YOUR GUIDE TO AVOIDING

401(K) ROLLOVER MISTAKES

HOW TO AVOID AN IRS PENALTY AND FULL TAXATION

THE LITTLE-KNOWN WEAPON YOU CAN USE

A DIRECT ROLLOVER MAY BE YOUR MISTAKE-PROOF OPTION

HOW TO ENSURE YOUR ACCOUNT STAYS WITH YOU

WHY ONE MOVE COULD BE YOUR LAST

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How to **avoid** an IRS penalty and full taxation

When you put money in a 401(k) account, you are essentially making a deal with the government. The government lets you put in the money without paying taxes on it, and you agree to leave the money there until you retire (or are at least close, which the government defines as age 59½). If you take the money out early, you aren't keeping your end of the deal and the government hits you where it hurts: your wallet.

Withdraw your money early and you'll generally pay a 10% penalty + regular income tax.

$14,000	gross distribution total
- $2,800	federal income tax (20%)
-$1,400	early withdrawal penalty (10%)
-$525	state tax (3.75%)
$9,275	net distribution total after taxes and fees

This hypothetical example of a withdrawal of $14,000 assumes a mandatory federal withholding rate of 20% and a state withholding rate of 3.75%. Individual tax rates will vary and you should speak with your tax professional about your personal situation.

After taxes and penalties, you're left with only about two-thirds of your money. Plus — particularly if you are young — you're *sacrificing the potential growth* that could come from keeping your money in a retirement account. So, while it might be tempting to consider your 401(k) a windfall, think carefully about cashing it out.

About those taxes: How do you avoid full taxation on this money? The short answer is … you can't. Back to that earlier agreement: The government has agreed not to tax your money when you put it in, but when you retire and take distributions, the government steps back in for its share. The benefit to you is that your money was able to grow tax-free all that time while it was in deferral.

You can't control the fact that you will pay taxes on your distributions, but you can control when and how you'll pay them.

A rollover mistake could lead to you paying higher taxes on the entire amount. Here's how: Your 401(k) distributions are viewed by the IRS as ordinary income; that's true whether you take $1 or $1 million. If the amount of a distribution pushes you into a higher tax bracket, you'll end up paying the higher tax rate on everything above the new bracket threshold. Ouch.

There are a few ways around this: many people plan to take their tax-deferred distributions over time and in smaller amounts. Another solution is balancing withdrawals from tax-deferred accounts and tax-free accounts, like Roth IRAs or properly structured life insurance policies. Since those accounts include money that has already been taxed, they won't be treated as ordinary income and could help you control your tax bracket later on in life.

After all, much like in life, it's not about the money you make, but the money you keep.

Don't treat your 401(k) like an ATM! Call our office for help.
RetireWithBuska.com | Wausau: 715-355-4445 | Eau Claire: 715-318-4550

