

Update



Management of Multiple Retirement Assets

The retiree with only a single-employer pension has become a rare species. With career changes and the availability of different types of tax-favored retirement plans, most successful individuals have built an assortment of assets to use for their retirement income. Each type of asset may have different payout options, distribution rules, and tax situations. So, it's not simple to decide what strategy will be best for generating retirement income with the least tax impact. When you retire, you'll need to carefully manage how you will draw on your assets. Any decisions should be based on carefully examining all of your choices.

THE TAX STATUS OF YOUR ASSETS

The law places restrictions on your freedom to use your assets. Access to your tax-deferred assets will be subject to distribution requirements and possible tax penalties. (Tax-deferred assets include rollover and ordinary IRA money, annuities, and deferred compensation from an employer.) Capital gains tax consequences may limit how you can make use of your personal investments and other assets. You will have only one opportunity to make choices affecting the amount of income you receive from Social Security and a company pension plan. A similar mix of assets and constraints may affect your spouse's assets.

Because you won't get a second chance on many of your retirement asset decisions, it's smart to get a professional to help you. The suggestions that follow can help start your thinking.

LOOK AT THE TOTAL PICTURE

You can begin by listing everything you have to work with — each of your assets and how much income each is likely to produce. Maybe, you won't have to use all your assets for income right away, or ever. But when you do draw income, you may be better off using some sources completely and holding others for later use. You should also make a list of the dates when you must start taking your distributions. With each asset you own, you should find out both the tax consequences and distribution options.

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USE TAXABLE ASSETS FIRST

If you draw down your ordinary investments and savings before your tax-deferred assets, you will be able to keep the tax-deferred assets growing longer without being affected by annual taxes. Take care, however. This strategy may be difficult to follow because the minimum distribution rules for tax-deferred assets prevent long delays in using tax-sheltered assets. You generally must start taking minimum amount distributions by April 1 of the year after you turn age 70½ (or after retirement, if later). You can't afford to start late because of the heavy tax penalties that apply (for example, 50% on 401(k) plan amounts that should have been withdrawn but weren't).

CONSIDER ANNUITY, INSTALLMENT, OR LUMP-SUM DISTRIBUTIONS

As for your tax-deferred plans (company pension, 401(k), or profit sharing), you may be able to choose among annuity, installment, and lump-sum payments. With annuity payments, your alternatives are income that will last for your life, or for both your life and your spouse's life. With installment payments, you receive amounts over

a number of years based on your life expectancy according to an IRS table. With a lump-sum payment, you receive a distribution of your entire retirement plan benefit right away. Your payout decision should follow a careful analysis of your individual financial situation and needs.

Many retirees don't carefully consider the lump-sum choice. They know it can cost a large income-tax payment. But (provided you have no need to use your distribution) you can roll your distribution over directly into a tax-deferred IRA and therefore, easily avoid the tax. But if you are receiving a lump sum from a non-qualified pension plan, you can't roll it over into an IRA.

PAUSE AND CAREFULLY CONSIDER ALL OPTIONS

Paying minimum taxes on multiple retirement assets will most likely require you to use both your personal investments and some distributions of tax-deferred money. You need to step back and carefully consider all your alternatives and the associated taxes before you act and — if you need to — do it with an expert's help.

ALTERNATIVES FOR DISTRIBUTION OF TAX-DEFERRED ASSETS

	Distribution Options Usual Retirement	Special Taxes and Requirements
Employer Pension	<ul style="list-style-type: none"> • Annuity • Lump Sum 	<ul style="list-style-type: none"> • Payments must start by age 70½* • Payments may be mandatory at retirement
401(k) or Profit-sharing Plan	<ul style="list-style-type: none"> • Lump Sum • Installment • Rollover to IRA 	<ul style="list-style-type: none"> • 50% penalty for not starting withdrawals by age 70½* • 10% penalty on withdrawals before age 59½ (55 if retired)
Traditional IRA	<ul style="list-style-type: none"> • Various Withdrawal Options 	<ul style="list-style-type: none"> • Withdrawals must start by age 70½** • 10% penalty on withdrawals before age 59½
Annuity	<ul style="list-style-type: none"> • Annuity • Installment 	<ul style="list-style-type: none"> • 10% penalty on withdrawals before age 59½
Deferred Compensation	<ul style="list-style-type: none"> • Annuity • Lump Sum 	<ul style="list-style-type: none"> • Payments usually required to start at retirement

*Deadline is April 1 of the year following the year the participant turns age 70½ or retires, whichever is later. Certain owners must begin distributions after reaching age 70½.

**Deadline is April 1 of the year following the year the IRA owner reaches age 70½ (only applies to traditional IRAs).

401(k) Plan Loans—More Expensive Than You Think

Perhaps you've considered taking a loan from your 401(k) plan to take a vacation or pay a big expense, like a college tuition bill. Maybe you view a 401(k) loan as “free money” because you pay the interest back to your own account. The interest rate may be attractive, and the loan may be relatively easy to obtain. Those are all pluses.

HIDDEN COSTS

When you take a closer look at a 401(k) loan, though, its true cost can be steep. First, you'll have to use *after-tax* dollars to repay your loan. The tax deferral that helps pay for your 401(k) contributions is not available for your loan repayments.

Also think of what happens when you pay yourself interest. No return is actually earned. You shift your own money around, but not one new penny is added to your assets. Meanwhile, you give up all the real earnings the borrowed money could have earned in your plan account.

