CAUBLE & HARRE WEALTH MANAGEMENT

401K or Rollover IRA? : Issues to Consider

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Have you changed jobs or retired and left money in a qualified company retirement plan? This asset could be the largest source of your financial support during your retirement. If you are eligible to take a distribution from your plan, you should understand your options and the tax consequences involved before you make any withdrawals.

You have four choices when you leave your employer.

1. Take your distribution as cash
2. Leave assets at a former employer
3. Move the assets to a new employer, or
4. Roll the assets into an Individual Retirement Account (IRA).

<u>Cash Distribution</u>

Taking your account balance as a cash distribution can provide you with immediate cash, but it is rarely a good idea.

You could lose nearly half of your balance to taxes and penalties. If you take a cash distribution before you are age 59 ½ (or age 55 with a separation of service), you will probably incur the mandatory 10% early withdrawal penalty. Since the distribution is considered ordinary income, you will also incur federal, state and local income taxes including a mandatory 20% federal withholding at the time of distribution. For a $50,000 withdrawal, total possible taxes and penalties could total 44% (10% early withdrawal, 28% federal tax, 6% Missouri tax). This doesn't include and possible local tax.

Another consideration is the opportunity cost of not leaving your money growing in a tax deferred account. For example, a $50,000 balance left to grow at a tax-deferred 8% annual return over 25 years would amount to $342,400. It would take $67,675 in a taxable account at an after-tax return of 6.7% to grow to this same amount starting today. Taking your distribution as cash should only be used as a last resort.

Issues to Consider:
Taking Cash Distribution

Pros	**Cons**
Immediate Cash	Penalties & taxes
	Loss of tax deferred growth

<u>Leave the Assets Where They Are With Former Employer</u>

If the plan allows it, leaving your assets right where they are can be a convenient option if you are happy with the investment vehicles offered by the plan.

You avoid income taxes and potential penalties and your investment continues to grow tax-deferred.

A qualified employer plan, such as a 401K plan is governed by ERISA and thereby given the highest level of creditor protection. Protection available to IRA's is governed by state law and varies from state to state. However, a 2005 U.S. Supreme Court ruling (Rousey v. Jacoway, 03-1407) shields traditional

IRA assets in bankruptcy when the funds are found reasonably necessary for the account holder's or his/her dependents' support. In addition a 2005 federal bankruptcy reform law protects up to $1 million held in traditional and Roth IRAs from creditors.

You may be allowed to borrow against the value of your account depending on plan rules. Also, keeping your money in your employers plan may give you more flexibility if you want to contribute to the plan in the future. If you have highly appreciated employer stock or if you were born in 1936 or before, you may qualify for special withdrawal strategies only available through a qualified plan. You are also eligible to roll the funds to and IRA at a later date.

Downsides to consider are that you may have better investment choices available to you through a rollover IRA. You may also be restricted in making changes to your investment choices in the company plan. Finally, withdrawal options for you and/or a beneficiary are more limited than with a rollover IRA.

Issues to Consider:
Keep Assets in Former Company Plan

Pros	Cons
Convenience	May have better investment choices in a rollover IRA
Avoid taxes and penalties	Potential restrictions in making changes to investments
Continue tax-deferred growth	Fewer withdrawal options for you and/or beneficiary
Highest level of creditor protection	May not access funds for first home purchase or medical expenses
If Plan allows, may be able to borrow against	
NUA distribution option for highly appreciated company stock	

<u>Move your Assets to Your New Employer's Plan</u>

Rolling your assets into your new employer's plan has many of the same advantages and disadvantages as leaving the assets with your former employer. You avoid incurring taxes and penalties and your funds continue to grow tax-deferred. You also may continue to have the ability to borrow against your balance. An additional benefit is account consolidation.

Generally you can move pre-tax contributions and earnings from your existing retirement plan into the new plan. As for after-tax contributions, you will need to check the rules of your new plan to see if they are allowed. You can roll your after-tax contributions into an IRA, but note that after-tax contributions may not be rolled from an IRA back into a qualified plan.

Disadvantages of moving the funds into a new employers plan include that you are restricted to the investments available in the new plan and withdrawal options and the ability to change your investment choices may be restricted for you and your beneficiaries.

Issues to Consider:
Roll Assets to New Company Plan

Pros	Cons
Convenience	More investment choices in a rollover IRA
Avoid taxes and penalties	Potential restrictions in making changes to investments
Continue tax-deferred growth	Withdrawal options for you and/or beneficiary less than IRA
Highest level of creditor protection	May not access funds for first home purchase or medical expenses
If Plan allows, may be able to borrow against funds	

<u>Roll your Assets into an Individual Retirement Account (IRA)</u>

Rolling your investments into an IRA allows them to continue growing tax deferred while also allowing you to avoid income taxes and penalties on the transfer. Your investment choices are almost unlimited with an IRA and you have more control over your investments allowing you to develop an investment strategy based on your own needs.

This option offers you easier access to your investments and maximum flexibility as you can, with certain restrictions, roll these assets into another employer's plan or convert to a Roth IRA at a later date. Withdrawal options can be more flexible than with company plans, and estate planning is easier and more flexible with rollover IRAs.

Some potential drawbacks are that you will be responsible for any potential account fees, instead of your employer and you cannot borrow against an IRA. Also, if you have highly appreciated company stock in the plan, special distribution options such as Net Unrealized Appreciation (NUA) and forward averaging are not available to you once the stock is distributed to an IRA. Creditor protection may be greater with a qualified company plan. Creditor protection of traditional IRA's and Roth IRA's is governed by state law. Beyond state law, traditional IRA assets are generally protected from creditors to the extent the funds are found reasonably necessary for support. Traditional and Roth IRA assets are protected only up to $1,000,000 under federal bankruptcy laws.

Issues to Consider:
Roll funds into a Rollover IRA

Pros	Cons
Investment options almost unlimited	Creditor protection depends on state law
Easier access to retirement funds	You may be responsible for account fees
May be converted to a Roth IRA, if you qualify	You cannot borrow against IRA funds
Tax deferred growth continued	No NUA or forward averaging
Penalties and taxes avoided	
If you qualify, funds for first home purchase, higher education, medical insurance and unreimbursed medical expenses	
May be able to roll into employer plan in the future, if certain restrictions are met	

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This discussion is meant to be an overview. The tax laws governing qualified plans and IRAs are very complicated and your decision should be based on your specific circumstances.

We recommend that you discuss your options with a trusted advisor.

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	Cash Distribution	Leave with former Employer Plan	Move to New Employer Plan	Rollover IRA
Immediate Cash	✓			
Avoid penalties & taxes		✓	✓	✓
Continue tax-deferred growth		✓	✓	✓
Highest level of creditor protection		✓	✓	
Net unrealized appreciation and forward averaging		✓		
More flexible withdrawal options				✓
Most control over investment options				✓
More flexible estate planning options				✓

Cauble & Harre Wealth Management, Inc. is an independent wealth management firm and a Registered Investment Advisor in the state of Missouri.

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