

The Weekly Scenario: Retirement Funds from Previous Employers – Weighing the Options

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The year 2020, and so far 2021, has been a reset of sorts. The ever-changing landscape has resulted in people deciding to retire, move or literally reset their careers. For most people, their retirement accounts represent a significant amount of wealth for them.

What to do with retirement funds from a previous employer is an important decision. This discussion should be had with an advisor before jumping in. I will discuss 3 of the primary options for most people.

Option #1 is to keep the funds in a company plan. A great reason to do so is that these plan assets receive federal creditor protection under ERISA. ERISA protection is a very high bar in bankruptcy, lawsuits and other judgments against the plan participant. Creditor protection should be considered before rolling these funds out of a company protected plan.

Another reason to stay in the company plan has to do with the age 55 plan exception. If a participant is age 55 or older in the year he separates from service, keeping the 401(k) money in the plan means there will be no 10% early withdrawal penalty. If a rollover to an IRA is done, the age 55-exception on this money is lost. IRA withdrawals prior to age 59 ½ will generally be subject to the 10% early withdrawal penalty.

Option #2 is to roll over the plan to a traditional IRA. IRAs have a number of benefits.

Typically, IRA rollovers permit flexibility in making changes more quickly without the administrative hurdles that other plans can impose. Many employer-based plans can be more restrictive for example in terms of permitting trusts to be beneficiaries or will need spousal consents. IRAs do not have such requirements so for the most flexible and favorable post death payout, the better choice is almost always rolling the company plan into an IRA. Plan participants that take distributions from employer plans thinking there will be no 10% penalty if the funds are used for higher education expenses or (first time) home purchases are mistaken. The exceptions to the penalty only apply to withdrawals from an IRA.

IRA plans can also generally offer more diverse and wide-ranging investment options.

Option #3 is to convert to a Roth IRA. A conversion can be done within the plan if the plan permits this. If there is no Roth component to the employer plan, rolling plan money to a Roth IRA is the only way to get into a Roth.

It is permissible to roll over part of the plan to a traditional IRA and part to a Roth IRA. This type of rollover to a Roth IRA would qualify as a valid conversion. However, it is not necessary to move the entire plan to a traditional IRA and then convert. For most people, it is recommended to roll after tax dollar plans (if applicable) into a Roth IRA (this would qualify as a tax-free conversion). After tax money rolled into a traditional IRA will create cost basis in the IRA and will need to be

accounted for going forward.