

ROLLOVER GUIDE

- Distribution Options
- Tax Rules
- Retirement Income Strategies
- Estate Planning

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EXECUTIVE SUMMARY

The changing world of work

Most workers in the United States count on employers to help them save for a financially secure retirement. The U.S. retirement market holds more than \$37 trillion in retirement savings. This includes employer-sponsored retirement plans and IRAs.¹

One of the most important financial decisions workers will make is what to do with assets they have accumulated in their employer's retirement plan when they leave their job. Traditionally, this decision needed to be made when workers retired, but it's not just a retirement issue anymore.

Today, most workers will change jobs several times during their working years. Unlike past generations who may have spent most of their career with a single employer, the median tenure for a worker today is only 4.2 years.² Each worker who decides to go to work for a new employer may be faced with the decision of what to do with the retirement plan assets in their prior employer's plan. The choices workers make each time they change jobs will have a significant impact on their retirement nest eggs.

In addition to job changers, by 2030, all baby boomers, currently estimated at 73 million, will reach age 65 or older.³ They will need to decide what to do with the funds they have saved through their employers' retirement plans.

Exploring options

Most workers will have four options for their retirement plan assets when they leave an employer:

- Leave the assets in the plan
- Roll the assets to another employer's plan (if continuing to work and plan is available)
- Roll the assets to an individual retirement account (IRA), with LPL or with another financial services firm; or
- Cash out the retirement savings

Determining which option is best can be challenging. There is no "one size fits all" solution. The best choice will vary depending upon an individual's unique financial needs and savings objectives.

Many workers have chosen to roll their savings from their prior employer's plan into an IRA. IRAs currently hold over \$13.2 trillion, representing a substantial portion of overall retirement savings in the U.S.⁴ But, an IRA rollover is not the only option and it may not be the best choice for a particular individual. Regulatory agencies—including the Securities and Exchange Commission (SEC); the Department of Labor (DOL); the Financial Industry Regulatory Authority (FINRA), the regulatory agency that oversees broker-dealers; and state securities regulators—

have emphasized how important it is for participants in an employer-sponsored retirement plan to understand all of their options and evaluate multiple factors when deciding whether to roll assets out of an employer-sponsored retirement plan.⁴

The Rollover Guide

The objective of the IRA Rollover Guide is to provide foundational education regarding how and when assets can be rolled out of an employer-sponsored retirement plan. The guide will highlight some of the variables that should be considered when evaluating the four distribution options and will describe the tax rules that apply to rollover transactions. The guide also contains a Glossary of Terms (Appendix A) defining many of the common technical terms individuals may encounter as they explore rollover options.

As with any important financial decision, an individual is often well served by seeking professional assistance. Financial advisors with investment expertise, as well as tax and legal advisers, can provide valuable support to individuals who want to learn more about their rollover options.

Automatic rollovers

Some rollovers occur automatically, even though an individual has not requested a payout from the employer plan. Many plans are designed to automatically pay out assets when a worker terminates employment if the individual has a plan balance of less than \$5,000 and has not directed the plan administrator to either make a distribution or roll it to another plan. These payouts are sometimes referred to as “automatic rollovers” or “force-outs.”

- If the balance is \$1,000 or less, it may be simply cashed out and sent to the individual without the individual’s authorization.
- If the vested plan balance is between \$1,000 and \$5,000, the amount automatically disbursed from the plan may be rolled over to an IRA that is set up on behalf of the former employee.

EXPLORING OPTIONS

When can money be paid out of a retirement plan?

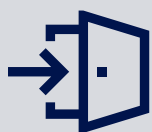
Retirement plans offered by employers—such as 401(k), 403(b), profit sharing, and defined benefit plans—are intended to help workers save for retirement, not to help them manage their short-term spending needs. To discourage retirement plan savings from being depleted early, there are a number of tax rules that restrict access to retirement savings prior to retirement years. One of these rules allows distributions from an employer plan only after certain events occur. These are sometimes referred to as “distribution triggering events.” Two common triggering events are severance from employment and plan termination. Special triggering event rules apply to certain types of contributions. For example, an employee’s deferrals into a 401(k) plan can only be disbursed if the individual has reached age 59½; or the individual has died, separated from service, retired, or become disabled (as defined in the plan document and the IRS); or the plan has terminated.

A rollover from an employer plan to an IRA or to another eligible plan generally cannot occur unless there has been a triggering event. Most rollovers are triggered by workers leaving their employers. However, some plans are designed to permit rollovers of certain types of assets while an individual is still employed (e.g., assets originating from a prior employer’s plan or after the employee reaches age 59 1/2). These types of distributions are referred to as “in-service” distributions.

