401(K) PLAN DISTRIBUTION CONSIDERATIONS

If you retire or are otherwise entitled to a distribution from your 401(k) plan (or other employer retirement plan), it is important that you understand your options and the advantages and disadvantages of each. This summary is designed to help you understand and evaluate your distribution alternatives.

You typically will have four choices when you are entitled to a distribution. They are:

- Leave the money in the current plan (unless the account has a small balance, and the plan “forces” distributions of small balances).
- Transfer the account balance to the plan of a successor employer. (This assumes that you are not retiring and will go to work for another employer who sponsors a plan that permits those transfers.)
- Roll the account balance into an individual retirement account or individual retirement annuity (IRA).
- Take a taxable distribution (which could reduce your retirement money by the income taxes and penalties charged on taxable distributions).

The first three options avoid the immediate taxation of the distribution; the fourth does not.

The decision should be based on your needs and circumstances. None of these alternatives is right for every plan participant in every situation. It’s not an easy decision, because of the long-term financial consequences.

The following information discusses many of the considerations that would be important to the typical participant of a 401(k) plan. Some – but not all – of these considerations may also apply to other types of plans. You need to decide which are the most important to you and whether other factors should be considered as well.

IMPORTANT NOTE: This summary is for general educational and informational purposes and should not be construed as advice, recommendations, or suggestions. This is not legal or tax advice and you should consult with your tax and legal advisors on these issues. These materials discuss distribution considerations that would be material in common scenarios. The characteristics of your plan or investments might require that additional matters be considered. That could be true if, for example, you have a Roth account or other pre-tax contributions. It could also be true if you have a participant loan or your account includes a company stock investment. Plus, you need to consider personal circumstances, for example, disability. This information does not consider your plan specific characteristics, types of investments, or personal circumstances (and the list here is not comprehensive). As a result, you need to make sure to take into account your individual considerations, including any that may not be included in these materials. Make sure to get expert advice.

1. Keep your money in the plan.

As a general rule, you may leave your money in your plan and keep the pre-tax status (until it is ultimately distributed). However, some plans have mandatory distributions for accounts worth less than $1,000 or even less than $5,000. Check with your plan administrator.

Advantages:

- The federal law governing the plan—ERISA—requires that the plan fiduciaries prudently monitor the cost and quality of the investments options in the plan.
- Your plan may offer investment choices and other services that are less expensive than those available to you outside of the plan.
- Employer-sponsored plans may offer better creditor protection than rollover IRAs (but both are protected in bankruptcy).
- If you have a participant loan, you may be able to continue to make payments on the loan rather than having to take a taxable distribution of the loan amount. However, some plans require payment of the loan when you leave your job. Check with your plan administrator.

Disadvantages:

- You don't have control over the plan investments or services available to you. Your former employer, as the plan fiduciary, will make those decisions.
- The plan may offer a limited number of investment choices (unless it permits you to use a brokerage account).
- The plan may assess fees to your account for administrative or other reasons.
- You may not have access through the plan to personalized investment advice or advice that takes into account your other assets or particular needs.
- You need to know whether the plan permits periodic (for example, monthly) payments if you intend to use the money for retirement income. You should also ask if the plan charges for those distributions.

2. Rollover your money into an IRA.

Another option for preserving the tax-deferred status of your retirement money is to transfer your plan account to a rollover IRA. It is important to find out about the range of investments and services available through a particular IRA and the fees for that IRA before choosing your rollover IRA.

Advantages:

- This is your account, and you have discretion over your money including deciding which financial institution, investments, and services to use—and whether to make changes in the future.
- A rollover IRA may also enable you to place all your investments with one investment professional, who could coordinate your overall financial and investment planning.
- An investment professional may be able to give you personalized advice about investing and retirement planning.
- A rollover IRA may allow you to consolidate your other tax-deferred retirement accounts in one place. This may be helpful for your financial and retirement planning. It may also prove helpful in managing the required minimum distributions (RMDs) you have to start taking when you reach age 72.
- IRAs are often more flexible than plans on withdrawals and distributions, *e.g.*, setting up regular periodic payments or an unscheduled withdrawal. Also, IRAs don't charge for periodic payments or special distributions (*e.g.*, the medical needs or family events).
- If you select an individual retirement annuity, you can obtain a guarantee of lifetime income.

