At Retirement-To Roll or Not to Roll

Topic:	At retirement should you rollover your 401(k) to an IRA?
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Executive Summary: At retirement corporate executives are faced with leaving their 401(k) with their former employer or rolling it over into one or more IRA's. Before deciding, three questions should be asked.

Who should manage your retirement portfolio after you leave your company? Should you leave your 401(k) with your former employer or should you roll it over into an IRA? This is one of the many questions that face corporate executives at retirement. Before deciding, consider the answer to these three questions:

1. What is my age and financial need at retirement?
2. Who are the beneficiaries of my 401(k)?
3. How can I get the best investment choices at the lowest cost for my portfolio?

<u>What is my age and financial need at retirement?</u>

IRA distribution laws are different than those for 401(k)'s. If you are at least 55, but no more than 59½, there are advantages for leaving your funds in the 401(k). During that age range, you can freely withdraw money from the 401(k) if you are no longer working for the company. On the other hand, if your funds are in an IRA, you may trigger a 10% penalty tax unless you set up a stream of "substantially equal payments" that must continue for at least 5 years under Section 72(t) of the IRS Code

If you retire before 55, then you may not make early withdrawals penalty-free from either your 401(k) or IRA unless you use the Section 72(t) exception for early distributions. Thus, if you make such an election, you must take substantially equal annual distributions until you reach 59 ½.

For example, Tom retires from Acme Manufacturing at age 56. His 401(k) balance is $1,600,000. He wants to find a new job and keep working, but is unsure of his chances. Tom may need to withdraw 401(k) funds to cover his expenses until he can find a new job. Because of his uncertainty, Tom would be better off leaving his funds in the 401(k) so he could withdraw whatever he needed without incurring a 10% penalty. If Tom had rolled his money into an IRA, his choices would have been more limiting. Either he would need to pay the 10% tax penalty on all withdrawals or he would have to take 5 years of distributions based on his life expectancy which would waste his tax deferral advantage if the need was only temporary.

If Tom did not need the money until after he reached 59 ½, then he should roll it over immediately into an IRA to enjoy the flexibility that it will give him and his beneficiaries. Rolling over to an IRA also broadens the array of investment choices beyond the usually limited 401(k) fund choices. Either way, Tom is a winner.

The age and financial need factors are summarized in the table below:

	Retire before 55	Retire 55 or older
May need money before 59 1/2	Roll to an IRA and use 72(t) exceptions	Leave in 401(k) and take as needed
Not need money before 59 1/2	Roll to an IRA	Roll to an IRA

Who are the beneficiaries of my 401(k)?

Let's assume Tom retires from Acme Manufacturing and under his 401(k) plan he has designated his wife to receive 50% upon his death and he two kids share the other 50%. The 401(k) plan must provide that the wife can receive her share over her lifetime which allows for tax efficient distribution. On the other hand, the typical 401(k) plan does not allow a similar payout scheme for non-spousal beneficiaries. Usually non-spousal beneficiary (e.g. children, grandchildren, trusts), will be forced to withdraw the funds over a relatively short period (often 5 years) at high tax rates up to 35%. In contrast, if Tom had rolled his 401(k) into an IRA (or multiple IRA's for children) before his death, then the more lenient IRA rules allow withdrawals at the much slower rate over the life expectancy of the child. This can result in much more tax deferred appreciation and potentially much lower taxes each year. Thus, if an executive wants to leave some of his 401(k) assets to his children (or to a trust), he should roll the funds into an IRA immediately. If he needs money before he reaches 59 ½, then he would use the 72(t) rules to take early distributions.

How can I get the quality investment choices at the lowest cost for my portfolio?

While many 401(k) plans are cautiously increasing the number of investment options, most do not take advantage of the full array of investment choices available in the marketplace. We have found that the increased flexibility of investment options afforded to IRA's enhances the potential investment return of the portfolio. Not only are the investment choices increased, but it can also decrease the management costs by utilizing more cost effective investment choices.

Bottom Line Recommendation

In almost all cases it is best to roll your 401(k) assets immediately into one or more IRA's. The one exception is if you retire between ages 55-59 ½, need money from your 401(K) only temporarily, and plan to leave it all to your spouse. In this case the best decision may be to leave the 401(k) alone until you reach 59 ½ and then roll it over to an IRA.

Please note that every situation is different and should be assessed by a professional before proceeding. Gains from tax-deferred investments are taxable as ordinary income upon withdrawal. If you have any questions or would like assistance with this or other matters, please call us at Vantage, 847-590-5555.

The information contained herein is of a general nature and should not be relied upon without first consulting a financial advisor. If you would like further information please email info@vantagefinancial.com.

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