One way to identify triggering events that apply to a specific plan is to review the plan’s Summary Plan Description (SPD). This document describes the plan’s features, including distribution options, and must be provided to each worker who participates in the plan. Other sources for this information include the plan’s recordkeeper, administrator, or participant support services available online or through a call center.

What options are available when a worker leaves an employer?

Once individuals are eligible to take a distribution in a defined contribution plan, they typically have four options.⁵



Before Separation

A worker invests part of their income in an employer-sponsored 401(k) plan. The worker may have access to professional investment advice in the plan and the employer (plan sponsor or another expert) is responsible for selecting and monitoring the investment options and plan service providers.

After Separation

When the worker leaves their job, they might be able to keep their assets in the plan, subject to the \$5,000 limit discussed on the previous page.

Next Step

The worker generally has four basic options for dealing with the 401(k) savings from his previous job.

Four Basic Options

- Leave funds in the employer's plan
- Roll over funds to another employer's plan if available
- Roll over funds to an IRA
- Cash out (subject to tax and penalties)

When a worker is eligible to take a distribution that may be rolled over, the plan administrator must provide a written explanation of the rules and tax consequences pertaining to the worker's distribution and rollover options. These notices are sometimes referred to as "402(f) notices," based on the section of

the Internal Revenue Code that contains the requirements for this notice. These notices are one resource for exploring the worker's distribution options. A copy of the distribution notice may be requested from the plan's administrator.

📖 **See a glossary of terms and a list of resources later in this document.**
"Rollover" – A distribution from an IRA or retirement plan that is moved directly or indirectly within 60 days to a receiving IRA or retirement plan

EVALUATING OPTIONS

What variables should a participant consider when deciding what to do with employer plan assets?

Leave funds in previous employer's plan

Potential benefits

Investment options	<ul style="list-style-type: none"> Investment options are required to be prudently selected and monitored by a plan.
Fees and fee disclosures	<ul style="list-style-type: none"> Plans have access to certain lower cost investment share classes and products that are generally not available to IRA and other retail investors. Investment fees will likely be lower when offered through retirement plans as compared with individual retail accounts. Standardized fee disclosures must be provided to help individuals compare costs among plan investment options and to alert individuals to fees charged to their account. Some administrative costs may be paid by the employer.
Plan administration and other services	<ul style="list-style-type: none"> Employer is responsible for administering the plan in compliance with various laws and regulations. Plan may offer services such as access to investment advice, education, call center support.
Distributions and loans	<ul style="list-style-type: none"> Many plans allow loans to active employees, permitting access to plan assets with the ability to restore tax-advantaged retirement savings. In addition to other exceptions, separation from service after age 55 is an exemption from the 10% early distribution tax (for distributions taken prior to age 59½) that is available for qualified plan distributions but not IRA distributions.
Creditor protection	<ul style="list-style-type: none"> Plan assets are generally not subject to creditor claims.
Other benefits	<ul style="list-style-type: none"> Pre-tax assets and tax-deferred earnings are not included in income until distributed from the plan.

Considerations

Investments	<ul style="list-style-type: none"> Menu of investments is determined by the plan fiduciary and may be narrower than in an IRA.
Fee plan administration and other services	<ul style="list-style-type: none"> Employer has the option to charge former employees' accounts for certain administrative fees that are not being assessed against current employees. Employer chooses service providers and available services for plan participants.
Distributions and loans	<ul style="list-style-type: none"> Plan may allow someone who is still employed to delay the required minimum distributions (RMDs) at age 73. Some plans require loan repayments to be made through wage withholding, limiting loan access for former employees. Plan may limit the types of distributions allowed, making it less feasible to take a stream of retirement income payments (commonly called "installment payments") or to implement estate planning strategies. Depending on the plan, investments designed to provide long-term retirement income (e.g., annuities) may not be available. 20% mandatory withholding on distributions (withholding also applies to distributions from IRAs).
Other considerations	<ul style="list-style-type: none"> If an individual has worked for several employers during their career, they may have assets in several different plans.

Roll over funds to another employer's plan

Same potential outcomes as leaving assets in previous employer's plan

Potential benefits	<ul style="list-style-type: none">Plan terms vary, but generally include the same potential benefits as leaving assets in previous employer's plan.Ability to consolidate assets to simplify investment decisions and overall management of retirement savings.
Considerations	<ul style="list-style-type: none">Plan terms vary, but generally include the same considerations as leaving assets in previous employer's plan. However, active employees may have access to loans and the employer might cover administrative fees and expenses for active employees.Need to compare investment options, plan features, distribution options, fees, and services in the available employer plans.

