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## Guide to 401(k) Rollovers

With the first of the baby boomers closing in on retirement age and many workers changing jobs every two to three years, an increasing number of investors are grappling with whether to leave money in a 401(k) plan, roll it over into an IRA or cash out.

It's an important question because for many Americans, the largest chunk of their nest eggs will come from company-sponsored retirement plans.

What you decide to do with your 401(k) funds when you leave a job will be based on your financial circumstances, your investment needs and the transaction's tax consequences. Some issues to consider:

### Taking the cash:

The temptation when you leave a job may be to use those savings to satisfy short-term spending urges, even if doing so will mar your long-term retirement goals. Nearly half of employees cash out their 401(k)s, with younger workers and those with smaller balances more likely to do so, according to research from Hewitt Associates.

If you cash out, your company probably will cut you a check for 80% of the funds. The rest will be withheld for federal taxes. You also may be hit with a 10% tax penalty if you are younger than 59½. Even worse, you have to start over building retirement savings.

Regret the hasty withdrawal? You have 60 days from when you get the distribution to roll it over into an IRA or your new employer's 401(k) to avoid the penalty. If you miss this deadline because of a mistake by your financial institution, the IRS grants an automatic extension. Taxpayers could also get a break when unusual circumstances, such as an illness, prevent them from getting the money back in time.

One of the few instances it could make sense to take out your retirement savings is when you have highly appreciated company stock. Under a little-known IRS rule, investors can get a huge tax break by asking the company to take the stock out of the 401(k) plan in an "in-kind distribution" and then putting it into a regular investment account.

You pay income taxes only on the value of the company stock when you bought it. So, if you initially paid \$10,000 and it's now worth \$100,000, you'd pay income taxes on the \$10,000 when you take it out of the



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company plan. The rest of the value is taxed at lower capital-gains rates when you eventually sell it.

The portion of the 401(k) plan that is not in company stock must be put elsewhere, such as an IRA, within a year to get the tax break.

### **Rolling over:**

When you transfer your 401(k) funds into an IRA rather than leaving them in the company's plan, you keep taxes deferred while making it easier to keep track of your investment.

### **Also consider rolling money over into an IRA when:**

- You want more investment options than are available in the 401(k) plan. Your company plan may have a set menu of prescreened investment options, but you can usually invest in individual stocks, mutual funds, even certificates of deposits in an IRA.
- You want control over your money. If you've changed jobs many times during your career, you may have retirement funds strewn all over. An IRA lets you consolidate this money in one place.
- You are planning to pass the money to your kids. IRAs give you greater flexibility in transferring these funds to beneficiaries, including letting your heirs stretch withdrawals over a long period of time rather than taking a lump sum.
- You plan to use some of the money to buy a first home or to fund your child's college education. If the money is in an IRA, the IRS will waive the 10% penalty for these uses, although you'll still have to pay income tax on the withdrawal.

To minimize the risk of mistake and to keep your money invested throughout the process, ask for a trustee-to-trustee transfer from your 401(k) to an IRA. The money is moved directly to the IRA without a check being written.

### **Staying in company plan:**

Many companies will allow you to stay in their 401(k) plan if you have more than \$5,000 in the account. If you're changing jobs, you also may be able to roll the money over to your new employer's plan.



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If you have \$1,000 to \$5,000 in your 401(k) and do nothing, your former employer is usually required to roll your money into an IRA.

#### Reasons to leave money in a 401(k) plan:

- You can borrow from it. You can't borrow from an IRA.
- Some people like having a set menu of funds picked by the company, rather than having to wade through hundreds of investment options on their own.
- Expenses may be lower in company-sponsored plans. Large employers are often able to negotiate investment discounts. But compare costs because higher fees may apply to 401(k) investors who have left the company.

With both 401(k)s and IRAs, you generally have to wait until you are 59½ to withdraw money without facing a tax penalty. One exception with 401(k) plans: If you leave the company and are at least 55 years old, you can take distributions without penalty.

#### Roll 401-K into a bonus or deferred annuity

An annuity, which receives a transfer from an IRA or 401k, is considered a "Qualified" plan. When you apply for an annuity with tax qualified money, the insurance company maintains the funds' tax qualified status into which your money is transferred directly. There is no mandatory withholding requirement if your funds are rolled over directly into an annuity.

So lets reiterate You have 3 options for employer-sponsored retirement plan funds when you leave an employer.

1. By leaving money in the former employer's plan, you are giving up some degree of control and flexibility
2. Investment choices are limited to those available in the plan and certain investment choices, such as company stock, can be very



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risky.

3. The former employer is probably not set up to provide an excellent level of customer service to your account.
4. If the company fails, access to retirement funds could be in Jeopardy.

#### Take a lump-sum distribution

- While this puts cash in their pockets, this is a bad idea because:
- The distribution is subject to federal, state, and local income taxes, including a 20% withholding for federal taxes
- Additionally, there is a 10% penalty tax if you are under age 59½
- Depending upon their age, tax bracket, and state of residence, **taking a lump-sum distribution could cost them 50% or more of their retirement savings**
- They must start over on building their retirement savings

#### Leave the money in your old employer's plan, or transfer it to their new employer's plan

- A much better choice than a lump-sum distribution, but still with some disadvantages:
- They are not in complete control of their money
- Limited investment choices
- Possibly poor customer service
- Ask yourself: Five, ten, or twenty years from now:
- How important will you be to your former employer?
- Are you sure the company will be alive and solvent?

#### Roll their funds over to an IRA

##### Advantages

- Continues the tax-deferred growth of their retirements savings
- Allows you to take control of your savings and put it in the type of financial vehicles, such as an equity index annuities, that best suits their needs and desires



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- Allows them to consolidate their retirement savings for easier Management.
- Allows them to put their savings with an insurance carrier that is financially strong and set up to provide excellent customer service.

#### **Why choose a fixed annuity for 401-K or IRA rollover funds?**

- Fixed annuities are known for offering tax deferral, but purchasing a fixed annuity within an IRA that already provides tax deferral results in no additional tax benefit
- So you should purchase a fixed annuity for its other features and benefits.

#### **The features and benefits of all fixed annuities:**

- Fixed annuities are issued by financially secure insurance carriers which hold legally-mandated reserves of at least \$1 for every \$1 of annuity cash value and which are regulated by state insurance departments.
- Fixed annuities guarantee interest earnings for the life of the Annuity.
- There is no risk to principal, other than the surrender charge
- Fixed annuities include various payout options when you are ready to take periodic income from your savings, such as when you retire.

#### **Index annuities are a type of fixed annuity that:**

- Have all the advantages of fixed annuities shown previously, such as guaranteed earnings and no risk to principal, plus they:  
Credit interest linked to stock market returns.
- Credit a portion of stock market gains while providing protection from stock market losses.
- Allow you to potentially receive more yield without risking safety.

#### **What is the process for rolling retirement funds into a fixed annuity?**

- Review the different types of annuities and guaranteed rates of return, bonus on deposit and other features with your financial advisor or insurance professional.
- Fill out the application for the annuity, including the funds transfer form - **that's it, you are done!**