What to do when your company terminates your employer-sponsored retirement plan

We find that companies sometimes find it necessary to terminate their employer-sponsored retirement plans. While this can cause much angst, the practical effect of a plan termination is that each affected participant becomes fully vested as of the date of the plan termination. Along with this news, comes a question as to what options might be available to participating employees in distributing the assets they've accumulated in these plans. The options may vary with each plan, but the following guidelines should be helpful in formulating your retirement strategy.

It is important that you consider all the alternatives available for these retirement savings before choosing the option that best suits your individual goals and needs. Your options may include the following:

- Rolling over the proceeds from your terminated plan to an IRA at our firm.
- Keeping the retirement funds with your employer in their new plan, if available.
- Taking the money as a lump-sum distribution and paying tax and penalties, should they apply.

Let's look more closely at these options and review the underlying reasons why one or the other might make the most sense for your retirement plan funds.

Seven reasons to consider rolling your employer-sponsored retirement plan assets into an IRA

1. An IRA at our firm offers you a full range of investment choices. You are no longer limited to the small number of investment options that may be found in most employer-sponsored retirement plans. You can customize your investment choices to meet your personal needs, and you can quickly and conveniently make the changes you wish.
2. One of the most significant reasons to consider an IRA rollover is to help keep your assets growing tax-deferred for your beneficiaries. A rollover allows your beneficiaries to establish an Inherited IRA upon your death. Your beneficiaries can stretch out the IRA, building wealth through continued tax-deferred compounding, then taking required minimum distributions (RMDs) over their single-life (term certain) expectancies. Please remember that the stretch IRA strategy is designed for investors who will not need the money in the account for their own retirement. There is no guarantee that there will be assets remaining in the account at the time of the IRA owner's death. If you don't execute a rollover during your lifetime, your beneficiaries will still have a chance to transfer the assets to an Inherited IRA.
   - A non-spouse beneficiary who inherits an employer-sponsored retirement plan must be permitted a direct trustee-to-trustee transfer from an employer-sponsored retirement plan to an Inherited Traditional or Inherited Roth IRA. Your beneficiary will need to establish an Inherited IRA. They will then need to contact the plan sponsor for help in executing the transfer of the assets into an Inherited IRA. Only a direct transfer to an Inherited IRA is allowed, no 60-day indirect rollovers.
   - A spouse beneficiary of your employer-sponsored retirement plans may choose to establish either an Inherited IRA (particularly if he/she is under age 59½), or roll over inherited benefits into his/her own IRA.

As you can see, the rules are complex and a mistake could be costly to the beneficiary. Additionally, your beneficiary could also have difficulty locating your former employer or they may not be aware that you have money left in an employer-sponsored plan where you worked years ago. So if you have assets left with a former employer, you might want to consider a rollover.

Beneficiaries should investigate all the options for handling an inheritance of qualified employer-sponsored plan assets with their tax and legal advisors before executing a strategy.

3. Many investors find that the conversion of retirement funds to a Roth IRA is an attractive planning option. Eligible rollover distributions from an employer-sponsored retirement plan can be converted to a Roth IRA. These conversions can be made through a direct rollover of before-tax and/or after-tax money from the employer-sponsored retirement plan:

	Roth IRA	**Inherited Roth IRA**
Participant	• Direct transfer • 60-day, indirect rollover*	
Spouse	• Direct transfer • 60-day, indirect rollover*	• Direct transfer
Non-spouse		• Direct transfer

** You are not required to deposit the entire amount at one time. Instead, this rollover can be completed with multiple contributions within the 60-day period. An account owner is limited to one indirect rollover from an IRA into a particular IRA every 365 days; this limit is applied separately to each IRA. The once every 365-day rule does not apply to a rollover from a qualified employer-sponsored plan to an IRA. You can roll over more than one distribution from the same employersponsored retirement plan within a year.*

A Roth conversion of after-tax amounts will not be taxable income. Any pre-tax amount converted will be included in the Roth or Inherited Roth IRA holder's gross income for the year.

Remember, RMDs must be taken each year from an Inherited Roth IRA to take advantage of the stretch IRA strategy. Anyone who has both an Inherited Traditional and an Inherited Roth IRA should know that RMDs must be taken from both accounts. Non-spousal beneficiaries who inherit Traditional IRAs **cannot** convert them to Inherited Roth IRAs.

4. An IRA can be more easily coordinated with your overall estate plan than an employer-sponsored retirement plan. Along with the ability for your beneficiaries to stretch distributions from an Inherited IRA over their lifetimes, you are offered the option of splitting accounts and naming several primary and contingent beneficiaries with an IRA. Federal law governs your employer-sponsored retirement plan and requires that if you are married, your spouse be named as beneficiary unless a waiver is signed. With an IRA you are free to name whomever you wish to benefit from your savings, unless you live in a community property or marital property state.

