Preserving Retirement Assets: An IRA Rollover Review

How will you replace your income when you retire? What will happen to your standard of living when your income ceases at retirement?

Prepared for:

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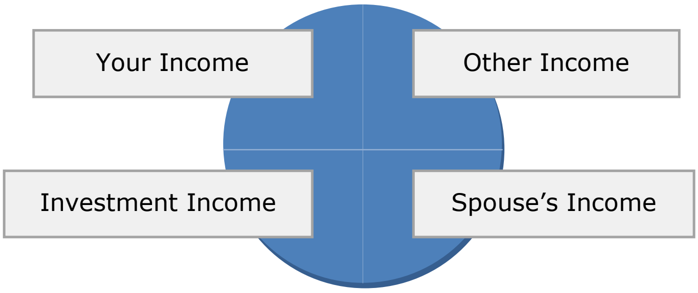
Your Earning Power

Your earning power – *your ability to earn an income* – is your most valuable asset.

Few people realize that a 30-year-old couple will earn 3.5 million dollars by age 65 if their total family income averages $100,000 for their entire careers, without any raises.

Earning Power:



How Much Will You Earn in a Lifetime?

Years to Age 65	Your Future Earning Power If Your Family Income Averages:			
	$50,000	**$100,000**	**$250,000**	**$500,000**
40	$2,000,000	$4,000,000	$10,000,000	$20,000,000
35	1,750,000	3,500,000	8,750,000	17,500,000
30	1,500,000	3,000,000	7,500,000	15,000,000
25	1,250,000	2,500,000	6,250,000	12,500,000
20	1,000,000	2,000,000	5,000,000	10,000,000
15	750,000	1,500,000	3,750,000	7,500,000
10	500,000	1,000,000	2,500,000	5,000,000
5	250,000	500,000	1,250,000	2,500,000

How will you replace your income at retirement?
What will happen to your standard of living when your income ceases at retirement?

Failing to Plan

Most People Do Not Plan to Fail. They Simply Fail to Plan and Set Goals.

The fact is that, once retirement is reached, it does not matter how much you earned during your working years.

What does matter is how much money you have saved and accumulated, as well as what you choose to do with those funds during retirement.

The biggest financial risk that anyone faces during retirement is the risk that savings will be depleted… the risk that income will be outlived!

When You Change Jobs

When you change jobs, you may have an important decision to make...what to do with your money in an employer-sponsored retirement plan, such as a 401(k) plan. Since these funds were originally intended to help provide financial security during retirement, you need to carefully evaluate which of the following options will best ensure that these assets remain available to contribute to a financially-secure retirement.

Take the Funds

You can withdraw the funds in a lump sum and do what you please with them. This is, however, rarely a good idea unless you need the funds for an emergency. Consider:

- A mandatory 20% federal income tax withholding will be subtracted from the lump sum you receive.
- You may have to pay additional federal (and possibly state) income tax on the lump sum distribution, depending on your tax bracket (and the distribution may put you in a higher bracket).
- Unless one of the exceptions is met, you may also have to pay a 10% premature distribution tax in addition to regular income tax.
- The funds will no longer benefit from the tax-deferred growth of a qualified retirement plan.

Leave the Funds

You can leave the funds in your previous employer's retirement plan, where they will continue to grow on a tax-deferred basis. If you're satisfied with the investment performance/options available, this may be a good alternative. Leaving the funds temporarily while you explore the various options open to you may also be a good alternative. (**Note**: If your vested balance in the retirement plan is $5,000 or less, you may be required to take a lump-sum distribution.)

Roll the Funds Over

You can take the funds from the plan and roll them over, either to your new employer's retirement plan (assuming the plan accepts rollovers) or to a traditional IRA or a Roth IRA, where you have more control over investment decisions. This approach offers the advantages of preserving the funds for use in retirement, while enabling them to continue to grow on a tax-deferred basis.

Lump-Sum Distribution Results

Why Taking the Funds May Be a Bad Idea:

While a lump-sum distribution can be tempting, it can also cost you thousands of dollars in taxes, penalties and lost growth opportunities…money that will not be available for future use in retirement.

Let's assume that you're under age 59-1/2 and in the 28% federal income tax bracket. For each $100,000 you have in a retirement plan with a former employer, these are the hypothetical results of rolling the funds into a traditional IRA or of taking a lump-sum distribution.

