



## IRA UPDATE: NOVEMBER 2012

Items to check before doing a rollover of an employer plan to an IRA:

- Spousal Rights- Under ERISA (Employee Retirement Income Security Act of 1974) generally requires a spouse to be the beneficiary of the plan regardless of who is indicated on the beneficiary form. Many plans however do not require spousal consent for an IRA rollover, so if you want to name someone other than your spouse as beneficiary, an IRA rollover may make sense for you. Keep in mind that some plans do require spousal consent for a rollover so you must check your plans rules.
- Outstanding Plan Loans- if you have an outstanding loan in your 401k, you might have to pay it back before completing a rollover. Some plans require the loan to be paid back within 30 or 60 days of termination.
- Employer plans generally have a higher level of creditor protection than IRAs so if asset protection is an issue, it may make more sense to leave the money in the plan.
- Roth 401k- Employer plans are increasingly adopting the Roth 401k allowing anyone regardless of income to contribute to a Roth account. Generally, one must be age 59 ½ and have had their Roth 401k for five years to receive qualified tax free distributions. A Roth 401k can be rolled over to a Roth IRA, however in order to receive qualified distributions, the Roth IRA must have been open for 5 years. If the Roth 401k is rolled over to a new Roth IRA, then the 5 year clock starts with the Roth IRA, not the Roth 401k. Therefore if you have a Roth 401k, it is generally a good idea to open a Roth IRA as soon as possible. If you make too much income to contribute directly to a Roth, consider a small Roth IRA conversion which would get the account open and the 5 year clock started.
- Net Unrealized Appreciation (NUA)- If you have employer stock within your 401k, you may be eligible for the NUA tax break. This allows you to distribute the stock in kind to a brokerage account and you only pay income tax on the basis (purchase value) of the stock in the year of the distribution while the unrealized appreciation is taxed as a long-term capital gain which is usually a lower rate and only at the time the stock is sold. If the stock is transferred via an IRA rollover, this benefit is lost forever so be sure to determine if this strategy is available to you before you do the rollover.
- Required Minimum Distributions- Generally when you reach age 70 ½ you are required to take distributions from your retirement plans. There is however an exception to this rule which is if you are still working and less than 5% owner of the company. This exception does not apply to IRAs, so if there is reason to not take the RMDs and you are still working, you may want to wait to do the rollover.
- Beneficiary Options- Under current law, a person who inherits an IRA cannot convert to an inherited Roth IRA. A beneficiary of an employer plan however can convert the inherited plan directly to a Roth IRA.
- 20% Mandatory Withholding- If any plan funds are made payable directly to the participant, there is a 20% mandatory tax withholding of the pre-tax amount. In order to complete a rollover, the individual must come up with the amount withheld out of pocket and deposit the full distribution amount into the IRA within 60

days. For example, if \$1,000,000 plan balance were distributed directly, \$200,000 would be automatically withheld for taxes thus the individual would need to come up with that \$200,000 to complete the rollover otherwise the withheld amount is deemed a taxable distribution. Once the tax return is filed, the withheld amount would be returned however this could be many months later. The solution is to do a trustee to trustee transfer where no tax withholding is required.

These are just a few common points to consider before rolling over your retirement plan to an IRA. There are many advantages to doing a rollover however these points should be considered before making the decision.

As always if any of this applies to you, give me a call to discuss your situation.

Sincerely,

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