

Retirement Plan Distributions — Your Options When You Lose Your Job

You've wisely saved for your retirement years by participating in your employer-sponsored retirement plan, such as a 401(k) or 403(b). When you lose your job, you have many decisions to make — one of which is deciding what to do with the assets you've accumulated. Whether you were with your employer for a few years, or for decades, the decision you make will play a critical role in determining the course of your financial future.

You can essentially do two things with the assets in your retirement plan; allow them to continue growing tax-deferred; or take a distribution. These options can lead to very different outcomes — so you'll want weigh the advantages and disadvantages of each before making your choice.

THINK ABOUT YOUR FINANCIAL FUTURE

The biggest advantage of your employer-sponsored retirement plan, is that your contributions and the earnings are growing on a tax-deferred basis. This both reduces your taxable income today and helps your money grow faster than it would in an account in which you are required to pay taxes every year.

If you want your retirement assets to continue growing for your future, there are generally three different routes you can take.

Leave your money in your former employer's plan —

If your plan permits, you can leave your money in it, although you can't add new contributions. However, if you leave your money in your former employer's retirement plan, you are limited to the investment options provided by the plan, and you and your beneficiaries may have restricted access to your money. Some plans also charge former employees a fee for remaining in the plan.

Move the money into your new employer's plan —

Once you find a new job, you can move your retirement plan assets into your new employer's plan, provided the

plan accepts rollovers. This may help you consolidate your retirement assets. However, you may be subject to a waiting period before the rollover is allowed and your investments will be limited to those offered by the plan. Your plan may also restrict your ability to control and access your money. If the plan meets ERISA guidelines, your assets are protected from creditors. Another consideration is that you may be able to take a loan from your new plan.

Roll your retirement assets into a Traditional IRA —

Depending on your individual situation, this “rollover” option could be your best choice. Rolling your assets to a traditional IRA offers you flexibility and a number of key advantages.

- ***Consolidation of Assets*** — You may be able to consolidate all of your retirement assets in one account. A single snapshot of your retirement assets can help simplify the tracking of your assets and prevent investment overlap.
- ***Investments*** — An IRA offers an almost unlimited array of investment choices. This allows you and your Financial Advisor greater flexibility in creating an investment portfolio that will help you meet your retirement planning and financial goals.
- ***Estate Planning*** — When your beneficiaries inherit your IRA assets, they may be able to “stretch” the distribution of those assets over their life expectancies and keep the assets growing tax-deferred.
- ***Distributions*** — An IRA generally has fewer limitations regarding distributions than an employer-sponsored retirement plan. Even if you are under the age of 59½, penalty-free withdrawals from a traditional IRA are allowed for a number of reasons.

ROTH 401(k)/403(b) ROLLOVERS

If your employer offers a Roth feature in your retirement plan, you have the option to contribute after-tax dollars, but your withdrawals and earnings will be



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tax-free (provided you're at least 59½ and you've had the account for at least five years when you start taking distributions).

When you change jobs, you can roll your Roth 401(k) or 403(b) assets directly to a Roth IRA. Or, if you choose, you can roll your distributions into your new employer's Roth 401(k) or 403(b) plan, providing the plan accepts such rollovers.

DIRECT CONVERSIONS TO A ROTH IRA

Beginning in 2008, you can directly convert assets from your employer-sponsored qualified retirement plan to your Roth IRA. It is important to remember that this will generally be a taxable event.

However, if you have after-tax, non-Roth assets in your plan when you terminate employment you may have the opportunity to directly convert those assets to a Roth IRA without a tax consequence. If the plan issues separate checks for the pre-tax and after-tax plan assets, then the pre-tax assets can be rolled to a traditional IRA while the after-tax assets can be converted directly to a Roth IRA, tax free, by-passing the pro-rata distribution rules.

Of course, Roth IRA conversion rules still apply (i.e. your MAGI must be less than \$100,000). However, the \$100,000 MAGI limit for conversion eligibility does not apply after December 31, 2009.

FINANCIAL TIPS FOR LIVING TODAY

When you lose your job, it's natural to worry about how you will survive financially. Here are three things you can do to help you regain the feeling of control until you have a regular income again.

