

Paula Boyka, CIMA®
Senior Vice President,
Investments
4643 S Ulster, Suite 1350
Denver, CO 80237
303-200-1440
Fax: 303-220-0790
paula.boyka@raymondjames.com
www.FrontRangeFinancialConsulting.com

Rollovers from Employer-Sponsored Retirement Plans

RAYMOND JAMES®

November 08, 2010

RAYMOND JAMES®

Rollovers from Employer-Sponsored Retirement Plans

In general

If you withdraw cash or other assets from an employer-sponsored retirement plan ("employer plan") in an "eligible rollover distribution," (defined below) you can defer paying tax on the distribution by rolling all or part of it over to another employer plan or to a traditional IRA. You don't include the amount rolled over in your income until you receive it in a distribution from the recipient plan or IRA.

You can also roll all or part of your distribution to a Roth IRA. You'll pay income tax on the taxable portion of your distribution at the time of the rollover, but qualified distributions from the Roth IRA are free from federal income taxes.

Caution: Special rules apply to distributions from designated Roth 401(k) and Roth 403(b) accounts. See "Roth Accounts and Roth IRAs" below.

Rollovers from employer plans generally take one of four forms:

1. A transfer from your employer plan directly to an IRA trustee/custodian (this is a type of direct rollover)
2. A transfer from your employer plan to you, and then, within 60 days, from you to an IRA trustee/custodian (this is a type of indirect rollover)
3. A transfer from your employer plan directly to the trustee of the retirement plan at a new employer (this is a type of direct rollover)
4. A transfer from your employer plan to you, and then from you to the trustee of a retirement plan at a new employer (this is a type of indirect rollover)

Tip: Eligible rollover distributions are typically paid from defined contribution plans. A defined contribution plan is a retirement plan in which contributions are based on a set formula (e.g., a percentage of the employee's pretax compensation), while the payout is based on total contributions and investment performance. The 401(k) plan is the most common type of defined contribution plan. However, you may also roll over a distribution you receive from a defined benefit plan if the distribution qualifies as an eligible rollover distribution.

Caution: If you were born before 1936, and you receive a lump sum distribution from your employer plan, your distribution may be eligible for special tax treatment which may be lost if you roll all or part of your distribution over to an IRA. Consult a tax professional.

Caution: Special rules may apply to employer plan distributions received by qualified individuals who are affected by certain presidentially-declared natural disasters, repayment of qualified reservist distributions, and to distributions of qualified settlement income to certain taxpayers in connection with the Exxon Valdez litigation.

What is an eligible rollover distribution?

An "eligible rollover distribution" is a distribution of all or part of your account balance in an employer plan, except:

1. Required minimum distributions
2. Hardship withdrawals
3. Certain periodic payments. You cannot roll over any of a series of substantially equal distributions

paid at least once a year over: Your lifetime or life expectancy

4. The joint lives or life expectancies of you and your beneficiary, or
5. A period of 10 years or more
6. Corrective distributions of excess contributions, excess deferrals, or excess annual additions (and any income allocable to these distributions)
7. An employer plan loan that has been treated as a distribution because it exceeds the allowable loan limit, that's in default due to missed payments, or that fails to satisfy certain other requirements
8. Dividends on employer securities
9. The cost of life insurance coverage paid by the plan
10. Contributions made under special automatic enrollment rules that are withdrawn pursuant to your request within 90 days of enrollment

Tip: Both in-service withdrawals and distributions following termination of employment may be rolled over if the distribution qualifies as an eligible rollover distribution.

Tip: If your distribution is an eligible rollover distribution, your plan administrator must send you a timely notice (a "402(f) notice") explaining the rollover rules, the withholding rules, and other related tax issues.

Caution: Special rollover rules apply to the nontaxable portion of your eligible rollover distribution (for example, amounts attributable to your non-Roth after-tax contributions). See "Rollover of nontaxable amounts," below.

Which plans must allow rollovers?

Certain employer plans must allow you to make a direct rollover *from* the plan. These are:

- Qualified employer-sponsored retirement plans (for example, 401(k) and profit-sharing plans)
- Qualified Section 403(a) annuities
- Section 403(b) plans
- Governmental Section 457(b) plans

You may also make indirect rollovers of distributions from these plans. For purposes of this article, when we refer to "employer plans" or "employer-sponsored retirement plans," we are referring to the plans listed above.

Tip: While simplified employee pension plans (SEPs) and SIMPLE IRA plans are employer-sponsored plans, they are IRA based, and rollovers of distributions from those plans are generally governed by the rules applicable to rollovers from traditional IRAs.

Caution: While an employer plan generally must allow direct rollovers to be made *from* the plan, it does not have to allow rollovers to be made *into* the plan. If you want to make a rollover into a new employer plan, check with the plan administrator to determine if your new plan accepts rollovers.

Caution: An employer plan does not have to allow you to make a direct rollover to certain defined benefit plans. However, you can make an indirect rollover if the defined benefit plan accepts rollovers.

Which plans can receive rollovers?

In general, you can roll over a distribution from an employer plan into an “eligible retirement plan.” An eligible retirement plan is an employer plan, a traditional IRA, or a Roth IRA.

