401(k) Rollovers

Whether you're starting a new job or getting ready to retire, you'll have to make a decision about your 401(k). You may be able to leave the account where it is. Or you can move—or rollover—some or all of your savings into another account. Be sure you know the benefits and penalties involved with each choice.

401(k) Portability

Chances are, you'll change jobs several times over the course of your career. Fortunately, 401(k) plans are portable. If you switch jobs before retirement, you usually can choose among several things to do with your 401(k): leave the money in your former employer's plan; roll over the money to your new employer's plan, if the plan accepts transfers; roll over the money into an individual retirement account (IRA); or take the cash value of your account. With the first three alternatives, you won't lose the contributions you've made, your employer's contributions if you're vested, or earnings you've accumulated in your old 401(k). And, your money will maintain its tax-deferred status until you withdraw it. You do have some time to consider your options and complete transactions. By law, you must have at least 30 days to decide what to do with your 401(k) when you switch jobs.

When You Don't Roll Over

Cashing out your account is a simple but costly option. You can ask your plan administrator for a check—but your employer will withhold 20 percent of your account balance to prepay the tax you'll owe. Plus, the IRS will consider your payout an early distribution, meaning you could owe the 10 percent early withdrawal penalty on top of combined federal, state and local taxes. That could total more than 50 percent of your account value. Think Twice The repercussions of taking money out now could be enormous: If you took $10,000 out of your 401(k) instead of rolling it over into an account earning 8 percent tax-deferred earnings, your retirement fund could end up more than $100,000 short after 30 years. If your former employer's plan has provided strong returns with reasonable fees, you might consider leaving your account behind. You don't give up the right to move your account to your new 401(k) or an IRA at any time. While your money remains in your former employer's 401(k) plan, you won't be able to make additional contributions to the account, and you may not be able to take a loan from the plan. In addition, some employers might charge higher fees if you're not an active employee. Further, you might not qualify to stay in your old 401(k) account: Your employer has the option of cashing out your account if the balance is less than $1,000 (minus 20 percent withholding) though it must provide for the automatic rolling over of your assets out of the plan and into an IRA if your plan balance is more than$1,000.

New Job, New Plan

Putting all your retirement savings into one 401(k) plan has its advantages. For example, it will make it easier for you to track your assets' performance. But you should evaluate your new employer's plan before deciding to roll your assets over. Make sure the new plan has plenty of investment choices and includes the investment options you prefer. Also check to make sure that accompanying fees aren't too high. If you're unhappy with the options provided by your new employer's 401(k), you can always consider your other options, including a rollover into an IRA. Remember, too, that even if your new employer accepts rollovers, you may have to wait until the next enrollment period, or sometimes until you've been on the job a full year, to move your assets.

Making Your Move

If you've decided to roll over your former employer's 401(k) directly into your new employer's plan, you'll have to: Arrange the rollover with your new 401(k) plan administrator. You may have to select the investments you'd like to make before you complete the rollover. Otherwise, you can transfer the lump sum and allocate it gradually to investments of your choosing. Complete the forms required to move your money from your former employer's plan. Ask your former plan administrator to send a check or electronically transmit your account value directly to the administrator of your new plan.

Indirect Rollovers

You can handle a rollover yourself by withdrawing money from your account and depositing it in your new employer's plan or an IRA. You may opt for an indirect rollover to take advantage of a short-term loan if you're temporarily between jobs or you're waiting to close on your old home to make the down payment on a new one. Caution: Opting for an indirect rollover as a short-term loan should be a financial last resort, since you'll face early withdrawal penalties unless you repay the loan within 60 days. When you indirectly roll over a 401(k), your employer gives you a check for the value of your account, minus 20 percent withholding. The IRS requires your employer to take out that 20 percent in case you decide to keep the money rather than roll it into another account. If you complete the full rollover within the time limit, the withholding will be returned to you when you file your tax return for the year. However, if you do decide to keep the money, the withholding will go towards the taxes you'll owe on the early distribution. Any pretax contributions and all earnings that you don't deposit within this 60 day window are considered withdrawals and are taxable. You may also be vulnerable to an additional 10% tax penalty if you are younger than 59½. In addition, your employer is required by law to withhold 20 percent of the potentially taxable amount you are moving. Even though that amount isn't included in the check you receive, you must provide it from another source if you want the full amount of your rollover to remain tax deferred.

Rolling 401(k) Assets into an IRA

When you retire or leave your job for any reason, you have the right to roll over your 401(k) assets to an IRA. You have a number of direct rollover options: Rolling your traditional 401(k) to a traditional IRA. You can roll your traditional 401(k) assets into a new or existing traditional IRA. To initiate the rollover, you complete the forms required by both the IRA provider you choose and your 401(k) plan administrator. The money is moved directly, either electronically or by check. No taxes are due on the assets you move, and any new earnings accumulate tax deferred. Rolling your Roth 401(k) to a Roth IRA. You can roll your Roth 401(k) assets into a new or existing Roth IRA with a custodian of your choice. You complete the forms required by the IRA provider and your 401(k) plan administrator, and the money is moved directly either electronically or by check. No taxes are due when the money is moved and any new earnings accumulate tax deferred. Earnings are eligible for tax-free withdrawal once the IRA has been open at least five years and you are at least 59½. Rolling your traditional 401(k) to a Roth IRA. If your traditional 401(k) plan permits direct rollovers to a Roth IRA, you can roll over assets in your traditional 401(k) to a new or existing Roth IRA. Keep in mind you'll have to pay taxes on the rollover amount you convert. It's a good idea to check with your plan administrator and a tax advisor to determine whether a move from a traditional 401(k) to a Roth IRA is allowed, and right for you. To authorize the rollover, you complete the forms required by your Roth IRA provider and your 401(k) plan administrator. Earnings that accumulate after the rollover will be eligible for tax-free withdrawal when the IRA into which your assets are moved has been open at least five years and you are at least 59½.

Investing Your Contributions

Once your money is in your IRA, you can invest it in any of the alternatives available through the custodian you have chosen. If you continue to earn income, you may continue to make contributions to your IRA, up to the annual limit set by Congress. You can see the annual caps in the Annual Contribution Limits section. However, you can't contribute more than you earn in a year, and you can't contribute to a traditional IRA once you turn 70½ even if you continue to earn income. You must take required minimum withdrawals from your traditional IRA by April 1 of the year following the year you turn 70½. Taxes on those withdrawals are due at the same rate you are paying on your other income. In contrast, Roth IRAs are not subject to minimum withdrawal requirements, since taxes have already been paid on contributions and any gains may be withdrawn tax-free.