Roll over funds to an IRA

Potential benefits

Investments	<ul style="list-style-type: none">Access to a broader range of investment service providers and service options than typically available in an employer plan.IRA owner can change investment service providers and service options (subject to IRA provider requirements).
Fees and fee disclosures	<ul style="list-style-type: none">IRA provider is required to provide a disclosure statement explaining the features of the IRA, serving a purpose similar to the Summary Plan Description provided for employer plans.Securities regulations require disclosures of fees and conflicts of interest for IRAs held with broker-dealers and investment advisers.
IRA administration and other services	<ul style="list-style-type: none">IRA trustee or custodian handles contribution and distribution reporting and will assist with age-73 RMD calculations.Other services, such as investment advice, brokerage recommendations, and investor education, are available and depend on what the IRA owner selects.
Distributions and loans	<ul style="list-style-type: none">Distributions are generally available without a specific triggering event at any time (subject to potential taxes, penalties, and IRA provider limitations).In addition to other exceptions, distributions for certain higher education expenses, first-home purchases, and payment of certain insurance premiums are exempt from the 10% early distribution tax (for distributions taken prior to age 59 1/2).In certain circumstances federal income tax is withheld at 10% if no election is made at the time of an IRA distribution.You may elect to have no tax or a different amount withheld.Roth IRAs are not subject to the age-73 RMD rules.Flexibility regarding distribution timing and amount can support retirement income and estate-planning objectives.
Creditor protection	<ul style="list-style-type: none">Creditor protection is available in bankruptcy in some states (but not to extent applicable to employer plans).⁶
Other considerations	<ul style="list-style-type: none">IRA owners may make annual contributions to IRAs, even after age 73, provided they have earned income.IRAs may be used to consolidate assets from multiple employer plans.IRAs may offer more flexible beneficiary options.

Considerations

Investments	<ul style="list-style-type: none">IRAs typically do not have access to lower cost institutional share classes and specialized investment options available only to plans.IRA owner is generally responsible for selecting and monitoring investments unless the IRA owner engages an advisor to provide discretionary investment services.
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Roll over funds to an IRA (Cont.)

Considerations

Fees and fee disclosures	<ul style="list-style-type: none"> ▪ IRAs and IRA investment options are generally more expensive than plans. Increased costs will reduce the performance of your investments and your total retirement savings over time. ▪ The standard fee disclosures provided to employer plan participants are not typically provided for IRAs.
Plan administration and other services	<ul style="list-style-type: none"> ▪ IRA owner is responsible for administering the IRA, with support from the IRA trustee or custodian. ▪ Services depend on what the IRA owner selects and may be more limited than offered in the employer plan (e.g., education, investment advice, support line).
Distribution and loans	<ul style="list-style-type: none"> ▪ No loans permitted from IRAs. ▪ A 10% early distribution tax applies to taxable distributions taken prior to age 59½, unless an exception applies. ▪ In certain circumstances federal income tax is withheld at 10% if no election is made at the time of an IRA distribution. ▪ You may elect to have no tax or a different amount withheld.
Creditor protection	<ul style="list-style-type: none"> ▪ IRAs are protected under federal bankruptcy law; protection amounts may vary depending on state law. For more information, see http://moranknobel.com/news/State_Laws_Protecting_IRAs.pdf ▪ IRAs are not afforded the broad federal protection from other types of creditor claims available for employer plans; however, state law may provide certain protections.⁶
Other considerations	<ul style="list-style-type: none"> ▪ RMDs must begin at age 73 for traditional IRAs. ▪ Inherited IRAs received January 1, 2020, and later must be fully distributed within 10 years for certain beneficiaries. ▪ There are exceptions to the 10-year distribution rule for spouses, minor children, beneficiaries less than 10 years younger than the decedent, and disabled individuals. ▪ Employer stock rolled from an employer plan to an IRA will be taxed as ordinary income when distributed, whereas stock held in other types of accounts may qualify for capital gains treatment.

