

By the numbers

- **45.2 million** U.S. households own IRAs.
- **45%** of traditional IRAs include rollover assets from employer-sponsored plans.
- **75%** of traditional IRA households rolled over assets due to job a change.

Source: Investment Company Institute, *Fundamentals*, September 2003

An IRA dilemma: to roll or not to roll

When you take a distribution from your company's retirement plan — at retirement or when you change jobs — you may find yourself with a sizable sum of money. This windfall of sorts is often referred to as a lump-sum distribution. In addition to wondering what you should do with this money, you may also have concerns about taxes and investing issues that you never had to think about before, such as early withdrawal penalties and a 20% mandatory withholding.

Because this money will play such a large part in ensuring that your years in retirement are comfortable, it's important for you to understand your options and make decisions that will serve your needs now and in the future. Following are answers to some of the most commonly asked questions about lump-sum distributions. Among the answers, you'll find information on Rollover IRAs, which may be your best option for preserving your retirement funds.

What are the potential drawbacks involved with taking a lump-sum distribution?

As more employers allow people to take lump-sum distributions, many people who might have had fairly modest incomes

suddenly find themselves having to decide what to do with what may be several hundred thousand dollars. Such a windfall can tempt some people to do things they may regret later. For example, having worked hard for the past five years without a vacation, you may be "talked into" taking that once-in-a-lifetime trip. Even if you have always been financially disciplined, the temptation might still seem too great to resist.

Can I use part of a distribution for important current expenses?

Although you may think it makes sense to use part of a lump-sum payment to eliminate large outstanding debts or pay off mortgages, a secure retirement can be jeopardized if this

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Key points

If you are changing jobs or getting ready to retire, you'll need to decide what to do with the assets you've accumulated in your employer-sponsored retirement plan account. A rollover IRA may be right for you. Consider these benefits:

- tax-deferred investing
- an income stream during retirement
- easy access to your assets in an emergency*
- a broad range of investment choices
- the ability to consolidate retirement assets

* Current income taxes and a possible 10% tax penalty often apply when you take your retirement money prior to age 59½.

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money isn't used wisely. It may look like a lot of money now, but as people retire earlier and live longer, estimates of how much an individual will need for a comfortable retirement are continually revised upward. Your nest egg may have to be a source of income for 20 or 30 years, or more. So if you spend even a little of your lump sum prematurely — even to pay down your debts — you'll have a smaller nest egg and less income during retirement. Keep in mind you'll have to pay income taxes on any money you withdraw now. In addition, you may be subject to an early withdrawal penalty tax of 10% unless you meet one of the age or systematic payout method exemptions provided in the Internal Revenue Code.

What if I'm leaving my job and am offered a lump-sum distribution?

The best first step might be to do nothing. In most cases, you won't be forced to take your money out of the company retirement plan immediately, which gives you time to make careful decisions. If your company has a traditional "defined benefit" pension plan, you may have a few months to decide what to do.

If you've also been participating in the company's 401(k) plan, you may be able to keep your money in that plan and put any lump-sum payments from a defined benefit plan into the

401(k) by way of a rollover. Your other options include rolling your retirement money into an IRA or into another retirement plan offered by your new employer.

What exactly is a rollover?

A rollover is a transfer of money from one employer's qualified retirement plan or IRA to another employer plan or IRA. Rollovers keep retirement money tax deferred until withdrawals begin.

How does a rollover IRA work?

One of the most popular choices for rollovers is a transfer of the assets from a retirement plan into an IRA, perhaps with a mutual fund company, that may offer more investment choices than that available in a 401(k).

These transfers can be tricky, with stiff taxes and tax withholding, if they're not done correctly. An investment professional can help guide you through the process. In most cases, for example, a rollover should be a direct, trustee-to-trustee transfer. In a direct rollover, you should not have a check made out to you.

But what if I need the money in an emergency?

There are many reasons why you may need income, whether it's to take an early retirement, start a business, or sustain yourself while you're between

jobs. If you need to generate income from your retirement plan distribution right away, one solution may be to roll it over into a traditional IRA and elect to receive regular payments.

Under Internal Revenue Code Section 72(t), your payments will not be subject to a 10% early withdrawal penalty as long as you take your money out in "substantially equal payments" based on life expectancy tables. There are several methods of calculating the level of payments to meet a variety of needs. However, a tax penalty will apply if you change the amount or stop payments before the greater of five years or before you turn age 59½. In other words, you must continue the payments for the longer of the two periods.

How much do I really save by rolling over the money versus taking it now?

You might be surprised. By removing even what seems like a small amount from your nest egg, you are opening yourself up to tax liability and, therefore, reducing the amount of money that can remain working for you. The table on page 3 is a hypothetical example of the choices available to a person changing jobs who is 34 years old, in the 25% tax bracket, and whose investment earns a hypothetical 6% annual return.

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Okay, you've convinced me. What should I do now?

If you decide to roll over your distribution, you'll need to determine how to invest your money. Among the most popular choices for IRAs are mutual funds, which offer professional, full-time management, diversification (to help reduce risk), and the flexibility to move from one fund to another as your needs change. Keep in mind, however, that the principal value and return of mutual funds will fluctuate with changes in market conditions, and shares, when redeemed, may be worth more or less than their original cost.

Your investment professional can help you choose the right fund or funds for your goals, time horizon, and tolerance for risk. He or she can also give you a prospectus containing more complete information, including investment objectives, risks, charges, and expenses, for any of the MFS products. You should read and consider the information carefully before investing.

Make a wise choice

	Taking money now	Directly rolling over distribution
Distribution	\$20,000	\$20,000
20% withholding tax	(\$4,000)	0
10% early withdrawal penalty	(\$2,000)	0
5% additional current tax owed	(\$1,000)	0
Available for reinvestment	\$13,000	\$20,000
Net value in 10 years	\$20,189	\$35,817
Net value in 20 years	\$31,352	\$64,143
Net value in 30 years	\$48,689	\$114,870

Tax on lump-sum distribution*

Gross distribution	\$114,870
Tax on lump-sum distribution	(\$28,717)
Net amount after taxes	\$86,152

* Based on single taxpayer under age 65 using one personal exemption, a standard deduction, and 2003 federal income tax rates.

Hypothetical examples are for illustrative purposes only and are not intended to represent the future performance of any MFS product.

Resources

Downing, Neil, *The New IRAs and How to Make Them Work for You*. Dearborn Trade, 2002, 224 p., \$18.95.

Slesnick, Twila, and Suttle, John C., *IRAs, 401(k)s, and Other Retirement Plans: Taking Your Money Out*. Nolo Press, 2003, 336 p., \$34.99.

Contact your investment professional for more information.

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