Taxes and penalties if you...	Roll $100,000 into a traditional IRA	Take a lump-sum distribution
■ 20% mandatory withholding at the time of distribution	$ 0	$20,000
■ 8% additional income tax due at filing	$ 0	$ 8,000
■ 10% premature distribution penalty tax	$ 0	$10,000
Ending Balance:	**$100,000**	**$62,000**

Cost to Take the Funds Today: $38,000

Value of $38,000 in...	5 Years	10 Years	15 Years	20 Years
5% Return	$48,499	$61,898	$78,999	$100,825
8% Return	$55,834	$82,039	$120,542	$177,116
10% Return	$61,199	$98,562	$158,735	$255,645

NOTE: The above is a hypothetical example for illustration purposes only and assumes that one of the exceptions to the premature distribution penalty tax is not available. In addition to the federal taxes illustrated above, state tax may also be payable. This example is not indicative of any particular investment or performance and does not reflect the fees and expenses associated with any particular investment, which would reduce the performance shown above if they were included. In addition, rates of return will vary over time, particularly for long-term investments.

A Potential Solution Using a Traditional IRA Rollover

When you change employment or an employer-sponsored retirement plan is terminated, a special type of IRA called a rollover can be used with a qualified plan distribution in one of two ways:

As a Qualified Plan Conduit:

The qualified plan distribution is transferred to a traditional IRA rollover, where it is held and maintains its tax-deferred status until it is transferred into the retirement plan of a new employer (assuming the plan allows it).

Qualified Retirement Plan Distribution → **Conduit IRA Rollover** → **New Qualified Retirement Plan**

As a Retirement Accumulation Vehicle:

The qualified plan distribution is transferred to a traditional IRA rollover, where the funds are invested and enjoy tax-deferred growth in a traditional IRA until needed for retirement income purposes.

Qualified Retirement Plan Distribution → **Traditional IRA Rollover**

Let's take a closer look at the two different IRA rollover methods.

IRA Rollover Methods

Indirect Rollover

In an indirect rollover, **the distribution is first paid to the employee**, who then has 60 days following receipt of the distribution to roll the funds over to the trustee of the new employer-sponsored retirement plan or to a traditional IRA.

Under federal tax rules, however, if the distribution is first paid to the employee, the plan administrator is **required to withhold 20% of the distribution**. This requirement can cause problems:

- While you receive only 80% of the distribution, you are required within 60 days to roll over 100% of the distribution to a new qualified retirement plan or to a traditional IRA in order to avoid income and, possibly, penalty taxes.
- This means that you must make up the 20% that is withheld out of other funds.
- When you file your tax return for the year, you can then request a refund of the 20% that was withheld at the time of the distribution.

> In order to avoid the mandatory 20% withholding requirement, a direct rollover should be used.

Direct Rollover

With a direct rollover, **the funds are transferred directly** from the trustee of the original qualified retirement plan to the trustee of the new qualified retirement plan or to the traditional IRA trustee (a trustee-to-trustee transfer). By arranging for a direct transfer of funds between qualified plan trustees, you avoid the 20% federal income tax withholding requirement.

Bankruptcy Protection

The funds in an employer-sponsored retirement plan are protected from the reach of creditors in the event of a bankruptcy. Whether IRA assets enjoyed this same protection had been questionable. With passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, however, effective October 17, 2005, up to $1 million of traditional and Roth IRA assets in the aggregate became protected from bankruptcy creditors. The $1 million exemption does not apply to rollover IRA assets, which retain their unlimited exemption. For this reason, it is generally preferable to segregate rollover IRA assets in a separate IRA account.

Additional IRA Rollover Information

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA 2001) increased the portability of retirement plan assets by allowing rollovers between all types of retirement plans. Certain rollover restrictions were eased as well. The Pension Protection Act of 2006 made these changes permanent.

Eligible Plans

Eligible rollover distributions from qualified plans, 403(b) annuities and Section 457 plans may be rolled over to any of the other types of plans that will accept such rollovers. A Section 457 governmental plan must separately account for funds received from qualified plans, 403(b) annuities or IRAs, or it may not accept such funds.

Spousal Rollovers

Distributions from a qualified plan paid to the surviving spouse of a deceased participant may be rolled over within 60 days to another qualified plan, a Section 403(b) annuity, a traditional IRA or a Section 457 plan.

