

Retirement Plan Distributions — Your Options When You Change Jobs

Over the years you, and perhaps your employer, have been contributing to your 401(k), or other employer-sponsored retirement plan, saving for your retirement. When you change jobs, you'll need to determine the best way to manage your retirement plan distribution to maximize your progress toward the retirement lifestyle you've envisioned. Whether you were with your former employer for just a few years, or decades, the decision you make will play a critical role in determining the course of your financial future.

When you change jobs, 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

The biggest advantage of your 401(k), or other employer-sponsored plan, is that your contributions are protected from current taxes and the earnings grow on a tax-deferred basis. Consequently, your money grows much faster than it would if it had been placed in an account on which you paid taxes every year.

One of the best things you can do relative to saving for 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 three 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 change jobs, 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. However, if you leave your money in your former employer's retirement plan, you are 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.
- *Move the money into your new employer's plan* — You can move your retirement plan assets into your new employer's plan, if the new plan accepts rollovers. This move might make sense if your new plan offers attractive investment options. 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. Other advantages to consider are that it will help you consolidate your retirement savings, and you may be able to take a loan from your new employer-sponsored retirement plan. Keep in mind, however, that when you roll your assets into your new employer's plan, you and your beneficiaries may have restricted access to these assets. You may also be subject to a waiting period before the rollover is allowed.



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■ 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 of your retirement assets and prevent investment overlap.
- *Investment flexibility:* An IRA offers an almost unlimited array of investment choices. This allows you and your Financial Advisor greater flexibility in creating an investment portfolio that will help you meet your retirement planning and financial goals.
- *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.
- *Distribution flexibility:* An IRA generally has far fewer limitations and rules regarding distributions than an employer-sponsored retirement plan. Even if you are under the age of 59½, penalty-free withdrawals from a Traditional IRA are allowed for a number of reasons.
- *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 you can eventually make tax-free withdrawals. (Note: when converting a Traditional IRA to a Roth IRA, you will generate a tax liability.)

TAKE A LUMP SUM PAYMENT

When you change jobs, you may be tempted to cash out your retirement plan and take the money as a lump sum. 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 over 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 under age 59½, or were younger than 55 when you left your employer, 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 do take a lump sum distribution, you can roll over the distribution into a Traditional IRA within 60 days of receiving the money. If you want to roll over 100% of your distribution, 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 penalized and taxed. Don’t deprive yourself of an important source of retirement savings.

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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 employee stock into 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 change jobs, 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% premature distribution penalty, 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 adviser, your RBC Wealth Management® Financial Advisor will work with you to determine if this may be a better option than rolling the stock into a Traditional IRA where all of its value will eventually be taxed as ordinary income.

Roth 401(k)/403(b) rollovers

Effective Jan. 1, 2006, employers can offer a “Roth” option in their 401(k) or 403(b) plans. If you use the Roth feature in your retirement plan, you’ll contribute after-tax dollars, but your withdrawals and earnings will be tax-free (provided you’re at least 59½ and you’ve had the account for at least five years when you start taking distributions).

When you change jobs, you can move your Roth 401(k) or 403(b) assets directly to a Roth IRA. Or, if you choose, you can roll your distributions into your new employer’s Roth 401(k) or 403(b) plan if the new plan accepts such rollovers. However, you cannot roll over the non-Roth portion of your 401(k) or 403(b) into a Roth IRA, nor can you convert “traditional” 401(k) or 403(b) assets into a Roth 401(k) or 403(b).

YOUR WEALTH-ACCUMULATION STRATEGY

Your RBC Wealth Management Financial Advisor can help you determine the retirement plan distribution option that best fits within your overall wealth management strategy. During your working years, the key element of this strategy is to accumulate sufficient financial resources to eventually pay for a comfortable retirement lifestyle and to meet other long-term goals.

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Consequently, you will need to make sure your retirement plan distributions work together in the most efficient way possible, along with your other assets, which may include the following:

- *Traditional or Roth IRA* — Whether or not you roll over your retirement distribution to an IRA, it's always a good idea to maintain either a Traditional or Roth IRA. With its tax advantages and an almost unlimited number of investment possibilities, an IRA is a powerful retirement-savings vehicle.
- *Investments held outside your retirement plan* — Your investment portfolio should contain a diversified mix of stocks, bonds, mutual funds and other securities. In structuring your portfolio, you will need to consider your risk tolerance, time horizon and specific goals.
- *Educational Savings Programs* — Apart from saving for retirement, you have other important financial goals — one of which may be paying for a child's college education. To meet this objective, you might want to consider tax-advantaged vehicles such as a Section 529 savings plan or a Coverdell Education Savings Account. By funding these plans, you may be able to avoid tapping into your retirement savings to pay for college.

CALL YOUR FINANCIAL ADVISOR

Your RBC Wealth Management Financial Advisor can evaluate your retirement plan distribution options and your investment portfolio to help you create a wealth-accumulation plan for your working years and your retirement. Your Financial Advisor can also help you monitor your progress, and change course as needed, to help you achieve your long-term objectives.

To develop a personalized accumulation strategy, contact your RBC Wealth Management Financial Advisor. Put your retirement savings plan into action soon.

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