



Timely Topics

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10 Costly 401(k) Rollover Mistakes

Considering a retirement rollover? A lot has been written on important points to consider. However there are some pretty common mistakes investors often make. Here are the top ten miss-steps that come to mind. For the purpose of these discussions I may refer to a 401(k). That is simply because it is the most common type of employer based retirement plan. The same is true if you have a 403b, 457, Thrift Savings Plan, Profit Sharing Plan, SEP IRA, SIMPLE IRA etc.

1. **Take the money and run!** Cashing out should only be a consideration if you are in dire financial distress. Cashing out may be tempting but it will cost you. You would lose one of the biggest advantages of a 401(k), the power of compounding within a tax deferred environment. This is the real beauty of a retirement plan. Time is on your side. If you take a distribution from a company retirement plan prior to age 59 ½ you could

get hit with a 10 % penalty and the entire balance becomes taxable income that year. There are a few exceptions to this rule including distributions made to a participant after separation from service if the separation occurred during or after the calendar year in which the participant reached age 55.

The employer is also obligated to withhold tax, usually 20%, which you may not owe depending on your filing status and tax situation. The additional income could also drive you into a higher tax bracket for the year costing you much more than just the tax on the rollover assets.

2. **Do Nothing!** Many people don't know what to do so they do nothing. Leaving retirement assets in a former 401(k) is rarely a good idea. However occasionally it makes sense. Get help from a trusted advisor to assess the pros and cons of your unique situation and the plan in question. We have found that



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Sales of CD's prior to maturity may result in loss of principal invested. Federal deposit insurance generally covers deposits of up to \$250,000 in the aggregate for each depositor in each bank, thrift, or credit union. A customer should ensure that purchasing any insured CD will not bring his or her aggregate deposit over \$250,000 FDIC insurance limit. Investors should be aware that there is no FDIC insurance coverage for any principal losses that may be incurred.

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most employer based plans have limited investment options expensive fund choices and are subject to fees that you may be unaware of. With new regulations regarding fee disclosure and transparency you may suddenly see the fees and not realize that they are higher than average.

By taking control of your assets and consolidating them into an IRA Rollover you may achieve better long-term investment results based on a more focused, coordinated investment strategy. Of course this depends on how you choose to invest those assets. An advisor can help you find a solution that provides a broader range of investment options, potentially lower fees and access to advice and guidance that you may not be getting from your employer based plan. Another important factor to consider is ease. A rollover should result in less

paperwork in the long run and fewer accounts to manage and coordinate. Establishing a new account does involve some paperwork but it should be a fairly easy process to administer.

3. **Hands Off!** Avoid taking possession of your funds. There is a rule that stipulates you have 60 days to rollover the assets from your former 401(k) into another qualified plan or an IRA. After the 60 day window it is considered taxable income for that year. It's too easy to forget to take action. Even if it's a small amount taking possession of the assets can be a costly mistake.
4. **Like Property!** If you take a cash distribution you must roll over cash into the new plan or IRA. If you take the cash and then buy stocks with it you can't put the stock into the rollover even if it's within the 60 day window.
5. **RMDs!** Consider the impact on your Required Minimum Distributions. Many people

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are choosing to work longer for numerous reasons; some find themselves with shortfall; some enjoy their work and don't know what else to do with their life; still others leave the rat race and then find more meaningful work that they enjoy. If you are nearing 70 ½ and still plan on working remember that you do not have to take RMDs from a current employer's plan in most situations. This is growing increasingly important as more and more people are working longer. When you are subject to RMDs and still have taxable income you may have higher tax rates while a higher percentage of your Social Security benefits are subject to tax.

In-service distributions (taking a distribution from your company retirement plan while still employed) can sometimes make sense but should be carefully considered. This is often done as a rollover into an Individual Retirement Account and is subject to plan rules. Keep in mind however that you still have to take RMDs from any IRAs even if you are still working but not your current employer's retirement plan. If you find yourself in this situation and you are fortunate to have a low cost 401(k) with great investment options and the plan allows you may want to consider rolling assets into the current plan if that is an option.

6. **Do it yourself!** Don't try this at home! Do you remember the old line...I'm not really a doctor but I play one on TV? By the way I used this the other day with my own doctor,

who is a great guy. He didn't laugh.☹ Many folks attempt to manage it themselves. This can be costly. I have found that most people do not have the time, knowledge or discipline to manage it themselves. Individuals are often overtaken by emotion and make knee-jerk reactions based on the latest headline noise. These emotional reactions cost investors dearly. They also fail to coordinate and correlate their investments in order to be truly diversified.

Don't be tempted to follow your brother in law's recommendation on the sexy hot stock of the day. This may not work to your advantage. Another temptation that investors often fall prey to is the idea of active trading. It can be fun for a while but what goes up can come down. This is your retirement savings. Take it seriously. It could last 30 – 40 years for some.

7. **Fail to update beneficiaries!** Out of sight, out of mind. Most working Americans will find that they will have multiple employers over the course of their careers. You leave an employer and life happens. Twenty years from now you are remarried and have two new kids. (It could happen!) Something happens to you unexpectedly and you die. You failed to update your beneficiary on ALL of your retirement accounts and that old 401(k) now goes to spouse #1 and not your kids. It may not matter what the will says. Oops!
8. **Cashing in company stock!** Do you have company stock that has significantly appreciated in value in your 401(k)? If so you may want to consider the impact of

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The “Net Unrealized Appreciation” rule. You may be able to take a distribution of the stock, move it into a taxable account and roll the balance into an IRA.

I would recommend that you talk to your accountant about this and make sure you make a tax favorable decision. **Why?** Because under the Net Unrealized Appreciation rules you may be able to take a lump-sum distribution from your 401(k) account, moving the employer stock into a taxable account and rolling the rest of the account into an IRA. By moving the stock into a taxable savings account only your cost basis of the stock will be taxed as a distribution. The gain isn’t taxed until you sell it and then it is taxed at long-term capital gain rates, (currently 15%). This could be a huge savings if you are in a much higher tax bracket. Whereas, if you sell the stock in the 401(k) and take a cash

distribution the entire amount is taxed as ordinary income.

9. ***Move it to the bank!***

Inflation is real. Think about how fast prices are rising for basics including gas and health care. A portfolio of bank guaranteed CDs may sound good after years of volatility in the market but they may not get you where you need to go. Interest rates are at an all-time low and may remain there for some time. Work with an advisor that will help you develop a portfolio that is based on your tolerance for risk and one that will out-pace inflation at the same time. The bank may be a great place for your emergency fund and money set aside for short term goals but for your long term goals such as retirement a diversified portfolio with some element of growth makes more sense for many people

10. ***Misplaced Loyalty!*** You owe it to yourself to take control of your financial future. What happens

when the employer files for bankruptcy or the plan administrator changes?

The plan can be frozen. When this happens you have limited access to your retirement plan assets, sometimes for years. You own company stock and you have seen it rise over the years. You hesitate to sell. What happens when the company makes a public mistake and the stock tumbles? Spinoffs, mergers and acquisitions can all have negative consequences. Once you leave you are soon out of the loop and may be unaware of changes in company culture, possible changes in ownership or industry specific risk. If you still love the stock and it makes sense buy some in your rollover.

If you are considering a rollover from a previous employer give me a call. I’d be happy to help answer any questions. As always we offer a no obligation initial consultation.

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