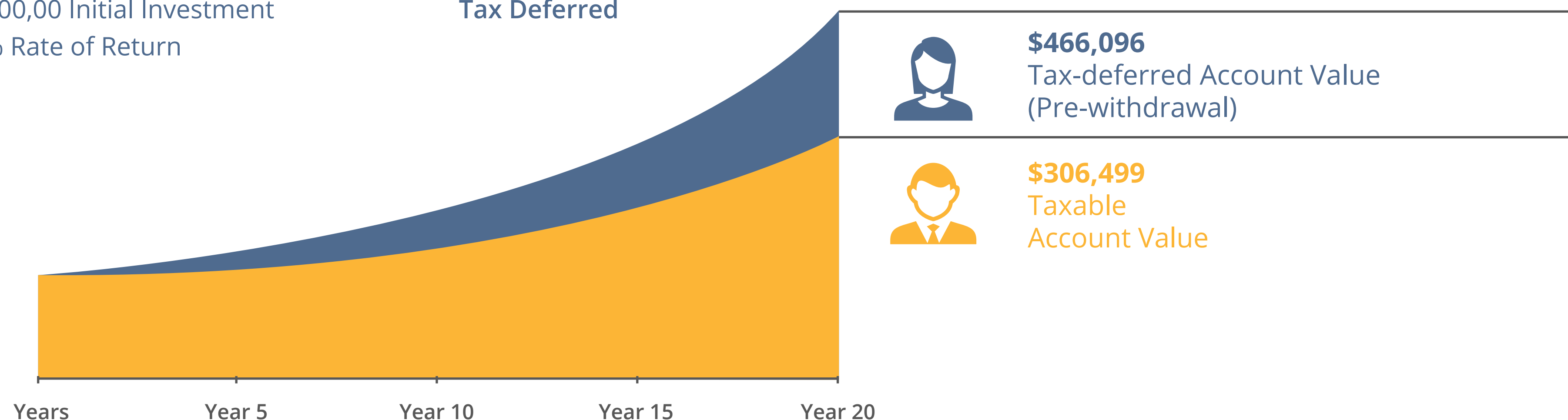
The **little-known weapon** you can use

The power of tax-deferred growth can be an amazing ally in your retirement savings.

The power of tax deferral is this: postponing taxes on earnings generated within your 401(k) can allow your investment returns to grow exponentially over time. This might not sound important, but it comes into play with a long-term investment like a 401(k). Keep in mind, though, that you will eventually have to pay taxes on the money when you withdraw it.

Take a look at the hypothetical example below comparing the growth of $100,000 in a tax-deferred account with the growth of a taxable account.

The Power of Tax Deferral



This hypothetical example assumes a 28% overall tax rate for both Jane and Joe

https://www.securitybenefit.com/individuals/article/make-saving-your-future-less-taxing

Hypothetical example assumes they both invest $100,000 and earn an annual rate of return of 8%. Each year, the owner of the taxable account pays taxes on gains at the ordinary income tax rate of 28%.

It's easy to see how important early contributions can be to a 401(k). The longer your money is invested, the more time it has to reap the benefits that tax-deferred growth can provide. If you cash out a 401(k) early, you are not only paying taxes and penalties; you'll also be giving up years of potential growth.

Instead of cashing out, consider these options:

If your employer allows, you can leave the money in your 401(k). However, depending on how often you change jobs, it ***can be hard to keep track of an old account.***

You can roll over the old 401(k) to your new 401(k), if you have one and you are happy with its investment choices and fees.

You can roll over the 401(k) into an ***Individual Retirement Account (IRA),*** which can potentially give you more control over your money.

Learn more about making this little-known weapon work for you!
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A direct rollover may be your most **mistake-proof** option

When rolling over a 401(k), you typically can choose between a direct rollover and an indirect rollover. With a direct rollover, your funds move directly from your 401(k) to your new Individual Retirement Account (IRA) — the money never crosses your path. If at all possible, this option is preferable, because in all likelihood it could be your most mistake-proof option. Keep reading to see why.

With an indirect rollover, you actually take possession of the money from your 401(k) and are responsible for putting it into another 401(k) or other retirement account. This is where it gets tricky.

While there are many rules and regulations associated with a 401(k) rollover, one of the most significant rules is also one of the easiest to miss: the **60-Day Rule**. This rule mandates that once you receive the money from your 401(k), you must complete your rollover within 60 days or the IRS considers it a withdrawal. If you are under age 59½, the penalties for an early withdrawal are substantial.

That's not the only potential drawback of an indirect rollover. When you withdraw your funds for an indirect rollover, your former employer typically is required to withhold 20% of the money for future taxes, in case you don't actually complete the rollover. If you follow the rules, you'll receive the 20% back, but potentially not how you'd want to.

Let's break it down using $200,000 as the amount of your 401(k).

You receive a check for $160,000 (80%) to roll over into a new account, while your former employer withholds $40,000 (20%). You follow the rules and put that money in an IRA within 60 days. The only way to avoid accidentally taking the other $40,000 as a distribution is to supplement it with the same amount of cash from your personal funds when you roll it over into your IRA.

If you don't (or can't) supplement that amount, the 20% is considered a withdrawal and is subject to tax (and penalties if you are younger than 59½). In this example, that means the IRS will be returning whatever's left of the $40,000 once taxes and penalties are removed.

Finally, there's one more factor to consider if you are exploring your rollover options, and it applies to both 401(k) plans and IRAs. You can only take one indirect withdrawal from either in any given 12-month period. A better option might be to perform a direct trustee-to-trustee rollover.