Disadvantages:

- With a rollover IRA, there is no plan fiduciary who prudently monitors the investments, and their cost and quality. Also, there will usually be more choices in an IRA and you have to select your own investments. However, if you have an advisor for your IRA, he or she can help you with the investment decisions.
- You may pay more in a rollover IRA for investments, services, and advice than you pay through your retirement plan (or a successor plan). Compare those costs to plan fees for services, investments, and administration.
- IRA investment fees can be complex and more difficult for you to evaluate. There may be conflicts of interest where you could be encouraged to select investments that pay the providers more money, but which might not be right for you.
- Generally, rollover IRAs are protected in bankruptcy, but may not otherwise offer the same level of creditor protection as employer-sponsored retirement plans.
- You can't borrow from an IRA—you can only access the money in an IRA by taking a taxable distribution (which may also subject you to tax penalties if you are younger than 59$^1/_2$).
- When you reach 72, you will have to take periodic taxable distributions from your IRA, but you would not have to from a plan as long as you are still working (unless you are a 5% or more owner of the business or unless the plan provides otherwise).

3. Transfer your money to a new employer's plan.

The third way to preserve the tax-deferred benefit of your plan account is to transfer the money in your account to a new employer's plan. While most employer plans allow new employees to roll their accounts in, not all do . . . so it is important that you ask. (This option is not available if you are retiring and will not be working for a new employer.)

Advantages:

- You will be able to make contributions to your 401(k) account at your new employer when you become eligible to participate in that plan and, you can have all of your 401(k) money in one place.
- The new plan could potentially offer lower cost investment options and services.
- You should ask about the administrative and other fees assessed to participants' accounts in the new employer's plan and compare them to your alternatives.
- If you have an existing plan loan, you may be able to roll it over to your new employer's plan through a "direct" rollover. Check with the plan administrators at both your former employer and your new employer.
- In some states, 401(k) plans offer better creditor protection than IRAs. (However, both rollover IRAs and 401(k) plans are protected under federal bankruptcy laws.)
- As long as you are working at the employer and unless you are a 5% or more owner of the business or unless the plan provides otherwise, you will not be required to take minimum distributions when you reach age 72.
- Many 401(k) plans have loan provisions. If you transfer your retirement funds to a new employer's plan that permits loans, you may be able to borrow from the money in the new plan.

Disadvantages:

- The new plan may not allow rollovers or, if it does, there may be a waiting period.
- You will not have control over the expenses, services, or investments in the new plan.
- The new plan might offer fewer or more expensive investment options than your former plan. Make sure that the option you choose has the right investments (at the right cost) for your needs.
- The new plan may not offer personalized advice on investments, retirement planning, or your other investments.
- The new plan may not offer the services that you need. Make sure that you understand what's available before you make a decision.

4. Withdraw your money from your account.

It's your money and you get to choose what's right for you. One decision you could make is to take a taxable distribution.

Advantages:

- You can use the money as you wish, for example, to pay off existing debt, bills, or other expenses.
- If you have made after-tax contributions (other than Roth contributions), you will be able to take these amounts tax-free (though you will be required to pay tax on the earnings on those amounts). (There are special rules for Roth contributions and, depending on the circumstances, a part of the payment may or may not be taxable if withdrawn from a plan.)
- If you have employer stock that is substantially appreciated, there may be tax advantages in taking a distribution of those shares. Check with your tax advisor.

Disadvantages:

- You'll owe federal (and possibly state) income taxes on the money you withdraw. The government requires 20% withholding for federal income taxes, so the amount you receive will automatically be reduced. Also, the withdrawn money could put you in a higher tax bracket, and you may owe more taxes.
- If you're under the age of $59^1/_2$, you would also owe 10% early distribution tax penalty, in addition to the income taxes.
- Once you spend the withdrawal, you will need to begin saving for retirement again, but with fewer years left to save and without the spent savings, it may delay your retirement date or result in a lower standard of living in retirement.