Caution: You cannot roll funds over from an employer plan to a SIMPLE IRA.

Caution: Distributions from governmental Section 457(b) plans are generally not subject to the 10 percent premature distribution tax. A Section 457(b) plan can receive a rollover from a plan that is subject to the 10 percent penalty tax only if the Section 457(b) plan agrees to separately account for that rollover. This is because the amount rolled over, and any allocable earnings, will continue to be subject to the 10 percent penalty upon distribution from the Section 457(b) plan (unless an exception applies at the time of payout).

Caution: An employer plan is not required to allow rollovers into the plan. In addition, if your retirement plan distribution includes assets other than cash (such as employer securities), your IRA trustee or the new plan trustee may, but isn't required to, accept those assets as part of a rollover.

Tip: Special rules apply to distributions from designated Roth 401(k) and Roth 403(b) accounts. In general, distributions from these accounts can only be rolled over to a Roth IRA, or to another designated Roth 401(k) or Roth 403(b) account. See “Roth Accounts and Roth IRAs,” below.

Are partial rollovers permitted?

Yes. However, only the portion that is rolled over qualifies as an income-tax-free transfer of funds. The remainder that is distributed to you is treated as a taxable distribution, subject to federal (and possibly state) income tax and perhaps a premature distribution tax penalty if you are under age 59½ (unless an exception applies).

Caution: If you direct your plan administrator to make a direct rollover of only a portion of your distribution, and your distribution includes both taxable and nontaxable dollars (for example, your after-tax contributions) the IRS has recently indicated that both the partial direct rollover, and the amount distributed to you, will include a pro-rata amount of the taxable and nontaxable dollars. This means, for example, that you cannot direct the plan administrator to make a partial direct rollover of all of your taxable dollars to a traditional IRA, and distribute the remaining nontaxable dollars to you. However, you may be able to accomplish this same result using an indirect rollover. This issue is currently unclear, so be sure to consult your tax professional.

Tip: If you receive a distribution from the employer plan that includes taxable and nontaxable dollars, and you make an indirect rollover to an eligible retirement plan, the amount rolled over is deemed to come first from the taxable dollars, and then from the nontaxable dollars.

Rollover of nontaxable amounts

You can roll over the nontaxable portion of an eligible rollover distribution (generally, your after-tax contributions), subject to some special rules:

- You cannot roll over the nontaxable portion of your distribution to a governmental Section 457(b) plan
- You can roll over nontaxable dollars from one employer plan to another employer plan only in a direct rollover (not a 60 day rollover). However, you can roll over nontaxable dollars to an IRA in a direct or indirect rollover
- You can roll over nontaxable dollars to an employer plan only if the receiving plan agrees to separately account for the nontaxable dollars and earnings

Caution: If you direct your plan administrator to make a direct rollover of only a portion of your distribution, and your distribution includes both taxable and nontaxable dollars (for example, your after-tax contributions) the IRS has recently indicated that both the partial direct rollover, and the amount distributed to you, will include a pro-rata amount of the taxable and nontaxable dollars. This means, for example, that you cannot direct the plan administrator to make a partial direct rollover of all of your taxable dollars to an IRA, and distribute the remaining nontaxable dollars to you. However, you may be able to accomplish this same result using an indirect rollover. This issue is currently unclear, so be sure to consult your tax professional.

Tip: If you receive a distribution from the employer plan that includes taxable and nontaxable dollars, and you make an indirect rollover to an eligible retirement plan, the amount rolled over is deemed to consist first of the taxable dollars, and then from the nontaxable dollars.

Technical Note: An employer plan can, in certain circumstances, treat employee contributions and earnings as a “separate contract” when determining the tax consequences of a distribution from the plan. If the plan contains this provision then any distribution of employer contributions and earnings may be taxed separately from any distribution of employee after-tax contributions and earnings. Consult your plan administrator for more details.

Who can make a rollover?

In addition to the plan participant, other plan payees may, in certain cases, be able to roll over distributions from employer plans:

Qualified domestic relations order (QDRO) payee. If you are the plan participant’s spouse or former spouse, you may be able to roll over all or part of an eligible rollover distribution from an employer plan that you receive under a QDRO. The rollover rules apply to you as if you were the participant. You can roll over the distribution into another employer plan, a traditional IRA, or (if you qualify based on your income and marital status) a Roth IRA.

Surviving spouse beneficiary. You may be able to roll over all or part of an eligible rollover distribution from an employer plan that you receive as the surviving spouse of a deceased participant. The rollover rules apply to you as if you were the participant. You can roll over the distribution into another employer plan, a traditional IRA, a Roth IRA.

Nonspouse beneficiary. If you are a designated beneficiary, but not the surviving spouse, of a deceased participant, you may be able to roll over all or part of an eligible rollover distribution you receive from an employer plan to a traditional IRA or to a Roth IRA. The distribution must be a direct rollover to an IRA that you set up to receive the distribution--indirect (60-day) rollovers are not permitted. The transfer will be treated as an eligible rollover distribution and the receiving IRA will be treated as an inherited IRA. This means that you cannot make any new contributions to the inherited IRA. It also means you cannot roll over any amounts into or out of the inherited IRA. However, you can make a trustee-to-trustee transfer as long as the IRA into which amounts are being moved is set up and maintained in the name of the deceased IRA owner for the benefit of you as the beneficiary (that is, the new IRA is also set up as an inherited IRA).