Take a distribution in cash

Potential benefits

Distribution	<ul style="list-style-type: none"> ▪ You can have money to spend now.
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Considerations

Distributions	<ul style="list-style-type: none"> ▪ Taking a cash distribution comes with a price. If you are thinking about cashing out, be sure to factor in these penalties and consider if you would be better off keeping your money invested for the long term. ▪ If you are under age 59 1/2, a 10% early withdrawal penalty may apply. ▪ Your distribution may also be subject to state and federal taxes, regardless of your age. ▪ You may also owe a mandatory 20% federal withholding tax. ▪ Taking a distribution of shares of company stock may lower taxes, if eligible. ▪ Consult your tax advisor for additional information.
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Special considerations for rollovers from defined benefit plans

The distribution options available in defined benefit plans are different from those commonly available in defined contribution plans. Defined benefit plans offer payments in the form of a life annuity that is guaranteed for life. Unlike defined contribution plans, which base the distribution amount on the amount contributed to the plan (plus earnings), a defined benefit plan calculates the amount of the payments based on a formula that takes into account certain factors such as the employee's years of service with the employer, compensation, and age at retirement. These payments are not eligible to be rolled over to an IRA or another employer's plan. Some defined benefit plans also allow individuals to take a lump sum amount. This lump sum may be eligible to be rolled over to an IRA or another eligible plan. While the impact of rolling a lump sum to an IRA or a new employer's defined contribution plan would be the same as outlined in the previous charts, leaving assets in the former employer's defined benefit plan and taking distributions from the plan have some unique characteristics that should be taken into consideration.

Funding and Investments

- In contrast to an IRA or 401(k) plan, your benefit is guaranteed (subject to adequate funding by the plan sponsor), and you do not bear investment risk
- Plan sponsor is responsible for making contributions to fund the projected payments, based on actuarial calculations
- Plan sponsor selects and monitors investments and bears the investment risk

Distributions

- In-service distributions are not permitted prior to age 62
- Predictable payment amounts (e.g., monthly) are based on plan's benefit formula, not tied to investment performance
- Payments are guaranteed for participant's life (or joint life of participant and spouse)
- Pension Benefit Guarantee Corporation (PBGC) guarantees payment up to a certain level if employer is unable to make payments
- Payments are usually locked in once they begin and cannot be changed

Exploring options

Most workers will have four options for their retirement plan assets when they leave an employer:

- Leave the assets in the prior employer's plan
- Roll the assets to a new employer's plan (if continuing to work and plan is available)
- Roll the assets to an IRA
- Cash out the retirement savings

Determining which option is best can be challenging for individuals. There is no "one size fits all" solution. The best choice will vary depending upon an individual's unique financial needs and savings objectives.

MASTERING THE MECHANICS OF A PLAN ROLLOVER

The previous sections addressed when assets could be rolled over and what factors individuals may want to consider when evaluating whether a rollover to an IRA or another eligible plan is appropriate for their retirement plan assets. In this section, we will address the mechanics of a rollover and introduce the players that are typically involved in a rollover.

Eligible plans and eligible assets

If an individual decides a rollover from a plan to an IRA or another plan is the best option, they need to select an eligible retirement arrangement to receive the rollover. As discussed earlier in the guide, an IRA is not the only option. In an effort to preserve

retirement plan assets for retirement, the laws and regulations allow for fairly free movement of assets among different types of retirement plans. The following chart, with data by the IRS, lists the types of plans and IRAs that can accept rollovers.

Rollover chart

Roll From	Roll To							
	Roth IRA	Traditional IRA	SIMPLE IRA	SEP-IRA	Governmental 457(b)	Qualified Plan (pre-tax)	403(b) (pre-tax)	Designated Roth Account (401(k), 403(b) or 457(b))
Roth IRA	Yes ²	No	No	No	No	No	No	No
Traditional IRA	Yes ³	Yes ²	Yes ^{2,7} , after two years	Yes ²	Yes ⁴	Yes	Yes	No
SIMPLE IRA	Yes ³ , after two years	Yes ² , after two years	Yes ²	Yes ² , after two years	Yes ⁴ , after two years	Yes, after two years	Yes, after two years	No
SEP-IRA	Yes ³	Yes ³	Yes ^{2,7} , after two years	Yes ²	Yes ⁴	Yes	Yes	No
Governmental 457(b)	Yes ³	Yes	Yes ⁷ , after two years	Yes	Yes	Yes	Yes	Yes ^{3,5}
Qualified Plan (pre-tax)	Yes ³	Yes	Yes ⁷ , after two years	Yes	Yes ⁴	Yes	Yes	Yes ^{3,5}
403 (b) (pre-tax)	Yes ³	Yes	Yes ⁷ , after two years	Yes	Yes ⁴	Yes	Yes	Yes ^{3,5}
Designated Roth Account (401(k), 403(b) or 457(b))	Yes	No	No	No	No	No	No	Yes ⁶

