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Title

IRA Rollovers: *Helping Retirement Savers Defer Taxes, Avoid Penalties*

If you participate in an employer-sponsored retirement plan, you may have concluded that you don't need a traditional IRA. Many people see the IRA as unnecessary because they don't exhaust the contribution limits of their employer plans. But don't be fooled into thinking that an IRA can't help you pursue your retirement saving goals. Chances are actually good that there may be at least one IRA rollover in your future.

An IRA rollover is a method of transferring assets to a traditional IRA from an employer-sponsored retirement plan, such as a 401(k) or a 403(b), or from another IRA. Rollovers are commonly used by workers who are changing jobs or retiring and want to move their assets out of a former employer's plan. Rollovers can also be used to consolidate retirement assets or change financial institutions. A correctly executed IRA rollover preserves the tax-deferred status of qualified retirement savings and helps avoid tax penalties.

Rollover dollars are a growing component of IRA account balances. In 2013, for example, IRA inflows from rollovers were more than 14 times higher than inflows from contribution dollars.¹ If you're moving assets from one IRA to another, you should be aware that you are limited to only one tax-free IRA-to-IRA rollover each year, regardless of how many IRAs you have.

Some employer-sponsored retirement accounts have limited investment choices. When you participate in an employer plan, your investment options are limited to those offered by the plan itself. Some employer plans have high fees. Once you leave the employer, you have several options for managing your retirement assets, including leaving them in the former employer's plan or transferring them to a new employer plan (if it allows rollover funds). However, an IRA may offer you more freedom to choose the investments that make sense for

By the Numbers

33.7% U.S. households who owned some type of IRA in 2014

30.0% Percentage of U.S. retirement wealth held in IRAs in 2014

Source: Investment Company Institute, 2015

your financial goals. Not only is the universe of investment options in an IRA much larger, but it may include individual securities and alternative investments.

Retirement assets scattered across a number of accounts may be difficult to manage.

By consolidating your retirement funds into a single IRA, you may have a clearer picture of your portfolio's assets and allocations, which could help you more easily make adjustments as your needs and circumstances evolve. This may be especially important when you reach age 70½ and are subject to annual required minimum distributions.

IRAs have provisions for penalty-free qualified withdrawals before age 59½.

First-time homebuyers (including buyers who haven't owned a home in the previous two years) may be able to withdraw up to \$10,000 (lifetime limit) toward the purchase of a home. IRA funds can also be withdrawn to pay qualified higher-education expenses for IRA owners and their spouses, children, and grandchildren. An IRA can even be used to pay qualified, unreimbursed medical expenses in excess of 10% of adjusted gross income.²

Penalty-free IRA withdrawals are also allowed if you become permanently disabled. However, spouses who inherit an IRA and elect to treat it as their own may be subject to the penalty on distributions before age 59½.

Even though these early-withdrawal exceptions may avoid the 10% federal income tax penalty, all distributions from traditional IRAs are subject to ordinary income taxes.

THE TYRANNY OF MISTAKES

An IRA rollover is simple in theory, but the details can be complicated. Failure to abide by the rules can result in tax penalties and unintended tax consequences. This makes it a good idea to fully understand your options before you initiate a rollover.

When you opt for a *trustee-to-trustee transfer (direct rollover)*, the assets are moved directly from your existing account to the new IRA. The details are handled by the financial institutions involved, which helps reduce the potential for error because you are never in possession of the funds.

With an *indirect rollover* from an employer-sponsored retirement plan, a check is made out in your name and only 80% of the vested balance will be distributed to you.

The remaining 20% is withheld to help cover taxes. You have 60 days to deposit the retirement assets in a new plan or IRA.

And here's where an indirect rollover can become complicated: You must deposit 100% of the employer-plan distribution in the new IRA even if you receive only 80% of your vested balance. This means you must replace the 20% that was withheld. If not, the difference between the total distribution (including the amount withheld for taxes) and the amount rolled over is subject to ordinary income tax and the 10% early-withdrawal penalty.

If you are age 55 or older in the year you separate from service with an employer, the early-withdrawal penalty is waived on employer-plan distributions. This is a major consideration if you might need access to your retirement funds in the near term. Once the assets are in an IRA, the 10% penalty *will* apply to nonqualified withdrawals before age 59½.

Before initiating an IRA rollover, consider consulting with your tax and financial professionals.

- 1) Employee Benefit Research Institute, 2015
- 2) Individuals age 65 and older can claim qualified, unreimbursed medical expenses exceeding 7.5% of AGI through 2016.

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