Direct rollovers vs. indirect rollovers

Once you decide to roll over your employer plan assets, you need to decide how the transfer will be made. Rollovers can be direct rollovers or indirect rollovers. The distinction is important because indirect rollovers can cost you a lot of money in some cases. A direct rollover is usually a better option. And in some cases, a direct rollover is the only option.

Direct rollovers

You can choose to have all or part of an eligible rollover distribution paid directly to another employer plan that accepts rollover distributions, to a traditional IRA, or (if you qualify) to a Roth IRA.

Generally, you will want to arrange for a direct rollover rather than an indirect rollover when your employer plan

assets are moving to either another employer's retirement plan or an IRA.

As the name suggests, a direct rollover involves arranging for the transfer of your retirement plan assets directly from the old plan trustee to either:

- The trustee of a retirement plan maintained by a new employer
- The trustee/custodian of a new or existing IRA in your name

With a direct rollover, you never actually take receipt of the retirement plan funds. The funds go directly from the old plan trustee to the trustee/custodian of the IRA or new plan. For this reason, a direct rollover is often referred to as a trustee-to-trustee transfer.

Caution: If you direct your plan administrator to make a direct rollover of only a portion of your distribution, and your distribution includes both taxable and nontaxable dollars (for example, your after-tax contributions) the IRS has recently indicated that both the partial direct rollover, and the amount distributed to you, will include a pro-rata amount of the taxable and nontaxable dollars. This means, for example, that you cannot direct the plan administrator to make a partial direct rollover of all of your taxable dollars to an IRA, and distribute the remaining nontaxable dollars to you. However, you may be able to accomplish this same result using an indirect rollover. This issue is currently unclear, so be sure to consult your tax professional.

Caution: An employer plan does not have to permit a direct rollover to certain defined benefit plans.

Indirect rollovers

With an indirect rollover, the trustee of your old employer plan distributes the funds to you, and then you transfer them to the trustee of your IRA or to the trustee of another employer plan. There are some complications and potential pitfalls with indirect rollovers. In general, it is best to avoid indirect rollovers and utilize direct rollovers instead.

Tip: If you receive a distribution from the employer plan that includes taxable and nontaxable dollars, and you make an indirect rollover to an eligible retirement plan, the amount rolled over is deemed to consist first of the taxable dollars, and then the nontaxable dollars.

First, with an indirect rollover, the administrator of your old plan must withhold 20 percent of the taxable portion of the distribution paid to you for federal income tax. This withholding requirement exists because the IRS is concerned that you may take the money as a taxable distribution rather than complete a timely, tax-free rollover to an IRA or another plan. Because of this possibility, the IRS simply assumes that the distribution will be a taxable distribution, not a tax-free rollover.

Technical Note: An eligible rollover distribution is not subject to withholding to the extent it consists of net unrealized appreciation from employer securities (NUA) that can be excluded from your gross income.

Here is the problem with the mandatory tax withholding for indirect rollovers: Generally, if you want to avoid all income taxes on your employer plan distribution, you must roll over 100 percent of the amount distributed to you from the plan. This generally means that you need to have additional funds available to replace the 20 percent withheld at the time of distribution.

Tip: You will eventually get the 20 percent back as a credit for federal income tax withheld when you file your income tax return the following year.

Caution: If you do not make up the 20 percent with additional funds, the 20 percent withheld will actually be considered a taxable distribution. If you fail to complete the rollover within 60 days, the entire distribution may be treated as a taxable distribution. Further, if you are under age 59½ and do not qualify for an exception, you will be subject to a 10 percent federal premature distribution tax (and perhaps a state penalty, too).

Example(s): Carol's vested balance in her former employer's plan is \$100,000. The entire \$100,000 is taxable. Instead of arranging a direct rollover of funds from her former plan to her traditional IRA, Carol decides to do the rollover herself. Since it is an indirect rollover, her plan administrator withholds 20 percent (\$20,000) for federal income tax purposes. Carol receives a check for \$80,000. However, she must roll over \$100,000 (the entire balance of her plan account) to avoid tax consequences. This means that Carol has to use \$20,000 of her own funds to make up the difference. Otherwise, if she rolls over only \$80,000, she will be subject to income tax (and perhaps penalties) on the \$20,000 shortfall.

However, if you've made after-tax contributions to your employer plan, you may be able to make a 100 percent tax-free rollover without having to use any additional funds. The example below shows why.

