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## Don't make this mistake with your IRA

Don't make this mistake with your IRA

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When properly planned, an IRA rollover should be a tax-free -- and a trouble-free -- transaction. But you do have to follow the rules to keep the tax-deferred status of your IRA assets, or face the consequences of the IRS.

The IRS gives you 60 days to rollover funds from a traditional IRA or a similar qualified account to another traditional IRA or qualified account. If you haven't completed the rollover within this 60-day window, your IRA rollover essentially becomes a taxable IRA withdrawal. That means the entire amount of the rollover will be subject to taxes at your current ordinary income tax rate. Plus, if you haven't reached age 59 1/2, you'll also face a 10 percent penalty on the withdrawal.

Another rule states that a rollover can only consist of the same property. (1) You cannot take the lump-sum distribution from your IRA, purchase other assets with the cash and then roll those assets over into a new IRA. This violates the same property rule. The IRS would consider the cash distribution from your IRA as income, subject to taxes at your current ordinary income rate plus any applicable penalties.

Here's an example of how an investor could run afoul of this rule:

A just-retired executive, age 58, has decided to rollover his 401(k) account from his former employer into an IRA. He wants to purchase some shares of the company's stock with his rollover assets. So, he takes a portion of the funds he has received from his 401(k) account to buy the shares, and places the remainder of the qualified money in a new IRA. Then, he deposits the shares of stock he purchased into the same IRA, in order to maintain the tax-deferred treatment of these assets.

The IRS would view the portion of the 401(k) rollover used to purchase the stock as taxable income, and the investor would owe taxes at his current ordinary income tax rate on this amount. Plus, the IRS would also assess a 10 percent penalty on this taxable amount, because he is younger than 59 1/2.

There's a relatively easy way to avoid these income taxes and penalties -- do a direct trustee-to-trustee transfer. This will let the IRA and retirement plan custodians do all the work of moving your assets. You don't have to worry about receiving a lump-sum distribution check and making sure you deposit the funds in a new IRA within the 60-day window. The trustees can also ensure that your assets are transferred in a time efficient manner. Please keep in mind the services provided by a trustee do involve costs that will reduce the overall return on your investment.

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