



## Retirement Planning

# When Should You Move Forward with a Reverse Rollover?

*There are many factors to consider before moving funds from an IRA into a 401(k) plan.*



*Brian Dobbis  
Retirement Solutions Lead*

*Note: This is an updated version of an article previously published in June 2022.*

Many investors are unaware of the many potential advantages available when rolling over retirement funds from their Individual Retirement Account (IRA) into their employer-sponsored 401(k) plan. This movement of funds, however, must be carefully reviewed, as there are many variables to consider.

Most individuals correctly view retirement account rollovers as a viable option to move tax-deferred funds from an employer-sponsored plan such as a 401(k) plan into an IRA. But retirement rollovers can be a two-way street. In certain situations, an eligible individual can roll retirement assets from their traditional IRA (including a SEP or a SIMPLE IRA) into an employer-sponsored retirement plan such as a 401(k), 403(b), or governmental 457(b). This movement of retirement funds is commonly known as a “reverse rollover” or “roll in.”

Surprisingly, where 401(k) plans are required to allow participants’ assets to roll the funds out of the plan into an IRA, there is no corresponding rule that plans must allow for rollovers into the plan from an IRA or from a former employer’s 401(k) plan. While most 401(k) plans do allow for a reverse rollover, check your plan’s Summary Plan Description or inquire with your Plan Administrator before initiating the process.

There are both advantages and disadvantages to doing a reverse rollover. Your own individual circumstances and needs should be carefully considered.

## Pro-Rata Distribution and How to Separate Pre-Tax and After-Tax Funds

A 401(k) plan is generally permitted to allow incoming rollovers of pre-tax funds only. Notably, Roth IRA or after-tax (nondeductible) IRA funds cannot be rolled over into a 401(k) or other employer-sponsored retirement plan.

Do you have an IRA (traditional, SEP, SIMPLE) that contains basis (i.e., after-tax dollars)? Usually, when any of an individual’s IRAs (excluding Roth IRA) contains both pre-tax (tax-deductible contributions plus earnings) and after-tax money, a withdrawal (e.g., rollover, Roth conversion, required minimum distribution, normal distribution, etc.) is partially taxable (“pro-rata” distribution of funds), making tax liability and reporting onerous.

An individual’s aggregated IRA account balance is determined as of December 31 of the year of distribution; however, the impact of a pro rata distribution can be lessened or eliminated by reducing the amount of pre-tax IRA dollars by year-end.



If, for example, you're considering converting an after-tax (nondeductible) IRA contribution to a Roth IRA (called a "backdoor" Roth conversion), a portion of the converted amount may be taxable unless you rid your existing IRAs of all pre-tax funds. This can be accomplished through a reverse rollover.

As mentioned, government rules do not allow for a reverse rollover of IRA basis. IRA funds. Instead, only pre-tax IRA funds qualify for reverse rollover treatment. While this rule, at first glance, may seem unfavorable, it offers the opportunity to "separate" IRA pre-tax and after-tax funds, which in turn offers a potential tax-free Roth IRA conversion!

The pro-rata formula looks at an individual's IRAs (including SEP and SIMPLE, but not Roth and inherited IRAs) as of December 31 of the year of the distribution. If you have any pre-tax IRA funds as of that date, a portion of the distribution will be subject to taxation. But, if you have rolled over your pre-tax IRA funds to a 401(k) IRA during the year, you'll be left with only basis as of December 31, and the conversion would likely be tax-free.

**Reverse Rollover Example:** Ben has a \$100,000 traditional IRA which \$30,000 consists of basis (after-tax funds), while the remaining \$70,000 is pre-tax (deductible contributions plus earnings).

As discussed, a 401(k) plan can, through a reverse rollover, accept only pre-tax funds; basis, however, can't be rolled over and instead must remain in Ben's IRA. Ben therefore rolls over \$70,000 to his 401(k); what's left in his IRA (\$30,000) is basis, which can now be converted to a Roth IRA without any tax liability!

In addition to doing a reverse rollover, IRA basis can be isolated in the following transactions:

- Making a Qualified Charitable Distribution
- Making a Qualified HSA Funding Distribution, a one-time direct transfer from a traditional IRA to an HSA.

Like a reverse rollover, these transactions can only be accomplished with pre-tax dollars, thus making these strategies exceptions to the pro-rata distribution rule.

### Key Takeaways

- A rollover occurs when an investor rolls over their employer-sponsored retirement plan (i.e., 401(k), 403(b), governmental 457(b), etc.) funds into an IRA. Less well known is a "reverse rollover," which is the opposite—rolling IRA money into a 401(k) or like plan.
- Not every plan permits a reverse rollover, check with your employer.
- IRA basis is reported via IRS Form 8606 "Nondeductible IRAs."

Individuals interested in a reverse rollover should understand all the ramifications before pursuing this strategy. Pro-rata rules are quite tricky. It is prudent to consult a tax advisor.