Example(s): Carol receives a \$120,000 lump sum distribution of her 401(k) plan benefit. This amount includes \$20,000 of Carol's nontaxable after-tax contributions, and \$100,000 of taxable pre-tax contributions, employer contributions, and investment earnings. Since the distribution is paid to Carol, her plan administrator withholds 20 percent of the taxable portion of her distribution for federal income tax purposes (.20 times \$100,000 equals \$20,000). As described earlier, if Carol makes an indirect rollover of only part of an eligible distribution, the rollover is treated as coming first from the taxable portion of the payout, and then from the nontaxable portion. If Carol rolls \$100,000 over to a traditional IRA in a 60-day rollover, no amount of the distribution to Carol is taxable because the \$100,000 of taxable dollars is deemed to be rolled over first. The \$20,000 not rolled over is treated as consisting of Carol's nontaxable after-tax contributions. Of course, if Carol wants to roll over an amount equal to the entire distribution (\$120,000) she will need to use \$20,000 of her own funds to make up the difference.

Second, you generally must complete the rollover of an eligible rollover distribution paid to you by the 60th day following the day on which you receive the distribution from your employer's plan. If you fail to make the rollover within 60 days, you may end up paying income tax (and perhaps penalties) on the entire distribution.

Tip: You may be entitled to an automatic waiver of the 60-day rule if you made a timely payment to a financial institution, and the financial institution fails to complete the rollover within the 60-day period, if certain specific requirements are met. In other cases, you can apply to the IRS for a waiver of the 60-day rule by filing a private letter ruling request. The IRS is authorized to grant waivers to the 60-day rule in cases where the failure to do so would be against equity or good conscience, such as in the event of a casualty, disaster, or other event beyond your reasonable control.

Third, certain amounts you receive from an employer plan can only be rolled over directly to an eligible retirement plan—indirect rollovers are prohibited. For example:

- Nontaxable dollars you receive from a Roth 401(k) or Roth 403(b) account can be rolled over to another Roth 401(k)/403(b) account only in a direct rollover
- The nontaxable portion of a distribution you receive from a qualified employer plan or from a 403(b) plan can be rolled over to another qualified plan or 403(b) plan only in a direct rollover
- Nonspouse beneficiaries can roll over amounts received from an employer plan to an IRA only in a direct rollover.

The only real benefit of an indirect rollover is that you have the equivalent of a 60-day "loan" from your retirement plan. But there is always the danger of missing the 60-day deadline and becoming subject to income tax (and perhaps penalties) on the distribution. By using a direct rollover, you generally avoid this risk because the money never enters your hands. In addition, direct rollovers are not subject to the federal withholding requirement that applies to indirect rollovers.

Rollovers of property

If you receive both property and cash in an eligible rollover distribution, you can roll over part or all of the

property, part or all of the cash, or any combination of the two that you choose.

To roll over an eligible rollover distribution of property, you must either roll over the actual property distributed, or sell it and roll over the proceeds. You cannot keep the distributed property and roll over an equal amount of cash or other property. If you sell the distributed property and roll over all the proceeds, no gain or loss is recognized on the sale. The sale proceeds (including any portion representing an increase in value) are treated as part of the distribution and are not included in your gross income.

If you roll over only part of the proceeds, you are taxed on the part you keep. You must allocate the proceeds you keep between the part representing ordinary income from the distribution (its value upon distribution) and the part representing gain or loss from the sale (its change in value from its distribution to its sale).

Example(s): On June 4, 2010, Jill received an eligible rollover distribution from her employer's noncontributory plan of \$50,000 in nonemployer stock. On June 24, 2010, Jill sold the stock for \$60,000. On July 3, 2010, she contributed \$60,000 cash to a traditional IRA. Jill does not include either the \$50,000 eligible rollover distribution or the \$10,000 gain from the sale of the stock in income. The entire \$60,000 rolled over will be ordinary income when she withdraws it from her IRA.

Property and cash distributed. If you receive a distribution that includes both cash and property, and you do not roll over the entire distribution, you may designate what part of the rollover is allocable to the cash distribution and what part is allocable to the proceeds from the sale of the distributed property. If the distribution includes an amount that is not taxable (other than the net unrealized appreciation in employer securities) as well as an eligible rollover distribution, you may also designate what part of the nontaxable amount is allocable to the cash distribution and what part is allocable to the property. Your designation must be made by the due date for filing your tax return, including extensions. You cannot change your designation after that date. If you do not make a designation on time, the rollover amount or the nontaxable amount must be allocated on a pro rata basis.

Caution: If you receive a lump sum distribution from your employer plan that includes employer stock or other securities, make sure to consult with your tax professional prior to making a rollover. In general, when you receive a distribution of employer securities you can elect to pay ordinary income tax only on the plan's cost basis in the securities. You won't pay any tax on any appreciation ("net unrealized appreciation," or NUA) until you sell the securities. However, if you roll the securities over to an IRA, NUA treatment will no longer be available.

Roth Accounts and Roth IRAs

Rollovers from designated Roth 401(k) and 403(b) accounts

Qualified distributions from a designated Roth 401(k)/Roth 403(b) account are entirely free from federal income taxes. Nonqualified distributions are subject to tax and potential early distribution penalties to the extent any investment earnings are distributed to you (your own Roth contributions always come out tax-free). Both qualified and nonqualified distributions may be eligible rollover distributions if they meet the requirements discussed earlier. You can roll over an eligible rollover distribution from a designated Roth 401(k) or 403(b) account only to another designated Roth account that accepts rollovers, or to a Roth IRA. Distributions can not be rolled over into any other retirement plan.

