401K Rollover Options

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So you're ready to retire. You've worked hard for many years, and now it's nearly time for you to sit back and enjoy the fruits of your labor. But before you retire, you need to take a careful look at your 401(k). There's a good chance your 401(k) is one of your single largest assets. And the decisions you make about it can have a lasting impact for you and your family.

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Four Options

1. Roll over into an IRA
By rolling the money into an IRA, you gain more control, have more flexibility in your investment options, and can benefit from the guidance of an Advisor. Plus, your funds grow tax-deferred. An IRA rollover makes it easy to track these funds by keeping them together.

2. Roll over into your new employer's plan.
Many employers will allow you to move the money from your former employer's retirement plan into your new plan. Check with your former employer. Keeping your money in one employer retirement plan may be convenient, but you may have limited control over your money and the investment options

3. Keep the money in your former employer's plan.
If your balance is $5,000 or more, you may be able to leave the money in your former employer's plan. This may be the simplest option, but disadvantages exist. You may have limited control over your money and investment options, and you may find it difficult to keep track of your money through the employer's administrator.

4. Take your money out of your former employer's plan.
You do have the option to withdraw some or all of the money in the plan. However, the money you take out may be taxable income, subject to a mandatory 20% IRS withholding, and a 10% IRS early withdrawal penalty. These taxes and penalties can drastically reduce the amount of money available to you at withdrawal.

Rolling over to an IRA

One of your most flexible rollover options is moving your full account value into an IRA. An IRA gives you greater freedom in choosing investments than a 401(k). You can decide for yourself whether you'd like to invest your retirement assets in insured bank accounts, mutual funds, individual stocks and bonds, or higher risk investments such as options or futures. You can choose among a wide range of IRA providers, or custodians, as well.

Rolling over to an IRA also gives you greater control over when you withdraw your money. With a 401(k) plan, you usually can't start taking withdrawals until after you retire. An IRA is more flexible, since as soon as you turn 59 1/2, you're allowed penalty-free withdrawals, even if you're still working.

Similarly, you usually must begin taking money from your 401(k) as soon as you retire. If you have income from other sources and don't want to take withdrawals from a tax-deferred account that quickly, an IRA will let you postpone withdrawals until April 1 of the year after you turn 70 1/2. In fact, many retired people roll over their 401(k) retirement assets into IRAs to avoid having to take money out.

As you consider your options, keep in mind that one of the greatest advantages of a 401(k) plan is that it allows you to save for retirement on a tax-deferred basis. When changing jobs, it's essential to consider the continued tax-deferral of these retirement funds, and, if possible, to avoid current taxes and penalties that can eat into the amount of money you've saved.

Why not a cash distribution? and RMD

Almost 70% of 401(k) participants who change jobs take their assets as a cash distribution. The smaller the size of the account, the more likely it is that the owner of the account will spend the money.

As tempting as it may be to view your 401(k) assets as a welcome infusion of cash to pay off credit card debt, a car loan, or help pay for an upcoming vacation, it's important to keep in mind that it's almost never in your best interest. As much as 50% or more of your account balance could be eroded by taxes and penalties. Even worse, you'll permanently lose the tax-deferred status of those assets.

For instance, if just once in 30 years you took $10,000 out of your 401(k) instead of rolling it over into an IRA earning 8% annually, your retirement nest egg could end up more than $100,000 short.

Instead, it's a good idea to take advantage of the portability of your 401(k) to evaluate your options and choose the one that best helps you meet your goals and your investment style. In the long run, you'll be glad you did.

Required Minimum Distribution

The IRS requires that you withdraw at least a minimum amount - known as a Required Minimum Distribution - from your retirement accounts annually, starting the year you turn age 70-1/2. Determining how much you are required to withdraw is an important issue in retirement planning. Meet with your Peak Financial Advisor to determine what this amount is.

Additional Considerations

Assuming that your new employer offers a retirement plan that will accept rollover contributions, is it better to rollover your traditional 401(k) funds to the new plan or to a traditional IRA? Each retirement savings vehicle has advantages and disadvantages. Here are some points to consider:

• A traditional IRA can offer almost unlimited investment options; a 401(k) plan limits you to the investment options offered by the plan.
• A traditional IRA can be converted to a Roth IRA if you qualify.
• A 401(k) may offer a higher level of protection from creditors.
• A 401(k) may allow you to borrow against the value of your account, depending on plan rules.
• A 401(k) offers more flexibility if you want to contribute to the plan in the future.

Finally, no matter which option you choose, you may want to discuss your particular situation with a tax professional (as well as your advisor) before deciding what to do with the funds in your 401(k).

Next Steps

1. If moving to a new job, talk to the new 401(k) plan administrator and find out what arrangements are necessary. For example, you may need to choose an asset allocation for the rollover amount.

2. Complete the required distribution forms from your former employer's plan administrator.

3. Request that a check be sent directly to the new plan's administrator or transferred electronically, if possible.