ANOTHER COMPLICATION

Your loan could become a cash problem if an employment change or something else interferes with your expected repayment schedule. Usually, you have only two options when you leave your employer: either repay the entire balance or let the outstanding amount be classified as a taxable distribution. The second alternative would mean paying not just income taxes on the unpaid balance of your loan, but also a 10% early withdrawal penalty if you can't satisfy one of the tax law's conditions for a penalty exception. So, for example, with a \$6,000 balance outstanding on the loan, you would have to pay \$2,700 (tax and penalty) if you were in a 35% tax bracket.

SHORT REPAYMENT PERIOD

Another possible complication of taking a plan loan may be the length of the repayment schedule. By law, the term of a 401(k) loan is limited to five years unless you use the money to fund the purchase of your principal residence. That rule could cause difficult timing problems if you intend to use your loan proceeds for college expenses. You would have to complete the repayment of a loan for freshman year expenses just a year after graduation, the sophomore year loan two years after, etc.

HARDSHIP WITHDRAWALS

What about simply withdrawing the money you need? In certain situations, you may be eligible for a “hardship” withdrawal from your plan. But taking a hardship withdrawal instead of a loan is rarely a desirable move.

Regular taxes — and a possible 10% early withdrawal penalty — would apply to the amount you withdraw. You'd lose the opportunity for future tax-deferred growth of the money. And, since you don't have to pay back a hardship withdrawal, you'd be depleting your retirement savings.

A BETTER WAY?

Before you take a retirement plan loan, you may want to look at other options. A loan that offers a longer term, such as a home equity loan, could be a more comfortable — and less costly — way to cover college costs or another major spending need. If you'd like assistance in analyzing the tax and long-term financial consequences of different alternatives, let us know.

On Target

If you're investing for retirement, you may want to consider a target-date fund.* Target-date funds typically aim to adjust their stock, bond, and cash equivalent holdings over time, taking a more conservative approach as the targeted retirement date nears. The target date is the approximate date when investors plan to start withdrawing their money. If you don't have the time or expertise to monitor your portfolio's asset allocation, you may find the target-date concept attractive.

Before you invest, however, keep in mind that funds with the same target date have investment mixes and performance records that vary significantly. The principal value of a fund is not guaranteed at any time, including

the target date. The pace at which a target-date fund becomes more conservative also differs from fund to fund. Many 2010 target-date funds performed poorly recently — despite the short time horizon — as they were not actually invested conservatively. Choose a fund with an investment strategy that fits your risk tolerance, in addition to your time frame. If a fund's objective changes, the fund's investment strategy also may change.

** You should consider the fund's investment objectives, charges, expenses, and risks carefully before you invest. The fund's prospectus, which can be obtained from your financial representative, contains this and other information about the fund. Read the prospectus carefully before you invest or send money. Shares, when redeemed, may be worth more or less than their original cost.*

Rollovers in Reverse

Moving your retirement savings from your employer's 401(k) plan to an individual retirement account (IRA) when you change jobs or retire keeps your money tax deferred. But did you know that the tax law also lets you move money from an IRA to a 401(k)?

You don't have to be on the move yourself to do an IRA-to-401(k) plan rollover. You can transfer your IRA money anytime, assuming your employer's plan will accept the rollover.

An IRA-to-401(k) plan rollover may be smart if leaving your job in your mid-fifties is a possibility and you anticipate needing access to your IRA money at that time. A rollover may be a way to avoid the 10% penalty that generally applies to IRA withdrawals taken before age 59½. A 401(k)

plan can make penalty-free distributions to you after you leave employment — including distributions of amounts transferred into the plan from your IRAs — provided you are at least age 55 in the year you separate from service.

Nondeductible IRA contributions aren't eligible for rollover. But don't rule out a rollover simply because your IRA contains nondeductible contributions. Moving all but those amounts to your employer's plan would give you the flexibility to draw down your remaining IRA balance (i.e., the nondeductible contributions) before age 59½ without worrying about taxes and penalties. They would apply only to the extent of any IRA earnings that accrue after the rollover.

Meeting Your Goals

IT'S NOT THE IMPOSSIBLE DREAM

Does it sometimes seem as if saving enough money to reach all your goals is a futile quest? Sure, investing for your future goals isn't always easy. But, you *can* accomplish your dreams if you focus on the task.

You'll probably have to make some changes along the way, but the end result will be worth it.

Cultivate a Saving Mentality. As with so many things, your mindset has a lot to do with your ability to save. Focusing on your goals — next year's new car, a comfortable retirement, or whatever they may be — can help provide the willpower you need to resist spending. Remember, every dollar you *don't* spend is another dollar you can save.

Pump Up Your Savings. If you want to save more, cutting expenses is typically the easiest way to find additional cash. You might be amazed by how much extra money you can come up with just by reining in your everyday

spending. For example, eliminating premium cable and phone services and cutting back on the number of times you go out to dinner or a movie can free up a surprising amount of extra cash.

Take Advantage of Your Employer's Plan. Saving for retirement is painless and convenient when you participate in your retirement plan at work. Be sure to take full advantage of any employer matching contributions. And, if you're age 50 or older, you may be able to make "catch-up" contributions and save even more.

Use a Guide. Your financial professional is your partner in designing and implementing an investing strategy. Your professional will help you review your progress and make suggestions if changes are needed. When it comes to your financial well-being, your financial professional may be one of your most important assets.



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