IRS regulations provide that separate five-year holding periods apply to Roth 401(k) accounts and Roth IRA's. A rollover from a Roth 401(k)/403(b) account to a Roth IRA does not affect the Roth IRA's five-year holding period, regardless of how long the dollars rolled over resided in the 401(k)/403(b) plan. If you receive a qualified distribution from your Roth 401(k)/403(b) account, and roll it over to your Roth IRA, the entire amount rolled over will be treated as a nontaxable contribution to the Roth IRA. You can withdraw this amount tax-free from the Roth IRA at any time. Any additional earnings, however, will be subject to the Roth IRA's five-year holding period. If you receive a qualified distribution from your Roth 401(k)/403(b) account, and roll it over to another Roth 401(k)/403(b) account, the entire amount rolled over will be treated as a nontaxable contribution to the new plan.

If you roll a distribution from your Roth 401(k)/403(b) account to another employer's Roth 401(k)/403(b) plan, your five-year holding period in the receiving plan, *for both the amount rolled over and other funds in the receiving plan*, will be the five-year holding period in the sending plan or the five-year holding period in the receiving plan,

whichever ends first (i.e, whichever is more favorable to you). This means that if you roll a qualified distribution from a Roth 401(k)/403(b) account to a new employer's 401(k)/403(b) account, both the amount rolled over, and all of the assets in the receiving 401(k)/403(b) account, will be deemed to have satisfied the five-year holding period requirement for qualified distributions.

If you receive a nonqualified distribution from your Roth 401(k)/403(b) account, some special rules apply:

First, if you receive a nonqualified distribution from your Roth 401(k)/403(b) account, the nontaxable portion can be rolled over to another Roth 401(k)/403(b) account only in a direct rollover--60-day rollovers are not permitted.

Second, if you make an indirect rollover of only part of a non-qualified distribution from a designated Roth account, the part rolled over is considered to be first from the taxable (earnings) portion of the distribution.

Example(s): On termination of employment you receive a lump sum distribution of \$14,000 that is not a qualified distribution from your designated Roth account. The distribution consists of \$11,000 of your after-tax Roth contributions and \$3,000 of investment earnings. Within 60 days of receipt, you make an indirect rollover of \$7,000 into a Roth IRA. The \$7,000 is deemed to consist of \$3,000 of investment earnings and \$4,000 of your contributions. Since you rolled over the part of the distribution that could be included in gross income (the taxable earnings), none of the distribution is included in your gross income.

Third, if you make a direct rollover of only a portion of your nonqualified distribution, the IRS position is that the direct rollover will consist of a pro-rata amount of your nontaxable Roth contributions and your taxable investment earnings.

Example(s): On termination of employment your Roth 401(k) balance is \$14,000, consisting of \$11,000 of your after-tax Roth contributions and \$3,000 of investment income. You have not satisfied the requirements for a tax free qualified distribution. You direct your plan administrator to make a direct rollover of \$3,000 to a Roth IRA, and distribute \$11,000 directly to you. The IRS has recently indicated that because you have made a partial direct rollover, the \$3,000 directly rolled over is deemed to consist of a pro-rata amount of your nontaxable contributions and taxable investment earnings. Approximately 21.4%, or \$642, of the amount rolled over is deemed to consist of taxable investment earnings and 78.6%, or \$2,357, is deemed to be your nontaxable after-tax Roth contributions. The remaining \$11,000 you receive would also consist of a nontaxable return of \$8,642 of your contributions, and \$2,357 of taxable investment earnings. Caution: this IRS position is controversial, and the tax result discussed is presently unclear. Be sure to consult your tax professional.

Fourth, if you receive a nonqualified distribution from your Roth 401(k)/403(b) account, and roll it over into a Roth IRA, only the amount of your Roth contributions to the 401(k)/403(b) plan, not the investment earnings, will be treated as a contribution to the Roth IRA. The investment earnings rolled over, along with any additional investment earnings, will be subject to the Roth IRA's five-year holding period. (As indicated earlier, IRS regulations provide that separate five-year holding periods apply to Roth 401(k)/403(b) accounts and Roth IRA's. A rollover from a Roth 401(k)/403(b) plan to a Roth IRA does not affect the Roth IRA's five-year holding period, regardless of how long the dollars rolled over resided in the 401(k)/403(b) plan.) Because the five-year holding period is one of the factors in determining when your distributions will be tax-free, make sure you understand the consequences before choosing how and when to roll over funds from a designated Roth 401(k)/403(b) account.

Example(s): Jane, who is 56, begins making Roth contributions to her employer's 401(k) plan in 2008. Her five-year holding period in the 401(k) plan ends December 31, 2012. In 2011, at age 60, Jane terminates her employment and decides to roll over her Roth 401(k) account to a Roth IRA, the first she has established. The distribution is not qualified because Jane has not satisfied Roth 401(k) five-year holding period. The distribution consists of \$10,000 of Jane's Roth 401(k) contributions, and \$2,000 of investment earnings. The \$10,000 will be treated as a contribution to the Roth IRA, which Jane can withdraw tax-free at any time. The \$2,000, however, will be treated as investment earnings in the Roth IRA. Because Jane established her first Roth IRA in 2011, the earliest she can receive a qualified distribution of investment earnings from the Roth IRA is 2016. She has effectively lost the four years she held those dollars in the 401(k) plan. Jane should have

waited one more year to make her rollover.