1 Qualified plans include, for example, profit sharing, 401(k), money purchase, and defined benefit plans

2 Only one rollover in any 12-month period

3 Must include in income

4 Must have separate accounts

5 Must be an in-plan rollover

6 Any non-taxable amounts distributed must be rolled over by direct trustee-to-trustee transfer

7 Applies to rollover contributions after December 18, 2015

For more information regarding retirement plans and rollovers, visit Tax Information for Retirement Plans (<https://www.irs.gov/retirement-plans>)

Upon a distribution event, the assets in an eligible employer retirement plan are generally eligible to be rolled over to another eligible plan or IRA. Certain types of distributions, however, are not eligible to be rolled over—even if there is a distribution event.

- Age-73 required minimum distributions (RMDs)
- Hardship distributions
- A series of substantially equal periodic payments
- Corrective distributions (e.g., excesses distributed from a 401(k) plan)
- Dividends on employer securities that are distributed from a plan
- Certain costs for life insurance coverage (PS58 costs)

Rollover process

Although there may be some variations based on the service providers, most rollovers to another eligible plan or an IRA will include the following steps.

- 1 Leave employer (or meet another distribution event)**
- 2 Select an IRA provider and type of IRA or select another eligible plan**
- 3 Sign documents to set up the IRA or have assets rolled over to another eligible plan**
- 4 Initiate the rollover with the employer**
- 5 Select investments for the IRA or other eligible plan**
- 6 Report movement to the IRS**

ROLLOVER GUIDE

Roles and responsibilities for plan to IRA rollovers

An IRA rollover will usually involve a number of different players. When rolling over to another plan, roles and responsibilities will generally depend on how the plan is administered and operated. You can find out more from the plan sponsor, administrator, or recordkeeper.

Role	Responsibilities
IRA Owner	<p>One of the prime characteristics of an IRA is that the IRA owner has control over the account, independent of an employer.</p> <ul style="list-style-type: none">▪ Decide what type of IRA to establish – for example, traditional or Roth▪ Select an IRA provider who will administer the IRA▪ Execute the IRA agreement and other required documentation to set up the IRA, review disclosures, and designate beneficiaries▪ Decide how much to roll over and whether to make annual contributions in future years▪ Select services and investments from among those available through the IRA provider▪ Track taxation, including any nondeductible contributions made to traditional IRAs (IRS Form 8606, Nondeductible IRAs)▪ Track timing rules such as the five-year rule in connection with Roth contributions▪ Report distribution from the plan and contribution to the IRA, and any future IRA contributions and distributions to the IRS on annual tax return (IRS Form 1040, U.S. Individual Income Tax Return)▪ Decide when and how much to distribute from IRA
Financial Professional	<p>Financial professionals provide investment expertise and help individuals evaluate the costs and benefits of various IRA services and investment products.</p> <ul style="list-style-type: none">▪ Introduce possible IRA product and service providers and help evaluate the various options▪ Serve as intermediary between IRA trustee or custodian and individual, if appropriate, to deliver IRA setup documentation▪ Provide investment expertise to educate IRA owners about the various investment options and services▪ Provide ongoing investment support to help the IRA owner monitor and adjust investments
Trustee or Custodian	<p>IRA assets typically must be held in a trust or in a custodial account for the benefit of the IRA owner (unless the assets consist only of insurance contracts). Most financial organizations that offer IRA products and services can hold the IRA assets, serving as trustee or custodian and provide the following services.</p> <ul style="list-style-type: none">▪ Provide plan documents and disclosures needed to open an IRA▪ Provide documentation to initiate the rollover from the prior employer's plan▪ Administer the rollover▪ Draft and deliver amendments when the laws and regulations affecting IRAs change▪ Prepare and deliver annual notices to IRA owners▪ Report information required by the IRS regarding IRA activity such as contributions and distributions on IRS Form 5498, IRA Contribution Information, and Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.▪ Administer contributions and distributions requested by the IRA owner, including collecting and remitting taxes▪ Calculate age 73 RMDs▪ Provide regulatory compliance guidance, be available to provide answers to questions regarding the IRA rules
Other Service Providers	<p>Because IRAs are often an element of an individual's estate plan or tax diversification strategy, IRA decisions may involve legal or tax advisors.</p> <ul style="list-style-type: none">▪ An attorney may be retained to discuss various strategies for transferring property and to draft legal documents, such as wills and trusts, that may be required to execute the individual's strategy▪ An accountant may be needed to assess options for minimizing the tax implications of various savings and retirement income strategies or when transferring property

