STIFEL
INVESTING

IRA Rollovers

IRA Rollovers — You may be ready for one sooner than you think.

Sooner or later, most Americans with retirement plans will be faced with receiving a distribution from their retirement plan and will need to make important decisions regarding how that distribution is handled. Being apprised of the choices available, and the possible consequences of those choices, may help protect the retirement funds you've worked so hard to accumulate. There are many situations that would warrant a rollover.

Whether you are changing jobs, retiring, or considering rolling one IRA to another, each situation must be evaluated carefully.

Moving on: A new job could mean a new retirement account.

Many of today's workers change jobs multiple times over the course of their career. When changing jobs, most workers prefer to start their new opportunities with a fresh, clear perspective. This usually means severing all ties with their former employer, which includes taking their 401(k) with them.

Even the employee who spends his or her career in one company may not be impervious to change, as the organization they work for is likely to make numerous changes to their corporate structure and benefits programs throughout the years. As unfortunate as it is, some companies may have to terminate their employee retirement programs due to financial reasons or mergers with other companies. Employees who go through these changes are often faced with a lump-sum distribution and a decision regarding what to do with it.

Approximately 80% of workers whose 401(k)s are less than $5,000 choose to cash in their plans when they switch jobs.[1] If you choose to cash in your 401(k) before the age of 59 1/2 (or age 55 and separated service) you will be required to pay a 10% penalty for early withdrawal as well as losing a significant portion of your funds to income taxes. In addition to the immediate impact, the opportunity for future tax-deferred growth would also be lost. This may seem like a small chunk of change now, but $5,000 held in an IRA for 20 years, even at a conservative rate, could make a drastic difference to the overall value of your account. It is also important to remember that when you convert your employer-sponsored plan to an IRA, you can continue to make annual contributions to the rollover account, increasing the power of tax-deferred compounding.

If you have over $5,000 vested in your retirement plan, you may choose to keep the funds within that company's plan when you leave. However, if you are a worker who is on the move, making numerous job changes, you may end up with numerous plans with a number of companies. This can prove to be confusing when evaluating your entire investment plan and in reviewing performance statements. Having one IRA to hold all of your retirement funds may make monitoring your investment strategy a great deal simpler. Also, the company you've left may make changes to their benefits plans in the future. Rolling over a 401(k) plan now can alleviate the burden of having to make changes if your old company suddenly goes bankrupt or merges with a competitor.

With company-sponsored plans, you are restricted to the menu of investments offered by those plans. By rolling over

funds to an IRA, you may find that you have more investment options to choose from and greater flexibility in the account.

Before starting the paperwork on any rollover process, keep in mind the following points:

- Make sure the rollover is a "direct rollover." This means that the check is made payable to the financial institution that will hold your IRA. If your old employer issues the check payable to your name, they will withhold a mandatory 20% as prepayment of estimated taxes due.
- Be aware of deadlines associated with the rollover. If you do have the check issued to your name, you'll have 60 days from the date you receive the check to complete the "indirect rollover." By missing the deadline, the IRS will consider the amount a withdrawal and assess ordinary income tax and an additional 10% penalty tax if you are less than 59 1/2 years old (or 55 and separated from service).

Facing retirement: Making the most out of your plan.

When you are ready to retire, you may have to make a choice between leaving your 401(k) intact with the company

you're retiring from, rolling over the funds to an IRA, or if you are allowed, starting annuity payments. Careful consideration must be given to a number of factors before making any decisions regarding your retirement funds.

Your age and whether or not you'll need to access your funds will be important factors in deciding which option to choose. For instance, if you are between the ages of 55-59 1/2, and quit your job, you'll want to carefully consider your plans for the next few years. If you plan on fully retiring, or working on a free-lance or part-time basis while relying on your retirement funds to supplement your income, you may want to leave your funds in your former employer's plan or roll over only part of your distribution. This is due to the fact that you can receive distributions from a qualified plan at age 55, if separated from service, without the 10% penalty. However, once you roll over to an IRA, you must wait until age 59 1/2 before you can receive penalty-free distributions.

In addition to having earlier, penalty-free access to your money, leaving your funds in a 401(k) plan may offer benefits, such as having low fees and discounts on investment-related expenses due to the large size of the plan. Some companies may even pay these expenses and fees all together. You may also choose to leave your funds where they are to defer taking any immediate action with your 401(k), leaving it up to your discretion as to when you want to do a rollover or receive distributions.

While there are valid reasons to stick with your 401(k) as you enter retirement, there are good reasons to consider rolling over to an IRA as well. Most investors find that IRAs offer a greater flexibility on investment options, as 401(k)s often have a limited menu of fund options. If your 401(k) is currently comprised of shares of employer stock, you may want to consider the ramifications of not being more diversified. A self-directed IRA would allow you to correct that problem. If your plan remains in shares of employer stock, you could save a significant amount in taxes by making a Net Unrealized Appreciation (NUA) election. With this election, shares are distributed from the plan "in kind" and just the basis of the stock will be taxed as ordinary income at the time of distribution. The appreciation will not be taxed until you liquidate the shares and will be taxed at the 20% capital gains rate. This could save you a substantial amount on taxes if your stock is highly appreciated and you are in a high tax bracket.

A valuable benefit of a Stifel IRA rollover is having the opportunity to work with a full-service investment firm. By getting to know you, your current financial situation, and future goals, an investment professional can offer a wide range of other investment products and services, such as financial planning, wealth preservation, insurance, or funding a college savings plan for a loved one.

Your plan may also offer an annuity option. By selecting this option, you'll be provided with a steady stream of income. However, these payments often do not transfer to your survivors after your death and some may not increase, over the years, with inflation. Most importantly, by electing the annuity option, you also don't have control over the money in order to make investment decisions that are tailored to your personal situation.

The IRA-to-IRA rollover: Is a conversion right for you?

Transferring funds from an employer-sponsored plan isn't the only type of rollover you may encounter. Once you've established an IRA, you may decide, for service or performance reasons, that your account isn't meeting your expectations. Or, you may have multiple IRAs that you wish to consolidate. Within certain guidelines, you may roll over one IRA to another. Normally, only one indirect rollover per account may occur in a 12-month period. Direct rollovers — when funds go directly from the old custodian to the new custodian — are unlimited.

Pay Taxes Now, or Later?

If you qualify, you may find that a Roth IRA is better for your personal situation. A Roth IRA offers a unique investment opportunity due to its tax-free advantages. With the Roth IRA, contributions are not deductible, but distributions can be withdrawn tax-free under certain conditions. Ordinary income tax is due on the amount converted in the year of conversion. For some, paying the tax up-front can offer significant tax savings later. Prior to 2010, only individuals with less than $100,000 in adjusted gross income (AGI) were permitted to take advantage of Roth IRA conversions. However, effective in 2010, the $100,000 AGI eligibility limitation was eliminated. It should be noted that the AGI eligibility limitation to make contributions directly into Roth IRAs continues to apply.

As of 2008, rollovers from a qualified retirement plan directly to a Roth IRA are also now permitted.

Take Action Now

Every investor has their own unique set of goals and priorities for retirement. Determining what you should do with your lump-sum distribution from a qualified retirement plan will be based on your individual situation. It is important that you understand your choices and their implications by consulting with both your tax professional and financial advisor. I encourage you to call me today, so we can discuss your rollover options and create a retirement strategy specific to your needs.

[1]Independent Survey, Hewitt Associates.