Example(s): Ann is 40 years old. She starts making Roth contributions to her employer's 401(k) plan in 2008. After 10 years, Ann terminates her employment and decides to roll over her Roth 401(k) account to a Roth IRA, the first she has established. The distribution consists of \$150,000 of Ann's Roth 401(k) contributions, and \$75,000 of investment earnings. Even though Ann has satisfied the 401(k) plan five-year holding period, the distribution is nonqualified because Ann is not 59 ½ or disabled. The \$150,000 will be treated as a contribution to the Roth IRA, which Ann can withdraw tax-free at any time. The \$75,000, however, will be treated as investment earnings in the Roth IRA. Because Ann established her first Roth IRA in 2018, the earliest she can receive a qualified distribution of those investment earnings from the Roth IRA is 2023.

Rollover of non-Roth distributions from employer plans to Roth IRAs.

If you receive an eligible rollover distribution of non-Roth funds from an employer plan, you can directly or indirectly roll over all or part of those funds to a Roth IRA. The taxable portion of the distribution that you roll over (or "convert") will be subject to federal income tax in the year of the rollover/conversion.

A special rule applies to distributions from employer plans during 2010 that you roll over to a Roth IRA. For 2010 conversions only, the taxable amount can be spread over a two year period. You can report half of the taxable income from the conversion on your 2011 income tax return, and the other half on your 2012 income tax return. Alternatively, you can report all of the taxable income on your 2010 income tax return.

Caution: Caution: Non-spouse beneficiaries can roll over funds from an employer plan to a Roth IRA only in a direct rollover. Indirect (i.e., 60-day) rollovers are not permitted.

Advantages of doing a rollover

A rollover is not a taxable distribution

A properly completed rollover (direct or indirect) is a tax-free transfer of assets, not a taxable distribution. This means that if you complete the rollover on a timely basis and follow other federal rollover rules, you will not be subject to income tax or early withdrawal penalties on the money when rolled over. You will not have to pay federal or state income tax on the money until you begin taking taxable distributions from the IRA or new plan. By that time, you may be retired and in a lower income tax bracket. Also, if you are 59½ or older when you take distributions, you will not have to worry about premature distribution penalties.

Caution: See special rules applicable to "Roth Accounts and Roth IRAs," above.

A rollover allows continued tax-deferred growth

When you do a rollover, you are simply moving your retirement money from one tax-favored savings vehicle to another. This allows the money to continue growing tax deferred in the IRA or new plan, with little or no interruption. Tax-deferred growth allows your retirement money to potentially grow more rapidly than it might outside an IRA or retirement plan. To understand why, consider the power of compounding. As your IRA or plan investments earn money, those earnings compound on top of your principal and any earnings that have already accrued. As this is happening, no tax is due while the funds remain in the IRA or plan. Depending on investment performance, the long-term effect on your savings can be dramatic. In most cases, this benefit is lost if you receive a distribution from your employer's plan and do not roll it over.

A rollover may be an option every time you leave a job

You may be able to roll over your vested benefits in a former employer's retirement plan every time you leave a job (whether voluntarily or involuntarily). In addition, if you join another employer's retirement plan and the plan accepts rollovers, you can generally roll over your benefits from the old plan to the new plan. There is no limit on the number of rollovers from an employer-sponsored retirement plan you can do, which is an advantage for those who change jobs frequently.

Disadvantages of doing a rollover

You cannot revoke a rollover election

Once you have elected in writing to roll over your retirement plan benefits to an IRA or another plan and received payment, you typically cannot change your mind and revoke the election. If you do try to revoke it, you will generally be subject to income tax and penalties on all or part of the distribution. Before you elect the rollover option, be absolutely certain that this is what you want.

An indirect rollover can be costly

If you are considering an indirect rollover, bear in mind the 20 percent mandatory withholding requirement. To complete the rollover, you must generally make up the 20 percent out of your own funds, or be subject to income tax and possibly penalties on the shortfall. This can be a problem if you do not have cash available to replace the 20 percent. Also, with an indirect rollover, you generally have only 60 days to complete the rollover. The 60-day period begins with the date on which you receive the distribution from the former employer's retirement plan. If you fail to complete the rollover within this time frame, all or part of the distribution to you will be taxable and perhaps penalized.

Loss of lump sum averaging and capital gain treatment

Lump-sum distributions from qualified employer plans payable to participants born before 1936 may qualify for special income tax benefits if specific requirements are satisfied. The benefits may include 10-year averaging and capital gains treatment (for distributions attributable to pre-1974 participation in an employer plan). If you roll over all or part of a distribution from a qualified employer plan into an IRA, neither that distribution, nor any future lump-sum distribution you receive from the qualified plan, will be eligible for special 10-year averaging or capital gains treatment. Note: alternate payees under a QDRO and plan beneficiaries may also be eligible to use these special tax rules if the plan participant was born before 1936 and other conditions are satisfied.

