

Retirement Plan Distribution Options for Retirees

Of all of the issues you have to face upon retirement, taking care of your 401(k) or other employer-sponsored retirement plan may just be the most important of all. Over the years, you have built up your retirement savings. Now, you have a decision to make and an opportunity to use these assets to help build the retirement you've dreamed of. You need to determine the best way to use these funds to create an income for you in retirement. This is especially important when you consider that today's retirees can look forward to a much longer retirement. For example, for a couple retiring at age 65 there is a 50% chance that at least one spouse will be alive at age 92¹.

When you retire, you can essentially do two things with the money from your retirement plan:

- Allow it to continue growing on a tax-deferred basis
- Take it as a lump-sum payment

These options can lead to very different outcomes — so you'll want to think carefully before making your choice.

KEEP YOUR MONEY GROWING TAX-DEFERRED

One of the best things you can do for your retirement is to keep your retirement assets in a tax-deferred account, and let them continue to grow for your future. By doing so, you will also avoid paying current income taxes on the funds you have accumulated. If you decide to keep your money working tax-deferred toward your retirement, there are generally two different routes you can take:

- *Leave your money in your former employer's plan* — If your plan permits, you can leave your money in it even after you retire, although you can't add new contributions. Leaving your plan intact could be a good option — if you are pleased with the existing investment choices. Also, if the plan meets ERISA guidelines, the creditor protection of plan assets provided by ERISA is still more beneficial to you, compared to an IRA. But keep in mind that if you leave your money in your retirement plan, you will be limited to the investment options provided by the plan, and you and your beneficiaries may have restricted access to your money. Some plans also charge former employees a fee for remaining in the plan.
- *Roll your retirement assets into a Traditional IRA* — Depending on your individual situation, this “rollover” option could be your best choice. Rolling your retirement plan assets to a Traditional IRA offers you the most flexibility. Advantages of an IRA rollover include:
 - *Consolidation of assets* — Moving your retirement savings to an IRA allows you to consolidate all of your retirement assets in one place. A single snapshot of your retirement assets can help simplify the tracking process of your retirement assets and prevent investment overlap.
 - *Greater estate planning flexibility* — When your beneficiaries inherit your assets through an IRA, they may be able to “stretch” the distribution of those assets over their life expectancies and keep the assets growing tax-deferred.



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- *Distribution flexibility* — An IRA generally has far fewer limitations and rules regarding distributions than an employer-sponsored retirement plan.
- *Conversion to a Roth IRA* — After you move your retirement account into a Traditional IRA, you may be eligible to convert to a Roth IRA, so that you can eventually make tax-free withdrawals. (Note: When converting a Traditional IRA to a Roth IRA, you will generate a tax liability.)
- *Creating a retirement income stream* — As a retiree, there are several ways that a retirement paycheck can be created for you. An IRA provides distribution flexibility allowing you and your Financial Advisor to develop a retirement income plan that helps meet your needs.

TAKE A LUMP SUM PAYMENT

The possibility of taking the proceeds from your employer-sponsored retirement plan in cash may be enticing. Before you have a check for the entire distribution (or even a portion of it) made out to you, there are a few things you should keep in mind.

If you choose this route, you will no longer benefit from tax-deferred earnings growth. In addition, when a distribution is not rolled directly into another retirement plan, you will receive only 80% of the balance, because your employer must send the other 20% to the IRS to be credited against your taxes. If you are younger than 55 when you retire, you may have to pay an additional 10% penalty tax. To make matters worse, if you are in the 25% bracket, or above, you will have at least another 5% taken from your nest egg at tax time.

However, if you take a lump sum distribution, you can roll over the distribution into a new or existing Traditional IRA within 60 days of receiving the money. If you want to roll over 100% of your distribution to an IRA, you'll have to find another

source of money to replace the 20% of your distribution that will be withheld by your employer. If you just roll over the 80% you received, you'll be taxed and possibly penalized (10%) on the 20% that was withheld and not rolled over.

Before taking the cash, you should think about all that hard work and sacrificing you have done, only to now be taxed and penalized.

NET UNREALIZED APPRECIATION

If your retirement plan contains employer stock and the value of the stock has appreciated greatly compared to the price you originally paid for it, you may want to weigh the benefits of rolling the employer stock to an IRA against those of a Net Unrealized Appreciation (NUA) strategy. The NUA may be important because there is special tax treatment available for in-kind distributions of employer stock that may result in significant tax savings for you.

Under the NUA strategy, when you retire, you would take an in-kind lump-sum distribution of employer stock from your retirement plan. You do not roll it into an IRA, even though any other holdings in the plan may be rolled into an IRA. When the distribution is taken you will pay ordinary income taxes, and a potential 10% pre-mature distribution penalty, if you retired prior to age 55, on the stock's cost basis. (The price per share at which you originally purchased the stock.) But the difference between the basis and the current market price — the net unrealized appreciation — is taxed at long-term capital gains rates only when the stock is sold, regardless of the holding period. Together with the help of your tax advisor, your RBC Wealth Management® Financial Advisor will work with you to determine if this may be a better option than rolling the stock into an IRA where all of its value will eventually be taxed as ordinary income.

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USING YOUR RETIREMENT ASSETS

TO CREATE A RETIREMENT INCOME PLAN

Which distribution option is right for you? There is no one “right” answer for everyone. Your RBC Wealth Management Financial Advisor can help you evaluate your distribution options and then work with you to create a retirement income plan that incorporates all of your assets, and takes into consideration a variety of factors, including the following:

- **Sources of income** — Your retirement plan distributions will be a key part of your retirement income, along with your investment portfolio earnings, Social Security, and any earned income you might receive if you do some part-time work.
- **Lifestyle and expenses** — What will you do when you retire? Your lifestyle choices will make a sizable difference in your retirement income needs. Keep in mind, when you retire, your expenses will not necessarily decrease. In fact, given rising health care costs and other factors, your retirement expenses could conceivably exceed your pre-retirement cost of living.
- **Inflation** — Over time, even a relatively mild annual inflation rate can significantly erode the value of assets you’ve set aside to meet your living expenses. For example, at an inflation rate of 3.0%, the \$100,000 you have today will be worth only \$55,368 in 20 years — a loss of 45% in value. Your Financial Advisor can help you build and maintain an investment portfolio that keeps you ahead of inflation during your retirement years.
- **Taxes** — When you retire, you won’t automatically move into a lower tax bracket — in fact, you might find your tax obligations increasing. Your Financial Advisor, working in conjunction with your tax advisor, can help you determine how best to manage your retirement income to help you control your taxes.

- **Projected longevity** — Many people underestimate the time they need to plan for living in retirement, which increases their likelihood of running out of savings. If you’re in good health, you could spend two — or even three — decades in retirement. Consider this: In 2000, the average life expectancy of 65-year-olds was about 16.5 years for males and 19.4 years for females, according to the Social Security Administration.
- **Withdrawal rate** — Given all the above factors, you will need to determine what percentage of your savings and investments you can withdraw each year without depleting your retirement assets sooner than expected. Your Financial Advisor can help you generate an income stream that is suitable for your individual needs.

CALL YOUR FINANCIAL CONSULTANT

Your RBC Wealth Management Financial Advisor will work with you in evaluating your retirement plan distribution options to determine which option creates the clearest path to your retirement goals. You will then work together to develop an investment portfolio designed to provide the income stream you will need to live comfortably while you are enjoying your retirement. Your Financial Advisor will also help you monitor your progress, and change course as needed, to help you achieve your retirement income goals and other long-term objectives.

¹*Society of Actuaries; US Center for Health, 2001*

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