What to do with your old 401(k)

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(Photo: usa today)

Don't know what to do with your old 401(k)? Few would blame you if that were the case after you changed or left your job. After all, you have at least six options.

Consider: You could leave your 401(k) in your former employer's plan; transfer it into your new employer's 401(k); roll it over into an Individual Retirement Account (IRA); take a lump-sum distribution; or make a Roth conversion or an in-plan Roth conversion.

Consider, too, that deciding what to do with the money in your account when switching jobs or retiring should not be taken lightly. In fact, new research from the Employee Benefit Research Institute (EBRI) suggests that it's one of the most important decisions that workers with 401(k)-type retirement plans face.

"A poor decision—for example, withdrawing the money prior to age 59½, which results in a 10% penalty in addition to income tax on that distribution—could reduce their retirement assets significantly," EBRI wrote in its report.

At present, what people currently do with their employment-based retirement savings largely depends on whether they retire or stay in the workforce. In the main, job changers over age 50 who stay in the labor force tend to leave their 401(k) in the previous employer's plan, while those who retire tend to take the money.

So what you should do with your old 401(k)? Well, it depends on many factors and, sadly, there are no easy answers. There are, however, certain advantages associated with each of the some of the options. Here's what experts Jeffrey Levine, a certified public accountant and IRA technical consultant with Ed Slott and Company in Rockville Centre, N.Y, and Jeffrey Cutter, a certified public accountant and founder of Cutter Financial Group, in East Falmouth, Mass. had to say.

Leaving money in a company plan

Advantages:

- There's federal creditor protection for plans covered by Employee Retirement Income Security Act of 1974 (ERISA). By contrast, there's just creditor protection at the state level for IRAs and that protection is uneven at best. In some states it's very strong. In other states, however, it's is relatively weak, Levine says. "You need to check with your state regarding protection issues," says Cutter. "This becomes very important for high-income professions who have a lot of legal exposure such as doctors, business owners."
- You can borrow money from your 401(k), says Levine. By contrast, a loan is prohibited transaction for IRAs.
- You can also buy life insurance with plan money, says Levine. By contrast, life insurance is a prohibited investment for IRAs.
- You can defer taking required minimum distributions (RMDs) beyond 70½, if you are still working for the company sponsoring the plan, are not a 5% or greater owner and the plan allows it, says Levine. "No such exception exists for IRAs, including SEP IRAs," says Levine.
- You can avoid the 10% early withdrawal distribution penalty with the age-55 exception. According to *The Slott Report,* the age 55 exception is one of the exceptions to the 10% early distribution penalty for retirement plan distributions taken prior to 59½. It allows certain individuals to take distributions from their retirement plans at 55 or later (instead of 59½) without being subject to the 10% penalty. "If you roll it over and you need the money you have to wait until 59½ or suffer a 10% penalty," says Cutter.

The IRA rollover

Advantages:

- Generally, you'll have a much wider choice of investments, including ones that protect you in bad times helping to avoid market losses, says Cutter. "This is extremely important for my pre-retired and retired clients who cannot suffer losses like they did in 2001-2002 and 2008," he says. By contrast, company-sponsored have a limited number of investment options, some of which don't protect you from market losses.
- IRA RMDs can be aggregated together and taken from any one (or more) IRA accounts as long as the right total is taken. "By contrast, company plans RMDs – other than 403(b) plans – must be calculated and taken by each plan separately," says Levine.
- IRAs are easier to manage for estate planning purposes. Why is that? Well, for one, you can create separate IRA accounts for different beneficiaries, says Levine. In other words, you have ability to create what are called stretch IRAs for beneficiaries, says Cutter.
- You'll have ability to combine multiple accounts into a single or small group of accounts. "Plans can allow roll-ins to combine accounts as

well, but that's at the discretion of the plan and many do not allow this," says Levine.

- There's no mandatory 20% withholding when you take a distribution from an IRA. "By contrast, plans must generally withhold 20% of pre-tax distributed amounts for federal taxes, says Levine.
- You have the ability to take distributions from your IRA whenever you want. By contrast, company plans can have their own distribution rules, says Levine.
- There are added benefits of the Roth IRA vs. the Roth 401(k) as well. Read Where Should You Convert? Roth IRA or Roth 401(k)?
- There are some special IRA-only exceptions to the 10% early distribution penalty. For instance, you can withdraw money from your IRA if you're first-time homebuyer or using the money to pay for higher education.

Lump-sum distributions

According to Levine, lump-sum distribution planning strategies are an animal into and of themselves. "They really depend on a person's individual circumstances and whether they qualify," he says.

And the most common lump-sum distribution planning strategy that may benefit someone is something called net unrealized appreciation or NUA, Levine says.

The rules for this are relatively complex, but to see if it should even be considered, a person can generally boil it down to these two simple questions: 1) Do you have stock of the company you work for inside your plan? 2) Is that stock highly appreciated since it was purchased within the plan?

"If the answer to both of these questions is yes, NUA is a lump-sum distribution planning strategy that should be seriously considered," says Levine.

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