Rolling It

By Mark A. Vergenes

If you're changing jobs, you may be wondering what to do with your 401(k) plan account. No matter what stage you are in your career or how close you are to retirement, it's important to understand your options.

Your Entitlements

If you leave your job (voluntarily or involuntarily), you'll be entitled to a distribution of your vested balance. Your vested balance always includes your own contributions (pretax, after-tax, and Roth) and typically any investment earnings on those amounts. It also includes employer contributions and earnings that have satisfied your plan's vesting schedule.

In general, there are two ways to become vested in your employer's contributions to your retirement plan:

- Cliff vesting means you're 100 percent vested in employer contributions after three years of service.
- Graded vesting happens gradually at 20 percent per year. After six years, employees are 100 percent vested.

Plans can have faster vesting schedules, and some even have 100 percent immediate vesting. You'll also be 100 percent vested once you've reached your plan's normal retirement age.

It's important to understand how your particular plan's vesting schedule works because you'll forfeit any employer contributions that aren't vested at the time you leave your job. Your summary plan description (SPD) will spell out how the vesting schedule for your particular plan works. If you don't have one, ask your plan administrator for it. If you're on the cusp of vesting, it may make sense to wait a bit before leaving if you have that luxury.

Don't Spend It—Roll It

While your retirement plan's pool of dollars may look attractive, don't spend it unless you absolutely need to. Taking a distribution means you'll be taxed at ordinary

Changing jobs? *401(k) rollovers come with lots of choices. Learn how to make the best ones.*

income tax rates on the entire value of your account except for any after-tax or Roth 401(k) contributions you've made. And if you're not yet age 55, an additional 10 percent penalty may apply to the taxable portion of your payout. (Special rules may apply if you receive a lump-sum distribution and you were born before 1936 or if the lump sum includes employer stock.)

If your vested balance is more than $5,000, you can leave your money in your employer's plan until you reach normal retirement age. Your employer, however, must also allow you to make a direct rollover to an individual retirement account (IRA) or to another employer's 401(k) plan. As the name suggests, in a direct rollover the money passes directly from your 401(k) plan account to the IRA or other plan. This is preferable to a 60-day rollover, in which you get the check and then roll the money over yourself because your employer has to withhold 20 percent of the taxable portion of a 60-day rollover. You can still roll over the entire amount of your distribution, but you'll need to come up with the 20 percent that's been withheld until you recapture that amount when you file your income tax return.

IRA or Employer 401(k)?

Picking between your own IRA and an employer 401(k) plan looks like a tough choice, but assuming both options are available to you, there's no right or wrong answer to this question. There are strong arguments to be made on both sides. You need to weigh all of the factors and make a decision based on your own needs and priorities. It's best to have a professional assist you with this, as the decision you make may have significant consequences—both now and in the future.

Reasons to roll over to an IRA:

- You'll generally have more investment choices with an IRA than with an employer's 401(k) plan. In a typical situation, you can freely move your money around to the various investments offered by your IRA trustee, and you may divide up your balance among as many of those investments as you want. By contrast, employer-sponsored plans typically give you a limited menu of investments (usually mutual funds) from which to choose.
- You can freely allocate your IRA dollars among different IRA trustees/custodians. There's no limit on how many direct, trustee-to-trustee IRA transfers you can do in a year. This gives you flexibility to change trustees often if you are

dissatisfied with investment performance or customer service. It can also allow you to have IRA accounts with more than one institution for added diversification. In an employer's plan, you can't move the funds to a different trustee unless you leave your job and roll over the funds.

- An IRA may give you more flexibility with distributions. Your distribution options in a 401(k) plan depend on the terms of that particular plan, and your options may be limited. However, with an IRA, the timing and amount of distributions is generally at your discretion (until you reach age 70½ and must start taking required minimum distributions (RMDs) in the case of a traditional IRA).
- You can roll over (essentially convert) your 401(k) plan distribution to a Roth IRA. You'll generally have to pay taxes on the amount you roll over (minus any after-tax contributions you've made), but any qualified distributions from the Roth IRA in the future will be tax-free.

Reasons to roll over to your new employer's 401(k) plan:

- Many employer-sponsored plans have loan provisions. If you roll over your retirement funds to a new employer's plan that permits loans, you may be able to borrow up to 50 percent of the amount you roll over if you need the money. You can't borrow from an IRA; IRA funds can only be accessed by taking a distribution, which may be subject to income tax and penalties. (You can, however, give yourself a short-term loan from an IRA by taking a distribution and then rolling the dollars back to an IRA within 60 days.)
- A rollover to your new employer's 401(k) plan may provide greater creditor protection than a rollover to an IRA. Most 401(k) plans receive unlimited protection from creditors under federal law. Creditors (with certain exceptions) cannot attach your plan funds to satisfy any of your debts and obligations, regardless of whether you've declared bankruptcy. In contrast, any amounts you roll over to a traditional or Roth IRA are generally protected under federal law only if you declare bankruptcy. Any creditor protection your IRA may receive in cases outside of bankruptcy will generally depend on the laws of your particular state. If you are concerned about asset protection, be sure to seek the assistance of a qualified professional.
- You may be able to postpone required minimum distributions. For traditional IRAs, these distributions must begin by April 1 following the year you reach age 70½. However, if you work past that age and are still participating in your employer's 401(k) plan, you can delay your first distribution from that plan until April 1 following the year of your retirement. (You also must own no more than 5 percent of the company.)
- If your distribution includes Roth 401(k) contributions and earnings, you can roll those amounts over to either a Roth IRA or your new employer's Roth 401(k) plan if it accepts rollovers. If you roll the funds over to a Roth IRA, the Roth IRA holding period will determine when you can begin receiving tax-free qualified distributions from the IRA. So if you're establishing a Roth IRA for the first time, your Roth 401(k) dollars will be subject to a new five-year holding period. On the other hand, if you roll the dollars over to your new employer's Roth 401(k) plan, your existing five-year holding period will carry over to the new plan. This may enable you to receive tax-free qualified distributions sooner.

When evaluating whether to initiate a rollover always be sure to:

- Ask about possible surrender charges that may be imposed by your employer plan or new surrender charges your IRA may impose.
- Compare investment fees and expenses charged by your IRA (and investment funds) with those charged by your employer plan (if any).
- Understand any accumulated rights or guarantees that you may be giving up by transferring funds out of your employer plan.

Outstanding Plan Loans

In general, if you have an outstanding plan loan, you'll need to pay it back or the outstanding balance will be taxed as if it had been distributed to you in cash. If you can't pay the loan back before you leave, you'll still have 60 days to roll over the amount that's been treated as a distribution to your IRA. Of course, you'll need to come up with the dollars from other sources.

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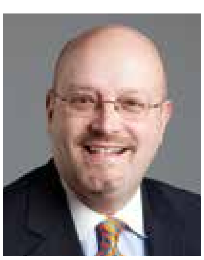

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