Is it better to roll over to an IRA or to another employer's plan?

One of the most common questions people ask is: Should I roll over my retirement money to an IRA or to another employer's retirement plan? Assuming both options are available to you, there is no right or wrong answer to this question. There are strong arguments to be made on both sides. You need to weigh all of the factors, and make a decision based on your own needs and priorities. It is best to have a professional assist you with this, since the decision you make may have significant consequences--both now and in the future.

Reasons to roll over to an IRA

- You generally have more investment choices with an IRA than with an employer plan. You typically may freely move your money around to the various investments offered by your IRA trustee, and you may divide up your balance among as many of those investments as you want. By contrast, employer plans typically give you a limited menu of investments (usually mutual funds) from which to choose.
- You can freely move your IRA dollars among different IRA trustees/custodians. Unlike indirect rollovers between IRAs, which are generally limited to one in any 12-month period, there is no limit on how many direct, trustee-to-trustee IRA transfers you can do in a year. This gives you flexibility to change trustees often if you are dissatisfied with investment performance or customer service. It can also allow you to have IRA accounts with more than one institution for added diversification. With an employer's plan, you cannot move the funds to a different trustee unless you leave your job and roll over the funds.
- An IRA may give you more flexibility with distributions. The distribution options available to you and your beneficiaries in an employer plan are typically limited. With an IRA, the timing and amount of distributions is generally at your discretion (until you must start taking required minimum distributions, if applicable).

Reasons to roll over to another employer's retirement plan

- Many employer-sponsored plans have loan provisions. If you roll over your retirement funds to a new employer's plan that permits loans, you can generally borrow against your vested balance in the new plan, including the amount rolled over, if you need money. You cannot borrow from an IRA--you can only access the money in an IRA by taking a distribution, which may be subject to income tax and penalties.
- A rollover to another employer plan may provide greater creditor protection than a rollover to an IRA. Assets in employer plans that are subject to the non-alienation provisions of ERISA (for example, most 401(k) plans) receive virtually unlimited protection from creditors under federal law. Your creditors cannot attach your plan funds to satisfy any of your debts and obligations, regardless of whether you've declared bankruptcy. In contrast, traditional and Roth IRAs are generally protected under federal law only if you declare bankruptcy. Any creditor protection your IRA may receive in cases outside of bankruptcy will generally depend on the laws of your particular state. If you are concerned about asset protection, be sure to seek the assistance of a qualified professional.

Caution: Individual (solo) 401(k) plans, governmental plans, and certain church plans are not subject to ERISA.

- Employer-sponsored retirement plans may impose lower administrative costs and investment fees (e.g., minimum fees) on investors than IRAs.
- You may be able to postpone required minimum distributions. These distributions usually must begin by April 1 following the year you reach age 70½. However, if you work past that age and are still participating in your employer's retirement plan, you can delay your first distribution from that plan until April 1 following the year of your retirement. (You also must own no more than five percent of the company.) This deferral exception is not available for IRAs. (Minimum distributions are not required from Roth IRAs during your lifetime.)
- While IRAs typically provide more investment choices than an employer plan, there may be certain investment opportunities in your particular plan that you can not replicate with an IRA.

Special considerations for distributions from Roth 401(k)/403(b) accounts

If you receive a nonqualified distribution from your Roth 401(k)/403(b) account, and roll it over into a Roth IRA, the investment earnings rolled over, along with any additional investment earnings, will be subject to the Roth IRA's five-year holding period. (IRS regulations provide that separate five-year holding periods apply to Roth 401(k) accounts and Roth IRA's. A rollover from a Roth 401(k) plan to a Roth IRA does not affect the Roth IRA's five-year holding period, regardless of how long the dollars rolled over resided in the 401(k) plan.)

On the other hand, if you receive a distribution from your Roth 401(k)/403(b) account, and roll it over into another Roth 401(k)/403(b) account, your five-year holding period in the receiving plan, *for both the amount rolled over and other funds in the receiving plan*, will be the five-year holding period in the sending plan or the five-year holding period in the receiving plan, whichever ends first (i.e., whichever is more favorable to you).

Required minimum distributions (RMDs) are generally required from Roth 401(k)/403(b) accounts after you turn 70½ (or after you retire if later, unless you're a 5% owner). However, Roth IRAs are not subject to the lifetime RMD rules. You can avoid the Roth 401(k)/403(b) lifetime RMD rules by rolling your eligible distribution over to a Roth IRA.

How to do a rollover

There are seven steps that you should follow to complete a rollover:

1. If rolling over to another employer's plan, check with the new plan administrator to make sure the plan accepts rollovers.