Tread carefully if you're considering an indirect rollover — missteps can be very costly.

https://www.finra.org/investors/401k-rollovers

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How to **ensure your account** stays with you

If you've ever spent an afternoon wondering what happened to that $20 in your wallet (Did you stop at the store? Go out to lunch? Did your spouse take it and forget to tell you?), you might not believe this statistic.

Through 2023, American's had lost track of more than

$ 1.6 TRILLION

in forgotten or left-behind 401(k) accounts.

https://www.benefitspro.com/2023/08/03/the-true-cost-of-forgotten-401k-accounts-1-65-trillion/?slreturn=20240611153122

With people changing jobs more often — people born between 1957 and 1964 held an average of 12.7 jobs from ages 18 to 56* — it's surprisingly easy to lose track of an old 401(k) account. And, while companies may try to fulfill their obligation of tracking you down, that isn't always easy, either — you may have moved or changed your name due to marriage or divorce. Obviously, lost accounts mean lost retirement income for you, and less money for your beneficiaries.

You can avoid this problem by rolling over your 401(k) into a new 401(k), if that's an option; or into an Individual Retirement Account (IRA). If you do want to leave your 401(k) with your old employer, make sure that they have updated contact information for you, and continue to track your account's performance.

These techniques can help you keep track of your accounts. But what happens if you aren't around to look for them? How would your beneficiaries find these accounts? Consolidation of accounts may certainly help, but there are also online tools like Generational Vault where you can store all your important documents digitally and access them 24/7.

You've spent years contributing to your 401(k). Ensure that those accounts are there for you and your family.

* *https://www.bls.gov/news.release/pdf/nlsoy.pdf*

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Why **one move** could be your last

If you are starting a new job that offers a 401(k), rolling over your old 401(k) to your new one may be your best move. But not always. Things to consider:

You may have more control over an IRA than a 401(k).
With an employer-sponsored plan like a 401(k), you typically choose how you want to allocate your money between several pre-selected investments. If you don't like those investments, there isn't much you can do. In contrast, an Individual Retirement Account (IRA) may allow you to choose from a large universe of investments. Note: If investing worries you, you can always seek the help of a financial services professional to assist you.

You can choose from a range of fees and services.
IRAs come in all shapes and sizes, from "do it all yourself" to "hand it off to a professional" options. The key is to find the balance between independence and professional assistance that works best for you, at a price you are willing to pay. Again, you often have more control.

You (usually) have the option for a Roth IRA.
While a traditional IRA gives you the chance to put aside funds before the government takes out taxes, you still have to pay taxes when you take out the money. With a Roth IRA, you pay taxes up front, but then your growth and qualified withdrawals are tax-free. While a potential tax-free source of income in retirement sounds good, remember these two things before you roll over an existing 401(k) and make a conversion to a Roth IRA: 1) You will have to pay income taxes on the full amount you convert into a Roth IRA, and 2) depending on current and future tax rates, a Roth IRA conversion might not be the option that fits your needs.

You may find additional benefits based on upcoming life events.
Depending on what your future has in store for you, IRAs and 401(k) plans offer different benefits. For instance, first-time homebuyers are able to take a $10,000 distribution from an IRA account without an early distribution penalty. There's no such exemption for withdrawals from a 401(k). Conversely, many 401(k) plans offer loans that enable you to avoid taxes and early withdrawal penalties, which IRAs don't allow. Discussing your unique situation with a financial services professional can help you assess your options.

	Rollover IRA	401(k) Plan
Investment Options	Self-directed; individual chooses which investments best fit their objectives without the restrictions of an employer-sponsored plan Life insurance cannot be purchased within an IRA	The plan sponsor determines which investments are available within the plan Some plans allow for a self-directed option Qualified plans may allow for life insurance purchases; 403(b) plans do not
Ownership	Individual owns and controls the account No blackout periods	The qualified plan trust owns the assets; participants are bound by the plan's constraints Assets may be subject to blackout periods, during which account access is limited
Withholding Rules	Distributions are generally subject to a 10% withholding tax, but account owner may elect not to withhold	Distributions are generally subject to a mandatory 20% federal income tax withholding unless individual directly rolls over the assets to another eligible retirement plan, IRA or Roth IRA

Additional Resources:
RothIRA.com
https://www.irs.gov/retirement-plans

With different rollover options, it can be difficult to know which suits your specific situation. Call our office for help.
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