401(k) ROLLOVERS

WHEN CHANGING JOBS

Quick Guide

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CAUTION: This guide is intended to introduce some of the basic issues and steps involved in retirement planning. It is not intended to be all-inclusive. There are many issues and topics to be addressed in a complete retirement plan, and working with a qualified professional is strongly recommended.

This guide was prepared using information from various sources that were deemed to be reliable, but the accuracy of this information is not guaranteed. It is understood that this guide is for informational purposes only and is not intended to be considered investment or tax advice.

The opinions, and views expressed are not necessarily those of the broker/dealer and have not been independently verified. Please note that representatives of the broker/dealer cannot give legal or tax advice. This discussion of taxes is neither complete nor is it necessarily up to date. The laws and regulations are complex and subject to changes. For complete details, speak to your attorney or qualified tax advisor.

When you change jobs, you may have several choices regarding your company's retirement plan savings:

- leave the money where it is, if your former employer has these provisions in its 401(k) plan
- roll it over into an IRA or into your new employer's retirement plan
- receive it in hand to spend or invest

If your account balance is at least $1,000, the 401(k) plan may rollover your entire account balance automatically to a designated IRA unless you elect to have the distribution transferred to a different IRA or retirement plan, or to receive it directly. If your account is worth more than $5,000, the plan cannot pay out your account balance until you tell the plan administrator you want the money—in other words, when you consent to the distribution. So be sure to fill out your plan's 401(k) final distribution form if you want to take the money with you. If you decide to leave the money in the plan, you can do so at least until the later of the age specified in the plan or age 70½, when you must begin taking required minimum distributions.

SUGGESTION: If you are required to take a total distribution, you can roll over the money into a traditional IRA or your new employer's retirement plan. You can continue where you left off in saving for your retirement.

IMPORTANT NOTE: There may be a fee involved if you leave the money in your former employer's 401(k) plan. Be sure to check with the plan administrator before making your decision.

Income Tax Considerations

Your 401(k) plan distribution is likely to be one of the largest sums of money you will ever receive, depending on how many years you participated in the plan. When you take the money out of your plan, there are tax consequences. Before you begin thinking about making a total withdrawal, you should consider the taxes you might have to pay on that money, and ways you can postpone them (if that is your goal).

When you receive a distribution from a 401(k) plan, it will be subject to ordinary income tax, unless the distribution is rolled over to a traditional IRA or another employer retirement plan, such as another 401(k) plan at your new employer. Your distribution is generally subject to 20% federal income tax withholding, unless the distribution is directly rolled over to a traditional IRA or another retirement plan.

This withholding applies to your pre-tax contributions, any employer matching contributions, and their earnings, as well as the ***earnings*** on your after-tax contributions, if available under your plan. The 20% withholding rule does not apply to any after-tax ***contributions*** you may have made, because you have already paid income tax on that money.

When you take a loan from the 401(k) plan, the amount of the loan is not subject to the 20% withholding requirements, because it is not considered a withdrawal. But be careful with loans when you leave your employer. If you leave the company before repaying the loan, or without making arrangements to repay the loan (if permitted), any unpaid loan balance will be considered a distribution and will be taxable. You may also be liable for the additional 10% early withdrawal penalty tax. So, be sure you pay off the loan before you leave, or, if permitted, arrange to make payments.

Beware the 10% Early Withdrawal Penalty Tax

401(k) plans allow you to begin withdrawing money, without penalty, after age 59½. However, there is a 10% penalty tax on withdrawals made before age 59½ (if you don't roll it over) from your 401(k) plan, unless the distribution is made under one of the limited circumstances allowed by law. That is, there is a penalty for taking your money "too soon."

Some Exceptions to the 10% Early Withdrawal Penalty for 401(k) Plans

The 10% early withdrawal penalty does not apply to these situations:

1. Distributions made after age 59½
2. Distributions made after you separate from service during or after the year in which you reach age 55
3. Distributions that you roll over to another qualified retirement plan, tax-sheltered annuity, or IRA within 60 days
4. Distributions made due to disability or after your death
5. Distributions for qualified medical expenses that exceed 10% of adjusted gross income in 2019 (7.5% in 2018)

6. Distributions after separation from service that are part of a scheduled series of substantially equal periodic payments

IMPORTANT NOTE: Using your retirement plan savings for non-retirement purposes should always be your last resort.

