Retirement Planning

401(k) Rollovers: Consolidation factors to consider.

By Eva Stark, JD, LL.M.

The average 50-year-old has held 12.4 jobs since reaching adulthood,[1] and younger generations may hold even more jobs by the time they reach the same age. As a result, in the absence of planning, an individual's retirement savings can become scattered among a multitude of accounts and be easily forgotten. Consolidating retirement accounts can help manage accounts and track progress toward retirement goals. However, before rolling over an old pre-tax 401(k) account into a new employer's 401(k) plan or a traditional IRA, several important factors must be considered.

PLAN INVESTMENT OPTIONS. One potential drawback to 401(k) plans is that investment options are limited to those offered by the plan. As a result, it is important to compare the investment selections offered by both the old and the new employer's plan before making a rollover decision. IRAs typically offer a much broader array of investment options for more customized investment strategies.

FEES. A 401(k) plan may charge fees such as administrative fees, investment fees, advisory fees and individual service fees (such as fees charged for setting up a loan). On the other hand, some 401(k) plans have low fees and offer low-cost "institutional shares" that are not available for IRAs. Before rolling funds out of a 401(k) plan, it is important to understand its fee structure.

Many employees pay little to no attention to fees, but a small difference in fees can have a substantial impact over a working career. While an employee has no control over the fees charged by his or her 401(k) plan, an individual may select among a multitude of financial institutions for an IRA to find the best value for his or her investment needs.

CREDITOR PROTECTION. 401(k) plans are ERISA qualified retirement plans that are typically protected from judgment creditors. Some limited exceptions include ex-spouses under a Qualified Domestic Relations Order (QDRO) and federal tax debts. In contrast, IRAs are not ERISA protected, although many states protect them under their exemption statutes. While some states offer full protection of IRAs, others may offer more limited protection, such as by capping the amount protected at a certain dollar amount. For those with asset protection concerns, it may be prudent to contact an attorney before rolling funds out of a 401(k) plan.

EARLY RETIREMENT. For individuals who plan to retire early, leaving funds in a 401(k) plan may help avoid the 10% early withdrawal penalty. An individual who leaves an employer after attaining age 55 may generally withdraw funds from that employer's 401(k) plan penalty free. In contrast, funds in an IRA may only be accessed penalty free after age 59½.

1 "Number of Jobs, Labor Market Experience, and Earnings Growth Among Americans at 50: Results from a Longitudinal Survey." Bureau of Labor Statistics. August 31, 2021. Available at https://www.bls.gov/news.release/pdf/nlsoy.pdf

EXTENDED CAREER. Many 401(k) plans will allow employees working past age 70½ to forego required minimum distributions. In contrast, an IRA owner must take required minimum distributions, regardless of employment status. For those who anticipate extending their careers, rolling funds into a new employer's 401(k) may help achieve additional tax deferral.

LOANS. While some 401(k) plans permit loans, IRAs do not. Individuals who desire to take loans from a 401(k) plan should review their plan documents to determine if loans are permitted. Loans must typically be repaid within 60 days of termination of employment, otherwise, income tax and a 10% early withdrawal penalty may apply.

WITHDRAWALS. IRA funds may generally be withdrawn at any time. 401(k) funds may typically only be withdrawn if employment is terminated, the employee attains age 59½, or the employee becomes eligible for a hardship withdrawal under plan rules. While some 401(k) plans allow "in-service distributions," this is not always the case. Early withdrawals either from an IRA or a 401(k) plan will typically trigger income taxes and an additional early withdrawal penalty of 10%. A handful of exceptions to the penalty (but not the tax) may be available, which differ slightly for IRAs and 401(k) plans.

NET UNREALIZED APPRECIATION. The rollover of company stock from a 401(k) plan into an IRA will generally cause the loss of preferential tax treatment on net unrealized appreciation. Company stock may be withdrawn from the 401(k) plan so that only the basis in the stock is taxed at ordinary income tax rates, while the gains (i.e., the net unrealized appreciation) are taxed at capital gains rates. To preserve this preferential treatment, it is important not to overlook company stock when considering a rollover.

Summary.

Over a working career, an employee may accumulate multiple retirement accounts. Evaluating whether and when to roll over funds into a new 401(k) plan or an individual retirement account may be a complex financial decision with potential pitfalls for the uninformed. The expertise of a trusted financial professional may be very valuable when making such an important decision.

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Before rolling over the proceeds of your retirement plan to an Individual Retirement Account (IRA) or annuity, consider whether you would benefit from other possible options such as leaving the funds in your current plan or transferring them into a new employer's plan. Consult with each employer's Human Resources Department to learn about important plan features and rules. Be sure to compare the fees and expenses of each plan and investment option to those of any other investments that you are considering. Review plan documents and the IRA agreement, as well as the prospectuses for plan investment options and any other investments that you are considering. Your Registered Representative can help explain any new product being offered. Neither New York Life nor its representatives or affiliates provide tax or legal advice. Consult with a tax or legal advisor to discuss any questions or concerns that you have, such as the tax consequences of withdrawing funds or removing shares of an employer's stock from a retirement plan and whether money invested in a retirement plan receives greater protection from creditors and legal judgments in your state than money invested in an IRA or annuity. Also consider that you may be able to take taxable, but penalty-free withdrawals from an employer-sponsored retirement plan between the ages of 55 and 59.5 that you would not be able to take if you invest in an IRA or annuity. Additionally, if you plan to work after you reach age 70.5, you may not be required to take minimum distributions from your current employer's retirement plan but would be required to do so for funds invested in an IRA or annuity. Securities are offered by Registered Representatives of NYLIFE Securities LLC, Member FINRA/SIPC, A Licensed Insurance Agency. SMRU 1845241 Exp. 2/22/2024