Rollover taxation rules

Tax-free rollover from employer plan to IRA or another employer plan – A rollover from an employer-sponsored retirement plan to a traditional IRA or to another employer plan is generally a tax-free movement of assets. Individuals can choose to roll over assets directly to the receiving IRA or employer plan. In a “direct rollover,” the check or wire is issued directly to the custodian or trustee of the IRA or other plan to be held for the benefit of the individual. Individuals can also choose to take a distribution from the plan and complete an “indirect rollover” or “60-day rollover” to an IRA or employer plan by redepositing the assets within 60 days following the date of distribution.

There is no income tax withholding on a direct rollover – the assets are moved directly from the plan to the receiving IRA or plan. If the transaction is an indirect rollover (i.e., paid to the individual first), the employer must withhold 20% of the taxable distribution amount. To complete a tax-free 60-day rollover, an individual must make up the 20% withheld when making the rollover into the IRA or plan. If the 20% is not made up, it will be taxable to the individual in the year of distribution and may be subject to the 10% early distribution tax. (Individuals may recover some or all of the 20% withheld when they file their tax return for the year.)

Tax-free rollovers and transfers among IRAs – IRA owners can freely move assets directly between IRA trustees or custodians, referred to as a “transfer.” IRA owners can also move assets in the form of an indirect rollover. Individuals may conduct only one indirect rollover during any 12-month period, even if they have multiple IRAs.⁷ This 12-month restriction does not apply to IRA transfers or to rollovers from employer retirement plans.

Taxable conversion from traditional IRA to Roth IRA – Similarly to the taxable rollover option between an employer plan and a Roth IRA, traditional IRA assets may be moved to a Roth IRA in a taxable transaction referred to as a conversion. This option enables an IRA owner to decide when to pay taxes on certain assets. Owners of traditional IRA accounts should consider the tax ramifications as well as age and income restrictions in regard to executing a conversion from a traditional IRA to a Roth IRA. Effective January 1, 2018, pursuant to the Tax Cuts and Jobs Act (P. L. No. 115-97), a conversion from a traditional IRA, SEP, or SIMPLE to a Roth IRA cannot be recharacterized.⁸

Taxable rollover/conversion from employer plan to Roth IRA – An individual can make a taxable rollover, also known as a conversion, from an employer plan to a Roth IRA. This transaction is taxable because assets in the plan that have not yet been taxed (e.g., employee deferrals, employer-matching and profit-sharing contributions) are moved into an account that only accepts after-tax assets (a Roth IRA). The amount being rolled is taxed in the year it is distributed from the plan. When the assets are ultimately distributed from the Roth IRA, the rollover amount can be taken out tax free. Any additional earnings in the Roth IRA will also be tax free if the distribution is considered a “qualified distribution.” The Tax Cuts and Jobs Act mentioned previously (effective January 1, 2018) also prohibits recharacterizing amounts rolled over to a Roth IRA from other retirement plans, such as 401(k) or 403(b) plans.⁸

UNDERSTANDING THE ROLE OF A ROLLOVER IN RETIREMENT INCOME STRATEGIES AND ESTATE PLANNING

Access to IRA or plan assets

Because retirement plan accounts were designed to help individuals save for retirement, Congress created rules to discourage individuals from withdrawing funds from their IRAs or eligible plan accounts prior to their “retirement” years. The distribution timing rules can have a big impact on how IRAs or eligible plan accounts will be used to fund retirement or other wealth management strategies.

- **Before age 59½** – An additional 10% early distribution tax applies to the taxable portion of any distribution taken prior to age 59½. There are some exceptions to the early distribution tax as highlighted below.
- **After age 59½** – Once an individual reaches age 59½, the option to take a distribution at any time continues and the 10% early distribution tax no longer applies.
- **Age 73** – The year an individual attains age 73 and every year thereafter, required minimum distributions (RMDs) must be taken from traditional IRAs. But, if the plan permits, RMDs may be delayed past 73, if the assets have been rolled over into another eligible account or remained in your existing plan and you are still employed by the employer.

Avoiding the 10% early distribution tax

A distribution taken prior to age 59½ from a plan or IRA is generally subject

to a 10% early distribution tax on the taxable portion of any distribution. This tax is in addition to income tax that may be owed on the distribution. Individuals may avoid the 10% early distribution tax if they qualify for one of the exceptions to the tax listed below.⁶ The exceptions noted with an asterisk (*) are available for IRA distributions but not qualified plan distributions.