Reasons to Consider a Rollover

Reasons to consider a reverse rollover from an IRA into a 401(k)	Reasons to keep your money in an IRA
<p><b>Delay 401(k) Required Minimum Distributions (RMDs)</b> – Are you age 73 or older, actively employed, and don’t need the income from your IRA generated through RMDs?</p> <p>Here, a reverse rollover could pay dividends because you aren’t forced to take 401(k) RMDs when you are age 73. If you’re working past age 73 for the employer sponsoring your 401(k), you may be able to roll your traditional IRA into your employer plan account. Known as the “still-working exception,” it is available only to participants who are actively employed and do not own more than 5% of the company sponsoring the plan. Check with your employer to see if this optional plan provision is available.</p> <p>RMDs from traditional IRAs must always be taken upon attaining age 73—regardless of your job status. <b>EXAMPLE:</b> Tim, using the still-working exception, did a reverse rollover to his 401(k) when he was age 71, knowing he wasn’t going to retire anytime soon. Later, Tim, now 83, retires in 2025. His reverse rollover deferred more than a decade of RMDs that he would otherwise have been forced to take from his IRA.</p> <p>You cannot delay RMDs from a traditional, SEP or SIMPLE IRA, regardless of job status.</p>	<p><b>Investment Options</b> – An IRA allows you to invest in virtually anything (with limited exceptions such as life insurance and collectibles). Whereas a 401(k) plan generally has a limited menu, offering pre-selected investments.</p>
<p><b>Plan Loans</b> – In most cases, a 401(k) offers access to plan loans, although it’s an optional provision. IRAs do not permit loans.</p>	<p><b>10% Penalty Tax Exceptions</b> – IRAs offer several exceptions to the 10% early distribution penalty tax for withdrawals before age 59½, (e.g., first-time home purchase, higher-education expenses). Doing a reverse rollover would preclude you from these exceptions.</p>
<p><b>Creditor Protection</b> – Funds held in a 401(k) plan are protected from creditors, whereas IRA protection (if any) is dependent on state law. Depending on your state’s statute, you may be better protected from creditors if your retirement funds are held in a 401(k) versus an IRA.</p>	<p><b>Easier Access/Distribution Flexibility</b> – You can access your IRA savings through a distribution at any time, age, or for any reason. The distribution, however, is generally subject to taxes and/or an early penalty (if under age 59½). In contrast, a distribution from a 401(k) can be taken only after certain events (i.e., severing service, disability, incurring a financial hardship, etc.).</p>
<p><b>Rule of 55</b> – When separating from service in the year you reach age 55 or older (50 or older for certain qualified public safety employees), you can take a distribution without incurring the 10% early withdrawal penalty that otherwise would apply for distributions occurring before age 59½.</p> <p>This option does not extend to an IRA. With an IRA (excluding Roth), you generally must wait until age 59½ to withdraw funds without penalty unless an exception applies.</p>	
<p><b>Lower Fees</b> – 401(k) plan administrative and or investment fees may be lower.</p>	

Source: [www.irs.gov](http://www.irs.gov), Lord Abbett.



LORD ABBETT®

### Important Information

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product, or service may be appropriate for your circumstances.

To comply with Treasury Department regulations, we inform you that, unless otherwise expressly indicated, any tax information contained herein is not intended or written to be used and cannot be used, for the purpose of (i) avoiding penalties that may be imposed under the Internal Revenue Code or any other applicable tax law, or (ii) promoting, marketing, recommending to another party any transaction, arrangement, or other matter.

These materials do not purport to provide any legal, tax, or accounting advice.

**Traditional IRA** contributions plus earnings, interest, dividends, and capital gains may compound tax-deferred until you withdraw them as retirement income. Amounts withdrawn from traditional IRA plans are generally included as taxable income in the year received and may be subject to 10% federal tax penalties if withdrawn prior to age 59½ unless an exception applies.

A **Roth IRA** is a tax-deferred and potentially tax-free savings plan available to all working individuals and their spouses who meet the IRS income requirements. Distributions, including accumulated earnings, may be made tax-free if the account has been held at least five years, and the individual is at least 59½, or if any of the IRS exceptions apply. Contributions to a Roth IRA are not tax-deductible, but withdrawals during retirement are generally tax-free.

A **SIMPLE IRA** is a retirement plan that may be established by employers, including self-employed individuals. The employer is allowed a tax deduction for contributions made to the SIMPLE. The employer makes either matching or nonelective contributions to each eligible employee's SIMPLE IRA, and employees may make salary deferral contributions.

A **Simplified Employer Pension (SEP)** is an IRA based plan that allows small business owners and their employees to save for retirement on a tax-deferred basis. Employers contribute up to 25% of eligible employee compensation on a discretionary basis up to \$70,000 (2025) annually. The employer completes IRS Form 5305-SEP to establish a SEP IRA plan.

The information is being provided for general educational purposes only and is not intended to provide legal or tax advice. You should consult your own legal or tax advisor for guidance on regulatory compliance matters. Any examples provided are for informational purposes only and are not intended to be reflective of actual results and are not indicative of any particular client situation.

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product or service may be appropriate for your circumstances.