updated Oct. 11, 2016).

13 Note that a taxpayer may still apply for a PLR if a hardship waiver is denied upon audit. *Id.* Question 9.

14 *See, e.g.*, PLR 201606032 (Nov. 9, 2015) (granting waiver due to emotional distress following spouse's death); PLR 200608025 (Feb. 24, 2006) (granting waiver due to care for disabled spouse).

15 *See, e.g.,* PLR 201618015 (Feb. 3, 2016) (granting wavier due to miscommunication by financial institution); PLR 201622039 (Mar. 3, 2016) (granting waiver due to financial institution's inability to follow taxpayer's instruction).

16 *See, e.g.,* PLR 201634026 (Aug. 19, 2016) (granting waiver where taxpayer took IRA distribution and died before completing rollover).

17 *See, e.g.*, PLR 200401025 (Nov. 5, 2003) (granting waiver where IRA withdrawal was beyond reasonable control of taxpayer suffering from Alzheimer's disease).

18 *See, e.g.*, PLR 201611024 (Mar. 11, 2016) (granting waiver where financial advisor mistakenly advised that distribution came from non-qualified annuity and would not be taxable).

19 *Accepting Late Rollover Contributions*, IRS.GOV, https://www.irs.gov/retirement-plans/accepting-late-rollover-contributions (last updated Aug. 26, 2016).