Moving from Your Company's Retirement Plan Before You Retire

When you leave your job, you may have several choices regarding your company's retirement plan savings:

- Leave the money where it is
- Roll it over to a traditional IRA or your new company plan
- Take it as a lump-sum distribution to spend or invest

If you're happy where it is and the company permits, leave it there. If you want more investment flexibility and control, roll it over to an IRA. If you like the choices that your new employer's plan offers, move it there.

SUGGESTION: If you are eligible to establish a Roth IRA, consider rolling your company retirement plan savings into a traditional IRA, then convert it to a Roth IRA.

Avoid taking a retirement plan distribution before retirement. Using your retirement plan savings for non-retirement purposes should always be your last resort unless, of course, you have a personal emergency.

Remember, you may have borrowing options in your 401(k) plan. If you feel more comfortable knowing you can borrow the money, should you need it, transfer it to your new employer's plan. If you leave the money in your old employer's plan, you probably won't be able to borrow the funds. If you move it to an IRA, you no longer have the privilege of borrowing your money. You'll have to withdraw it—and pay taxes and a possible penalty.

If you are in-between jobs, you may roll your distribution over into a conduit IRA. If you commingle it with an existing IRA, in which qualified plan assets have not been segregated, capital gain and averaging tax treatment (for individuals born before 1936) will not be available.

When you leave an employer, you generally receive a termination package in which you can elect a distribution option. If you're going to be moving your funds, instruct your previous employer where to send your distribution. Your new employer or an IRA institution can provide you with the name and address of the new custodian.

Protect Your Retirement Assets

One last word when leaving a job, particularly if you've been laid off; you may be tempted to use the money for day-to-day living expenses. Exhaust every other possibility before you withdraw your money. Between income taxes and a possible penalty tax, you will pay a tremendous price in both the short- and long-term if you invade your retirement account. Here's why:

Suppose you are 40 years old, you are in the 25% tax bracket, and you need $10,000. You have no other savings. You decide to withdraw $10,000 from your company retirement plan. You'll have to withdraw another $5,385, a total of $15,385 just to net $10,000. Why so much? The government requires you to pay income tax as well as a 10% penalty (assuming you're under age 59½). See the section *Early Withdrawals* for information about exceptions to the 10% penalty.

How Much Will You Actually Have to Borrow to Net $10,000?	
Withdrawal amount	$15,385
minus income tax at 25%	$3,846
minus 10% penalty if under age 59 ½	$1,539
Equals	$10,000

Since you are required to pay income tax and penalty tax, it is actually costing you 54% more. That's the short-term effect of taking the withdrawal.

The long-term effect—assuming a 7% tax-deferred return and you don't retire until age 65—is that the $15,385 could have grown to $83,501 in 25 years.

Rollover into a Traditional IRA or Other Retirement Plan

The law provides some ways to delay paying taxes by allowing your 401(k) plan money to be rolled over into a traditional IRA or another company's retirement plan, e.g. a 401(k) plan. A rollover must generally be completed within 60 days of when the distribution was received. It is usually wise to roll over your distribution, because you are deferring taxes on your former 401(k) contributions and you continue to delay paying taxes on the amount it earns as well.

IMPORTANT NOTE: If you roll over your 401(k) funds to a traditional IRA, you may no longer be eligible for 10-year averaging unless you roll it into a conduit IRA (for taxpayers born before 1936).

SUGGESTION: From the year 2010 the income limitation on converting a traditional IRA to a ROTH IRA has been removed (even if you are married filing separately, provided you meet some conditions). You would be required to pay tax on any deductible contributions and any earnings on the date of the conversion. The 10% early distribution penalty does not apply on the conversion.

Direct Rollover to a Traditional IRA or Other Retirement Plan Avoids the 20% Withholding Tax

If you roll over your 401(k) distribution directly to a traditional IRA or other retirement plan, you pay no taxes on the money at that time, and you are not subject to the 20% withholding requirement. This can be accomplished by completing the appropriate plan documentation and establishing a qualified IRA account. You never touch the money or get involved with the transfer. This is called a "direct rollover."

Rollover into a Traditional IRA or Other Retirement Plan Even if the 20% Is Withheld

Even if you receive the 401(k) money directly and the 20% tax is withheld, you may still put the money in a traditional IRA or other retirement plan, generally within 60 days of receiving the 401(k) distribution. You can even put the full value of the 401(k) in the IRA or other retirement plan after 20% federal tax has been withheld, but you will need to have cash available equal to the 20% withholding amount.

