401 (k) rollover?

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Are you holding one or more 401(k) plan accounts from former employers? You have several options:

1.Leave the money and do nothing.

2.Roll it into your new employer's 401(k), if allowed.

3.Cash it out.

4.Roll it into an IRA.

5.Convert it to a Roth IRA account.

So what do I do?

First of all, I want to applaud you for taking advantage of the benefits of participating in a company sponsored 401(k) plan:

- Pre-Tax contributions lessen your tax liability now.
- Money grows tax-deferred – not taxed until you take distributions.
- Money is portable – you can take it with you when you leave
- Employer Matching – offered by many employers, it gives you free money and an automatic return on your investment
- Investment Flexibility – usually at least a small choice in funds to diversify your assets.
- Most plans offer some loan privileges to active employees, allowing you to pay yourself back, rather than paying a lender, for unexpected financial needs. These loans also do not show on your credit record, but if you leave the firm, the loan will be due in full or you may have a taxable event and penalties on the loan balance.
- 401k assets (not Solo 401K assets) are creditor protected by law, including situation involving bankruptcy (there are some exceptions), whereas IRA accounts are only asset protected up to $1million.
- Some 401k plans now offer Roth 401k accounts for after-tax contributions that may provide tax-free withdrawals in retirement.
- If you leave your job between between age 55 and age 59 ½ you may be able to take penalty free withdrawals generally not permitted in an IRA until age 59 ½.

Now, back to the question….what do you do with the 401(k) accounts when you change employers or are no longer working?

Cash Out? If you are under age 59 1/2 and decide to cash out, you may have to pay penalties, in addition to having to claim distributions as ordinary income. Your employer will be required to withhold 20% of the withdrawal for taxes, and tax penalties may apply. Unless your financial situation is dire, try to avoid this route. You worked hard to save this money for your retirement, so keep it earmarked for your retirement. If you decide to cash out, then change your mind; you can put that money into an IRA, if you do so within 60 days and have it classified as a rollover to avoid those taxes and penalties. There are, however, recent IRS rulings limiting you to one tax-free IRA rollover each tax year on all of your IRA accounts.

Roll into your new 401k? Some employer 401k plans will allow for the rollover of 401k accounts from former employers. This allows you to consolidate your investments into the one account, where the benefits of a 401k listed above would apply.

Rollover to IRA? In some cases, it makes sense to roll your 401(k) directly into an IRA and leave that asset to continue to grow. If you have multiple 401(k) accounts, this can also allow for consolidation of your assets into one account. Many individual IRAs have a broader selection of investment choices than company 401(k) plans, allowing for potentially greater diversification.

Rollover to Roth? Another newer option available is to roll the assets from the company plan into a Roth IRA, where they may provide a tax-free source of income in retirement. This may be beneficial if you anticipate higher tax rates in the future. Roth contributions, however, unlike traditional IRA contributions, are not made with pre-tax money and do not reduce your current tax liability. These rollovers from a 401k into a Roth IRA are taxable as regular income at the time of the rollover, so you must take that extra potential tax burden into consideration. You also do not have to take required minimum distributions (RMDs) as you must if you leave the money in a 401(k) or move the assets to a traditional IRA.

Higher Fees with a Rollover? Be careful to compare the fees you are paying in your current 401k to the fees you will pay in an IRA or your new 401k. The new fees will usually be greater, so you must both the fees and the pros and cons of what you will be gaining in exchange for that potentially higher fee, as well as the 401k benefits you may be losing.

Seek professional guidance? When you roll your 401(k) into an IRA of either type, you gain the ability for allocation advice from a wider variety of trained professionals with investment experience. Our firm can help.

Even if a rollover of your 401(k) doesn't make sense for your situation, you may still want to seek advice on making allocation decisions within your account. Our firm can provide the advice you need.

Small Business Owner? Additionally, if you are a small business owner thinking about implementing a 401(k) plan for you and your employees, or a sole proprietor looking to implement a SoloK or UniK for your own retirement investing, we can help get you set up in a plan that is right for your needs.

Before making any decisions on 401(k) assets or plan needs, please contact our office to discuss your situation at 770.931.1414 or contact another financial professional for advice.

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