- Amount of unreimbursed medical expenses (>7.5% AGI; after 2012, 10% if under age 65)⁹
- Health insurance premiums following unemployment *
- Disability
- Death
- Attainment of age 59½
- Qualified higher-education expenses *
- First-time home purchase (up to \$10,000)*
- IRS levy (used to satisfy a tax debt)
- Distributions by a qualified Reservist
- Substantially equal periodic payments

One of the most common techniques used to access IRA and plan assets before age 59½ is to take “substantially equal periodic payments.” This option can be used at any age. Under this exception to the 10% tax, IRA owners set up a schedule of “substantially equal” payments. The payments must be made at least annually and must be made for a certain period of

time. The amount of each year's payment is typically calculated using one of three methods outlined in IRS guidance: the required minimum distribution method, the annuitization method, or the amortization method.

The plan participant IRA owner must receive a payment at least annually until he or she reaches age 59½ or for five years, whichever period is longer. If the series of substantially equal periodic payments stops or is modified before the end of the minimum payment period, the protection from the 10% tax is lost and the IRA owner will be required to pay the 10% early distribution tax retroactively for the distributions that occurred each year the arrangement was in place, plus interest.

However, if an individual separates from service during or after the calendar year in which they attain age 55, distributions from the employer's plans (but not IRAs) are exempt from the early 10% distribution penalty.

RMD rules

Required minimum distribution (RMD) requirements are an important consideration in any retirement income strategy and may play a role in estate planning. Traditional IRAs must begin disbursing a portion of the IRA each year once an individual reaches age 73. The IRA owner may delay taking the RMD until April 1 of the following year. It is important to note that when you delay taking your first RMD until April of the following year, you will take two RMDs in the following

year. Each year's RMD is calculated by taking the IRA's prior-year December 31 balance and dividing it by a life expectancy factor, typically based on the age of the IRA owner. The RMD rules determine the minimum payment an IRA owner must take from an IRA each year. Most IRAs will allow the IRA owner to take larger payments than required under the RMD rules.

If an IRA owner fails to take an RMD for a year, a 25% excess accumulation tax applies to the portion of the RMD amount that should have been distributed but remained in the IRA. Although IRA owners are ultimately responsible for calculating and distributing their RMDs, many IRA trustees and custodians automatically calculate the RMD amount for the IRA owner. Those who do not routinely notify IRA owners of the RMD amount must calculate the RMD for the IRA owner upon request.

If you leave your money in your existing plan or roll your assets into another eligible plan, you may be able to delay RMDs past age 73, if you are still employed, depending on the terms of the plan.

Inheriting IRA assets

Subject to the SECURE Act of 2019, when an IRA owner dies, the individual beneficiary named by the IRA owner will be required to draw down his or her entire inherited balance within 10 years. This rule applies regardless of whether RMDs had begun prior to the IRA owner's death. The 10-year rule does not apply to any portion payable to an "eligible designated

beneficiary." An eligible designated beneficiary is any beneficiary who is:

- The surviving spouse
- A minor child
- A disabled or chronically ill individual, or
- Any person who is less than 10 years younger than the original IRA owner

A spouse beneficiary is not required to take distribution earlier than the date on which the original IRA owner would have attained age 73. In addition, the surviving spouse has the option of converting the inherited IRA to his or her own.

In the case of a minor child, the 10-year rule does not apply until the date the child reaches the age of majority.

The 10-year rule will also apply upon the subsequent death of any eligible designated beneficiary.

Finally, for non-individual beneficiaries such as estates, non-qualified trusts, or charities, the inherited interest must be distributed within five years if the participant dies before the required beginning date or by the remaining single life expectancy of the deceased participant if they died after their required beginning date.

For additional information, please refer to the SECURE Act provisions available at www.irs.gov or consult your tax advisor.

If the trustee or custodian permits, a beneficiary may move inherited IRA assets into a separate inherited IRA. This is a new IRA established with inherited IRA documents and funded with a transfer of inherited assets after the death of the

IRA owner. Individuals who inherit assets from employer plans may also be able to directly roll assets into an inherited IRA.

Traditional IRA assets will be included in the beneficiary's taxable income in the year the distribution is received (excluding any basis created by nondeductible contributions). The taxation of Roth IRA distributions will vary depending upon whether the distribution is "qualified" (i.e., the Roth IRA satisfied the five-year aging requirement). Qualified distributions will be tax free to beneficiaries. If a distribution is not qualified, the earnings portion of the distribution will be taxable to the beneficiary, but the amount representing the original Roth contributions will be tax free.

