

info sheet

401(k) plan choices for job changers

When you change jobs, it can be for any number of reasons. Regardless of what triggers a job change, however, most experts agree such an event creates a perfect opportunity to reevaluate your long-term financial plan. After all, this is one of the few times — aside from actual retirement — that you'll be faced with making decisions about what to do with the money you've been saving in your 401(k) plan. Reviewing your situation at this transitional time can not only help you feel better about your new job, it can get you refocused on your long-term savings plan.

When you leave an employer, you're likely to have several options. You may

- stay invested in your previous employer's plan
- invest your assets in the new employer's plan
- take your distribution in cash
- roll your assets into another qualified plan or IRA

First and foremost, you should know that by taking a cash distribution from your 401(k) plan before age 59½, you could be opening yourself up to tax liability that could significantly lessen your after-tax payout. Although taking that distribution in cash to pay off bills or to start a new business venture may seem like a good idea, it will ultimately leave you with a smaller nest egg. By leaving your investments in your old employer's plan, on the other hand, you may be limiting your investment choices and distribution options.

As you can see, there are many pros and cons associated with each option. Below is just a summary of those options. Your investment professional will be able to help you make the right decisions based on your individual situation.

Choice 1 — Stay invested in your previous employer's plan

Depending on your plan, you may or may not have this option. If you are able to leave the money right where it is, however, you should ask yourself the following questions.

- Am I happy with my investment choices?
- Am I limiting my access to these assets now that I am no longer employed there?
- Do I have any after-tax contributions in this plan?

On the plus side, the existence of after-tax contributions may be the most compelling reason to stay in your previous employer's plan, since after-tax contributions are allowed to grow tax deferred as long as you keep them in the plan. You might also be satisfied with the performance of the investments within your previous employer's plan — investments that may not be available to you in a new plan.

On the minus side, you might be forced to give up certain privileges you enjoyed as an employee, making access to the assets more difficult in the event of an emergency. Before you decide to move your nest egg, it's important to look at the entire picture, including accessibility issues and any changes you might have made to your financial strategy. It's quite possible that, despite there being several advantages to leaving the money where it is, your previous employer's plan may not be in line with your revamped financial plan.

Choice 2 — Invest your assets in the new employer's plan

Let's say you've looked over your new employer's retirement plan and, having decided it does fit your long-term strategy, you choose to move your assets. Doing so will ensure that your retirement assets remain tax deferred. It will also keep your assets in a centralized location.

That's the good news. The bad news is that your new employer may not allow you to participate in its plan right away, as many companies require new employees to complete a minimum of six months of service before enrolling. This may pose a problem if you are looking to transfer assets immediately upon leaving your previous employer.

Also, if you had contributed after-tax money to your previous employer's plan, these assets are not eligible for transfer into the new plan. Therefore, while you're waiting out the time requirement to place pre-tax assets into your employer's new plan, it might be wise to convert your money into a rollover IRA (see Choice 4).

Choice 3 — Take your distribution in cash

You have saved diligently and are well on your way to establishing a nice nest egg for retirement. However, the possibility of taking that money in cash when you change jobs is enticing. The new kitchen, along with the luxury import car, would be excellent additions to your everyday life. But before you have a check for the entire distribution (or even part of it) made out to you, there are a few things you should keep in mind.

By having the check made out in your name, you're handing over to the government almost a third of your account. When a distribution is not directly rolled over into an IRA or another qualified plan — as is the case when it is taken in cash — the employer automatically withholds 20% of the money. If you are younger than age 59½, the IRS hits you with an additional 10% penalty. To make matters worse, taxpayers in the 28% bracket or above will have at least another 8% taken from the now-dwindling nest egg. In short, you may compromise your strategy of building for a comfortable retirement.

If, after taking the distribution in cash, you decide you'd like to roll it into another plan, you can still do so. However, you must reinvest the assets within 60 days of the date you received the distribution if you want the 20% withheld by your employer to be credited to you when you file your year-end tax return.

The bottom line is that, before taking the cash, you should think long and hard about all the hard work and sacrificing you've done, only to now be penalized and taxed. And if you are still tempted, a meeting with your investment professional will likely quell any remaining doubts you might have about the effect even a small cash distribution will have on your retirement income.

Choice 4 — Roll your assets into another qualified plan or IRA

Of the four distribution choices discussed here, rolling over assets to another tax-deferred investment offers the most investment flexibility and the least exposure to taxes and penalties.

A rollover is a lump-sum distribution that is “rolled over” into an IRA or other qualified plan. When changing jobs, you should request a check for the amount you wish to roll over from your 401(k) *and have it made out to the trustee of the new plan or rollover IRA* (qualified plans include 401(k), 403(b), pension, and profit sharing plans). You can request that the check be sent to you or directly to the new trustee. Please note, however, that unless you’re taking the distribution in cash, the check should never be made out to you.

As long as the originating 401(k) does not contain a mixture of salary deductions (pretax) and post-tax contributions, the entire balance can be rolled into the IRA — tax free. This provides a convenient place to keep your retirement money growing tax deferred while you wait to meet the time requirements of your new employer’s plan.

The key is to roll your assets into an investment that offers a wide variety of investment choices that meet your financial objectives. Among the most popular choices for traditional IRAs, for example, are mutual funds. Allocating IRA assets among mutual funds offers investors professional, full-time management, diversification (to help reduce risk), and the flexibility

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to move from one fund to another as investment needs change. Keep in mind, however, that the principal value and return of mutual funds will fluctuate with changes in market conditions, and your investment may be worth more or less than you originally paid upon withdrawal.

Take your time and invest wisely

Most experts agree that what you do with your 401(k) assets when you change jobs could be one of the most important financial decisions you ever make. The best thing you can do when faced with these four choices is to think things over carefully. In most cases, you won’t be required to make a decision immediately, which leaves you plenty of time to meet with your investment professional. He or she can help you decide the best way to invest those assets to help maximize your income at retirement.

Resources for Further Information

Hartman, Julia. **Strategic Job Jumping: Fifty Very Smart Tactics for Building Your Career.** Prima Publishing, 1997, 176 pages, \$13.

Slesnick, Twila; Suttle, John C. **IRAs, 401(k)s, and Other Retirement Plans: How to Take Your Money Out.** Nolo Press, 1998, 200 pages, \$21.95.

Rowland, Mary. **A Commonsense Guide to Your 401(k).** Bloomberg Press, 1997, 240 p., \$19.95.

Contact your investment professional for more information or to construct a personalized Heritage Planning Profile to help your parents, your children, or yourself.