For example, you have $60,000 in your 401(k) when you leave the company at age 35. None of the $60,000 is attributable to after-tax contributions, so all of it is subject to tax. You decide not to make a direct rollover and the 401(k) plan administrator mails you a check for $48,000, which represents the $60,000 that was in your account minus the 20% withheld for taxes. In order to roll over the full $60,000 to your IRA or other retirement plan, you have to have $12,000 available in cash. You can claim the 20% tax that was withheld on your tax return, and as long as you roll over the entire retirement distribution, the distribution won't be taxable. If you do not come up with the additional $12,000 and roll over only $48,000, you will have to pay income tax on $12,000 and, if applicable, the 10% early withdrawal penalty.

SUGGESTION: Elect a direct rollover from your 401(k) plan to a traditional IRA or other retirement plan to avoid the withholding rule.

Conduit IRAs

If you plan on rolling your 401(k) distribution into another retirement plan, but can't do it right away, it is highly advisable to use a "conduit IRA" to hold the money in the interim. A conduit IRA is a traditional IRA set up exclusively to hold your 401(k) distribution for a short period of time until you are able to roll it into your new employer's 401(k) plan or other retirement plan. You must not make any new or additional contributions to this IRA or commingle it with any other retirement money. If you do, you will not be eligible for the 10-year averaging treatment available to plan participants born before 1936.

The Roth IRA - How Does It Fit In?

IMPORTANT NOTE: See the section Roth IRA Conversions to learn about Roth IRA conversions that may be available to you even if you do not meet the criteria for a Roth IRA.

From tax year 2010 the modified gross income limit is eliminated, allowing higher income taxpayers to convert traditional IRAs to Roth accounts. You are required to pay tax on the deductible and pre-tax contributions and any earnings on the date of the conversion. The 10% early distribution penalty does not apply on the conversion.

If you are eligible to establish a Roth IRA, you will need to consider if you should roll over your qualified retirement plan money into a traditional IRA and then convert it to a Roth IRA. The analysis is quite complicated and the assumptions regarding your tax bracket before and after retirement will help you make the decision.

For example, if you estimate that your current tax bracket will be the same as your tax bracket in retirement, it may make sense to convert a traditional IRA to a Roth IRA upon rolling over the qualified retirement money into the traditional IRA.

If, on the other hand, you are currently in a high tax bracket (say 28%) and you estimate your bracket in retirement to be much lower (say 15%), then it may not make sense to convert the traditional IRA to a Roth IRA.

Summary of Distribution Options When You Leave Your Company

Don't jump the gun by taking a distribution of your 401(k) money before you look at all your options and make an informed decision. To summarize, you have the following options if you want to roll over your distribution:

- You may have the option to leave the money in your old employer's 401(k) plan.
- Directly roll over your 401(k) money into your new employer's 401(k) plan or other retirement plan, assuming the new plan will allow you to do so right away.
- Directly roll over your 401(k) money into a conduit IRA until your new employer's 401(k) plan or other qualified plan will accept the money (necessary for plan participants born before 1936 to preserve capital gain and averaging treatment).
- Directly roll over your 401(k) money into a traditional IRA and continue to fund your retirement. This is advisable if you do not have access to a 401(k) or other qualified plan in your new job, or you want to manage your own retirement assets. Also, the IRA money is available for withdrawal without the need to satisfy an employer's hardship criteria, and penalty-free withdrawals are available for qualified education expenses and qualified first-time homebuyers.

Directly roll over your 401(k) money into a traditional IRA and convert it to a Roth IRA unless you file as married filing separately.

IMPORTANT NOTE: See the section Roth IRA Conversions to learn about Roth IRA conversions that may be available to you even if you do not meet the criteria for a Roth IRA.

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Distributions over Your Life Expectancy

Another way to avoid the 10% early withdrawal penalty tax on a distribution from a 401(k) plan upon leaving the company is to take the distribution over your life expectancy.

You must take a series of substantially equal periodic payments at least once a year over your life expectancy or the joint lives of you and your beneficiary. Of course, you will pay ordinary income tax on the distributions you receive each year. The withdrawal schedule must continue at least five years, and at least until you reach age 59½. This option should only be considered when you really need the money or are close to retirement. Otherwise, you'll be depleting your retirement savings before retirement.

IMPORTANT NOTE: Not all 401(k) plans allow this type of distribution option. Check with your plan administrator.

SUGGESTION: Another way to avoid the 10% penalty tax is to directly roll over your 401(k) distribution to a traditional IRA and then take distributions over your life expectancy. Consider setting up more than one IRA and take distributions from only one of them to keep you from depleting all your retirement savings. ♦