Prioritize and Economize — Make a list of ways you can both cut unnecessary expenses and save money on the essentials. Then prepare a baseline budget that details how you plan to survive financially while you're unemployed.

Ask about your severance pay — You may have the option of receiving your severance in a single payment or as a continuation of salary. You also should find out when you will receive your final paycheck and if you are eligible for compensation for unused vacation or sick days.

Apply for unemployment compensation — If eligible, file for unemployment compensation right away, even if you may not be able to receive the benefits until later.

WHAT IF THESE STEPS ARE NOT ENOUGH?

When you lose your job, you may be tempted to take a payout from your retirement plan because you feel you need the cash. A few words of caution, withdrawing money from a tax-deferred retirement account is costly. This distribution will be subject to ordinary personal income tax and if you are under age 59½ — or were younger than 55 when you left your employer — you may have to pay an additional 10% penalty.

TAKING DISTRIBUTIONS

If you absolutely need the money now and there are no other alternative income sources, you have several options to consider, each with tax consequences too complex to explain fully here. For help deciding which distribution option is best suited for your situation, consult your tax advisor and RBC Wealth Management® Financial Advisor. They may be able to help you structure a plan that gives you the liquidity you need today and also keeps some of your money working toward your financial future.

Discretionary Distributions

You may be allowed to take periodic distributions from your retirement plan. They may be scheduled or unscheduled. The advantage is that you take only what you need, letting the balance grow tax-deferred either in the plan or in an IRA. These distributions are generally subject to penalties and taxes, depending on your age and circumstances.

However, if you take a distribution from a qualified retirement plan after you have separated from service,

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and your separation occurred during or after the calendar year in which you turned 55 you will not be subject to the 10% pre-mature distribution penalty. If you roll over funds from the qualified plan to an IRA, this exception will no longer apply.

Substantially Equal Periodic Payments

Internal Revenue Code Section 72(t) allows you penalty-free access to assets in IRAs and employer-sponsored retirement plans by taking “Substantially Equal Periodic Payments”. These distributions may help create a replacement “paycheck” for you. Tapping into your retirement assets early also has drawbacks; you increase the risk of outliving your assets.

For payments to be considered “Substantially Equal Periodic Payments”:

- The payments must be a series of payments taken at least annually;
- You must continue taking the distributions — for the longer of five years or until you reach age 59½; and
- The payment amount must be calculated according to one of three IRS approved methods: life expectancy, amortization, or annuitization.

While the distributions are not subject to the 10% pre-mature distribution penalty, taxes must still be paid on the distributions. An individual who begins distributions using either the amortization or annuitization may make an irrevocable switch to the life expectancy method, which will reduce the required amount to be distributed. Any other change would be considered a modification and may result in retroactive penalties.

Please note, you must be separated from service in order to take “Substantially Equal Periodic Payments” from a qualified plan.

Net Unrealized Appreciation

If your employer-sponsored retirement plan contains employer stock that has appreciated greatly you may actually save money by not rolling the employer stock

into an IRA. You still pay ordinary income taxes, and a potential 10% pre-mature distribution penalty, on the stock’s cost basis (the price per share at which you originally purchased the stock). But when the stock is sold, the difference between the basis and the current market price — the net unrealized appreciation — is taxed at long-term capital gains rates, regardless of the holding period.

SOME GOOD NEWS

If you decide to take a lump sum distribution, you can roll over the distribution into a traditional IRA within 60 days of receiving the money. If you want to roll over 100% of your distribution, you’ll have to find another source of money to replace the 20% of your distribution that was withheld for taxes. If you just roll over the 80% you received, you’ll be taxed and possibly penalized (10%) on the 20% that was withheld and not rolled over.

THESE ARE IMPORTANT DECISIONS. HELP IS AVAILABLE.

Losing your job is hard. But your RBC Wealth Management Financial Advisor can help you get through this difficult time — while helping you continue preparing for your future financially. Together you will evaluate your retirement plan distribution options and your investment portfolio to help you make prudent financial decisions for today and for tomorrow. He or she can also help you monitor your progress, and change course as needed, to help you achieve your long-term financial objectives.

For personalized assistance choosing an appropriate strategy for your employer-sponsored retirement plan, contact your RBC Wealth Management Financial Advisor today.

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