2. Consult your tax advisor before selecting a rollover to make sure this is the right option for you. Rollovers can have a long-term impact on your retirement planning, as well as your tax liabilities. In addition, certain distributions from employer plans are eligible for special tax treatment that may be lost if you roll all or part of the distribution over to an IRA.
3. Review the notice from your old plan administrator explaining the rollover rules, the direct rollover option, the consequences of an indirect rollover, the withholding rules, and the possible reduction or deferral of taxes.
4. Decide whether you want to do a direct rollover or an indirect rollover. Then, make the necessary arrangements with your old plan administrator, and either the new plan administrator or the IRA custodian/trustee.
5. Obtain your spouse's consent, if required. Some plans require written spousal consent.
6. Make sure that a check (made out properly, and in the correct amount) is sent from your old employer's plan to the new employer's plan, the IRA trustee/custodian, or you personally, depending upon the method of distribution you selected. If the check is not made out properly, don't endorse it or deposit it. Have a new check prepared with the correct payee.
7. If you receive the funds personally, make sure that you roll over those funds within 60 days to an IRA or another employer's plan to avoid taxes and penalties. In general, you should avoid a distribution directly to you in order to avoid the 20 percent federal withholding requirement.

Income tax consequences of doing a rollover

As discussed, a timely and properly completed rollover is treated as a tax-free transfer of retirement assets. However, if an indirect rollover is not completed within 60 days, the portion of the distribution that is not rolled over will generally be treated as taxable income to you (excluding any after-tax contributions you made to your plan). In addition, if you are under age 59½ and do not qualify for an exception, the taxable portion of your distribution may be subject to a 10 percent federal premature distribution penalty tax on the distribution (and possibly a state penalty as well).

Caution: See special rules applicable to "Roth Accounts and Roth IRAs," above.

Estate and gift tax consequences of doing a rollover

Any amounts remaining in your retirement plans and IRAs at the time of your death are treated like the rest of your assets for federal estate tax (and possibly state death tax) purposes--they are included in your taxable estate to determine if estate tax is due.

Tip: Your beneficiary may be entitled to an income tax deduction equal to the estate taxes paid that are attributable to the inclusion of your IRA(s) in your estate (the "income in respect of a decedent," or IRD, deduction). Consult your tax professional.

Qualified plan automatic rollover rule

Qualified retirement plans often contain a provision that requires the mandatory cashout, without your consent, of small benefits--generally vested benefits with a present value of \$5,000 or less--if you (the plan participant) terminate employment before you reach age 62 or the plan's normal retirement age, whichever is later. However, if the mandatory cashout is greater than \$1,000, the plan must make the payment to an IRA established for you, unless you affirmatively elect to receive the payment in cash, or to roll it over into another qualified employer retirement plan or into an IRA. The rule doesn't apply to distributions to beneficiaries or alternate payees, to plan loan offset amounts, or to distributions that don't qualify as eligible rollover distributions. This rule also applies to Section 403(b) plans and governmental Section 457(b) plans.

Conduit IRAs

A conduit IRA is not technically a specific type of IRA. It is an IRA that is being used for a specific purpose--as the term "conduit" suggests, to temporarily hold funds that you have rolled over from a former employer's retirement plan. Prior to 2002, conduit IRAs had special importance--using a conduit IRA was the only way funds could move from a qualified employer plan to an IRA, and then back to another qualified employer plan. The conduit IRA could only contain funds rolled over from an employer plan, and the investment earnings on those funds. You were not allowed to commingle those rolled over funds with regular IRA contributions and their earnings. If you violated this rule, you lost the right to later move the rolled over funds and their earnings from the conduit IRA to another employer's qualified plan.

However, as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Congress passed provisions to make it easier to roll over funds between IRAs and different types of employer-sponsored retirement plans, and conduit IRAs are now largely only of historical importance.

While conduit IRAs may be of limited importance, it still may make sense to maintain separate IRAs in some instances. For example, amounts you roll over from an employer plan to a traditional or Roth IRA (and earnings on those funds) are generally entitled to unlimited protection from your creditors under federal law in the event you declare bankruptcy. However, your other (non-rollover) traditional and Roth IRA assets are generally protected only to an aggregate limit of \$1,171,650 (as of April 1, 2010). It may make sense in some cases to maintain a separate IRA for the amount rolled over in order to more easily track the dollars that are entitled to unlimited bankruptcy protection.

Similarly, if you convert a traditional IRA to a Roth IRA it may make sense to use a separate Roth IRA for the conversion, in case you need to undo, or "recharacterize," the conversion in the future. This will make it easier to identify the earnings attributable to the conversion, which will also have to revert to a traditional IRA if you recharacterize.

Paula Boyka, CIMA®
Senior Vice President,
Investments
4643 S Ulster, Suite 1350
Denver, CO 80237
303-200-1440
Fax: 303-220-0790
paula.boyka@raymondjames.com
www.FrontRangeFinancialConsulting.com

This information was developed by Forefield, Inc. an independent third party. It is general in nature, is not a complete statement of all information necessary for making an investment decision, and is not a recommendation or a solicitation to buy or sell any security. Investments and strategies mentioned may not be suitable for all investors. Past performance may not be indicative of future results. Raymond James & Associates, Inc. member New York Stock Exchange/SIPC does not provide advice on tax, legal or mortgage issues. These matters should be discussed with an appropriate professional.