5. Some of our clients decide to invest some of their IRA in annuities.[1] This annuity option is not generally available in an employer-sponsored retirement plan. Annuities have gained favor as an IRA investment during volatile market conditions because many variable annuity contracts now offer an optional rider that provides an annual increasing guaranteed death benefit. That feature may offer a hedge against fluctuating markets.[2]

Variable annuities are long-term investments suitable for retirement funding and are subject to market fluctuations and investment risk.

1 *Using a retirement plan already provides tax deferral. Therefore, an Annuity should only be used to fund a qualified retirement plan when an investor is interested in the other benefits an annuity has to offer, such as lifetime income option and the death benefit protection. In order to provide these features, there are mortality and risk/administrative expenses associated with annuities that are not associated with other investments.*

2 *Distributions from an annuity before age 59½ may incur a 10% tax penalty. Distributions may be subject to surrender charges and have the effect of reducing death benefit and contract value. Fees are charged to pay for death benefits and other riders guaranteed by the issuing insurance company. Guarantee is based on the claims-paying ability of the issuing company. Insurance products are offered through nonbank insurance agency affiliates of our firm and are underwritten by unaffiliated insurance companies. Not available in all states. The guaranteed death benefit is guaranteed by the issuer to be paid to your heirs. The guarantee does not apply to the investment return or safety of the underlying funds in the variable annuity.*

6. Whatever your age, with an IRA, you have immediate access to your funds. While it's true that if you are under age 59½, you may still have a 10% penalty along with the taxes that are owed, you will have the ability to get to those funds quickly. Employer-sponsored retirement plans may have restrictions on distributions and administratively will often take longer to process your distribution request.

7. Rolling over your funds to an IRA allows you to consolidate your retirement assets. This makes it easier for you to stay in control, to manage your beneficiary and distribution planning, and to review your asset allocation as you move through your life stages.

Three reasons to keep your retirement funds in your employer's new plan

If your company is offering a new plan you may want to consider the following options.

1. If you have an outstanding loan from your 401(k), 403(b), etc., you may decide to leave your assets in your company's new employer-sponsored retirement plan to avoid taxes being due. You will need to contact the plan administrator to find out if this is an option. If this is not an option then the plan may give a short period of time (i.e. 30 or 60 days) to repay that outstanding balance. Also, you may elect to execute a rollover to an IRA without paying off the loan. However, if the outstanding balance is not repaid, it is generally subject to income tax and possibly a 10% premature distribution penalty. You cannot roll a loan into an IRA.

2. If you are planning to work into your 70s, you may delay RMDs by keeping your retirement assets in an employer-sponsored retirement plan. You can delay as long as you are still working, are not a 5% or more owner of the company, and the plan allows you to wait until you retire to begin RMDs. Your first RMD will be due by April 1 the year following the year you separate from service. The portability rules may minimize this consideration because you will have flexibility in moving your retirement assets from plan to plan and from IRA to plan, but this may be an important consideration for some.

3. Finally, employer-sponsored retirement plan assets receive federal creditor protection. While IRAs are offered some protection from bankruptcy trustees, they are subject to state creditor protection laws regarding malpractice, divorce, creditor problems, or other types of lawsuits. IRA contributions and earnings in IRAs are protected, from bankruptcy, up to $1 million. IRA rollovers from qualified employer-sponsored retirement plans are fully protected, from bankruptcy, with no cap.

Three considerations when assets are distributed from terminated plans

1. You might consider taking a lump-sum distribution from the plan if you were age 55 or older in the year you left your job and you need to tap your retirement funds. Distributions from your employer-sponsored retirement plan will be taxable, but if you were 55 or older the year you separated from service, you will avoid the 10% early distribution penalty. While there are various reasons for which this option may be chosen, it is often simply because there is a lack of financial education. Before choosing to take a lump-sum distribution from your terminated plan, seek the advice of your financial professional with our firm to discuss the impact this decision can have on your retirement security.

2. Because of ERISA regulations, in some instances, a plan participant with less than $5,000 in a plan may receive an automatic lump-sum distribution when the plan or participant is terminated. Your employer must take a mandatory 20% federal withholding from your account when these distributions are paid

directly to you. Be sure to contact your retirement plan sponsor or your company's human resources department to fully understand your options for your terminated plan. Also, seek the counsel of your tax advisor to determine resulting taxes and any penalties due from these distributions.

3. If your employer sponsored retirement plan included highly appreciated company stock, consider taking a distribution of all or part of the stock and rolling the rest of the plan assets over to an IRA. With a qualifying lump-sum distribution, you will avoid paying current tax on the Net Unrealized Appreciation (NUA), as well as on the amount rolled over to your IRA. The only income tax and perhaps 10% penalty you'll pay at the time of distribution will be on the cost basis of the stock when it was acquired in the plan. Tax on the NUA is postponed until the stock is sold and is imposed at long-term capital-gains rates, which are typically lower than ordinary income tax rates.

Talk to us

We can help you understand the options available to you when your employer-sponsored retirement plan is terminated, so you can make more informed decisions.

We do not provide legal or tax advice but can work with you and your other advisors to help you determine which option is best for you.