After-Tax Employee Contributions

After-tax employee contributions distributed from a qualified plan after December 31, 2001 can be rolled over to a traditional IRA or to a defined contribution plan in a direct trustee-to-trustee transfer, if separately accounted for.

Roth Accounts

If you have a designated Roth account in a qualified plan, you should roll that Roth account over into a Roth IRA in order to maintain the income tax free character of Roth distributions.

Hardship Exception

The Act gave the Secretary of the Treasury the authority to waive the 60-day rule for rollovers where failure to comply is due to casualty, disaster or events beyond the reasonable control of the taxpayer.

IRA rollover requirements can be complex. Depending on the original source of the funds and the objectives of the IRA rollover, different requirements may apply.

In order to avoid unforeseen and/or negative tax consequences, you should seek professional tax advice before implementing an IRA rollover.

Traditional IRA Rollover Taxation

During Life:

Growth: IRA earnings accumulate tax-deferred until distributed.

Distributions: IRA distributions are taxed under the rules of IRC Sec. 72. This means that the taxpayer is entitled to recover any after-tax employee contributions that were rolled over into the IRA tax-free when distributions begin. Other than this tax-free return of the "investment in the contract," all traditional IRA distributions are includable in gross income in the year received. In addition:

- **Premature distributions** made prior to age 59-1/2 are subject to a 10% excise or "penalty" tax, in addition to the regular income tax on the amount of the distribution. (Exceptions to the penalty tax include payments made on account of death, disability, to cover certain medical expenses, to pay qualified higher education expenses, for the purchase of a first home ($10,000 lifetime limit), or in a series of substantially equal periodic payments over the taxpayer's life expectancy.)

- **Minimum distributions** from an IRA must begin by April 1 of the year after the year in which the taxpayer attains age 70-1/2, or a 50% excise tax is levied on the difference between what was paid out and what should have been paid out under IRA minimum distribution rules.

At Death:

Estate Taxation: The value of the IRA is included in the gross estate of the deceased owner.

Income Taxation: Traditional IRA distributions to a beneficiary are taxed in the same manner as if received by the IRA owner.

Roth IRA Rollovers

Roth Account Rollovers:

Certain qualified plans, such as 401(k) plans, 403(b) TDA plans and section 457(b) governmental plans, have the option of allowing plan participants to elect to have all or a portion of their contributions placed in a designated Roth account in the plan. When a plan participant selects this option, contributions made to the designated Roth account are **not tax deductible** for federal income tax purposes. Growth on contributions in the Roth account, however, is free of federal income tax and, assuming certain requirements are met, distributions from the Roth account are received free of federal income tax.

If you receive a distribution from a Roth account in a qualified plan, you will need to roll that distribution into a Roth IRA in order to maintain the tax-free status of future distributions. In addition, a distribution from a designated Roth account in an employer plan is not taxable when rolled into a Roth IRA, regardless of whether the distribution is a qualified distribution at the time of the rollover.

Roth IRA Rollovers:

Qualified plan distributions can be rolled over into a Roth IRA, where they continue to grow free of federal income tax and, assuming certain requirements are met, distributions from the Roth IRA are received income tax free. While the availability of tax-free distributions in the future is attractive, there is an important consideration in evaluating this option.

A rollover to a Roth IRA of distributions not made from a designated Roth account are includible in gross income in the year of the distribution. The amount included in gross income is equal to the amount rolled over, reduced by the amount of any after-tax contributions that are included in the rolled over amount. This means that, for example, a $100,000 qualified plan distribution consisting entirely of pre-tax contributions and rolled into a Roth IRA will generate a $25,000 income tax bill for someone in the 25% tax bracket plus a possible 10% penalty tax.

In deciding whether to make a rollover to a Roth IRA, consider if:

- You can pay the tax on the rollover with funds other than those from the retirement plan. If you use a portion of the plan distribution to pay the tax due on the rollover, you'll then have less money building up tax-free within the Roth IRA.

- You anticipate paying taxes at a higher tax rate in the future than you are paying now. If not, a traditional IRA rollover may make more sense.

- You have a number of years to go before you might need to take withdrawals from the Roth IRA, giving you an opportunity to recoup the taxes paid on the rollover.

In order to avoid unforeseen and/or negative tax consequences, you should seek professional tax advice before implementing a Roth IRA rollover.

Important Information

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