

info sheet

Weighing your 401(k) options at retirement

So you're ready to retire. You've worked hard for many years, and now it's nearly time for you to sit back and enjoy the fruits of your labor. Because you've always been a responsible person, however, there are several things you probably want to do before you even start thinking of planning that first fishing trip or tropical vacation. That's why, instead of calling your travel agent, you're busy reviewing the checklist of things you must do before you retire.

Perhaps you want to draft a new household budget. Or, if you're selling your home and moving to a retirement community or a smaller house, you've got mountains of phone calls and paperwork to complete. You might also have important decisions to make about your medical coverage, your aging parents, and your estate. And of course, you must decide what to do with the assets you've been saving in your company-sponsored 401(k) plan.

Of all the issues you have to face upon retirement, the latter just might be the most important of all. The decisions you make about the proceeds from your 401(k) plan can have a tremendous bearing on how financially secure you are for the rest of your life. That's why, before you do anything else, you should meet with your investment professional, who can help you decide what is best for you.

To help get a dialogue going with your investment professional, we've compiled a list of options you might want to refer to when considering what to do

with your 401(k) distribution at retirement — a distribution that could be valued at several hundred thousand dollars or more. Although this is not an all-inclusive list, it can get you started down the right path.

Taking your 401(k) distribution in cash

The possibility of taking the proceeds from your 401(k) distribution in cash when you retire is enticing. Before you have a check for the entire distribution (or even part of it) made out to you, however, 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 employer retirement plan or IRA — as is the case when it is taken in cash — the employer automatically withholds 20% of the money. If you are younger than age 55, the IRS hits you with an additional 10% penalty. To make matters worse, taxpayers in the 25% bracket or above will have at least another 5% taken from their nest egg.

If, after taking the distribution in cash, you decide you'd like to roll it into an IRA, 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 that 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 at retirement will have on your retirement income.

Rolling your assets into an IRA

Of all the distribution choices available to you at retirement, 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, for example, a rollover IRA. To do this, you should request a check for the amount you wish to roll over from your 401(k) *and have it made out to the IRA trustee*. 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.

Although what you ultimately decide to do will depend on your individual situation, there are some rough guidelines you can follow.

- **Traditional IRA** – If you need the income immediately at retirement, you can simply roll your 401(k) assets into a rollover IRA. A rollover IRA requires account owners to stop making annual contributions and to begin taking distributions, at least annually, at age 70½.

- **Roth IRA** – Once you've completed the rollover, you can, if you wish, convert the assets to a Roth IRA. You will be required to pay income taxes, but not penalties, on the amount you convert. This strategy might work best for people who don't need the income immediately and would like to continue putting money away indefinitely. The Roth IRA has no required minimum distributions and no age at which you must stop contributing and begin taking distributions. In addition, distributions from a Roth IRA are tax free if certain requirements are met. However, to continue funding the rollover IRA and the Roth IRA, you must have earned income.

The entire balance can be rolled into a traditional IRA — tax free. Starting in 2002, even post-tax contributions in your 401(k) account, which were previously not eligible for rollover, can be rolled over to an IRA.* 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 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 upon withdrawal than you originally paid.

*For distributions made after 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 provides that distributions from qualified plans, 403(b) arrangements, and Section 457 plans may be rolled over to any of the other types of plans, including IRAs, that now accept such rollovers. The rollover restrictions previously imposed upon such plans have been eliminated. In addition, after-tax employee contributions, which in the past could not be rolled over, may now be rolled over to another retirement plan or traditional IRA as long as the accepting plan permits such rollovers. Plans are not required to accept rollovers. Given the complexity of the new rollover rules, you should seek the advice of your legal and tax advisers prior to requesting a rollover distribution from your employer's plan.

Think it through

Regardless of which option you choose, the key is to think it through and make the decision that's best for you. Again, you would do well to discuss this issue up front with your investment professional. After all, you've been planning for a long time to have the kind of retirement some people only dream about — planning that could be put in jeopardy by making an uninformed decision.

Resources for further information

Rowland, Mary, *A Commonsense Guide to Your 401(k)*, Bloomberg Press, 1999, 265 pages.

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

Flores, Dan, *The Retirement Revolution: A Strategic Guide to Understanding and Investing Lump Sum Distributions from Qualified Retirement Plans*, iUniverse.com, 2003, 356 pages.

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