Stretch IRA

Previously, inherited IRAs could be distributed over the course of the beneficiary's lifetime which could result in significantly reducing the tax consequences of such distributions. Referred to as a "stretch IRA," this distribution strategy allowed the IRA owner to take the minimum payment required and leave as much of the IRA balance as possible invested for as long as possible to grow tax deferred. With careful beneficiary planning, the IRA distributions could be stretched over a significant number of years across multiple generations. However, the SECURE Act of 2019 has eliminated this strategy for most non-spouse beneficiaries.

Trusts and estates as IRA beneficiaries

IRA owners have the option to name a trust, a charity, or an estate as the IRA beneficiary. Naming a trust as beneficiary enables the IRA owner to dictate to some extent how the IRA assets will be disbursed after their death. These arrangements are sometimes referred to as "trusteed IRAs." Trusts are also used in some estate planning strategies to minimize the impact of estate taxes. Some IRA owners choose to name their estate as their beneficiary. The assets would then be handled according to the terms of the IRA owner's will.

If an estate, trust, or other entity that is not a person, such as a charity, becomes an IRA beneficiary, it has more limited payment options than a person would have. In addition to taking a lump sum payment, if death occurred before the IRA owner was required to begin RMDs, a beneficiary who is not a person generally must take distributions under the five-year rule. If death occurred after RMDs were required to begin, a beneficiary that is not a person may take life expectancy payments based on the decedent's remaining life expectancy. There are exceptions for certain types of qualified trusts, which have an option to take life expectancy payments if the IRA holder died before January 1, 2020 or the 10-year rule if they die after December 31, 2019.

The tax rules and legal implications of naming estates and trusts as beneficiaries can be complex. Tax or legal advisors will

often be needed to create the necessary legal documentation to implement an individual's particular strategy.

Trusteed IRAs

A Trusteed IRA, also known as an Individual Retirement Trust (IRT), is a trust account that integrates IRA retirement savings goals with estate planning objectives. For tax purposes, a Trusteed IRA is treated the same as any other IRA. The difference between an IRT and a custodial IRA stems from how the IRA assets are handled when an IRA owner dies. With a typical custodial IRA, an IRA owner's beneficiary takes full control of the inherited IRA assets upon the death of the IRA owner. The beneficiary determines when and how much will be distributed from the IRA, so long as the beneficiary takes at least the minimum annual payment dictated by the Internal Revenue Code.

In a Trusteed IRA, the IRA assets will be disbursed by the trustee according to a schedule or a set of conditions defined by the IRA owner prior to their death. The IRA owner and his or her attorney will usually work with the IRA trustee to draft a beneficiary designation and trust agreement that will dictate how the IRA assets will be distributed, subject to the minimum payment requirements under the Internal Revenue Code. There are a variety of scenarios in which this level of control over IRA distributions may be appealing to an IRA owner. Some examples include IRA owners who want to:

- Create a plan to handle the financial needs of minor children or a dependent with special needs
- Set certain conditions on the receipt of IRA assets (e.g., attaining a certain age, completing college) subject to IRS distribution requirements
- Provide financial support to a surviving spouse while ensuring the remaining assets pass to the children of a prior marriage

IRA owners should carefully weigh the benefits along with the costs of a Trusteed IRA. Trust documents and customized beneficiary designations will need to be created, usually by tax and legal professionals. There will also be trustee fees associated with administering the IRA.

B – Links to Additional Rollover Resources. Refer to the Glossary of Terms (Appendix A) for definitions of common technical terms that may appear in marketing and educational materials relating to plan distribution options.

As with any important financial decision, an individual should consider seeking professional assistance. Financial advisors with investment expertise, as well as plan sponsors and tax and legal advisors, can provide valuable support to individuals who want to learn more about plan distribution options.

Summary

Deciding what to do with assets saved in an employer-sponsored retirement plan is one of the most important financial decisions a worker will make. For more information about distribution options, check out some of the Internal Revenue Service and Department of Labor resources listed in the Appendix

Footnotes

- 1 “The US Retirement Market, Second Quarter 2021.” Investment Company Institute September 2021, <https://www.ici.org/research/stats/retirement>
- 2 “Employee Tenure Summary.” U.S. Bureau of Labor Statistics, U.S. Bureau of Labor Statistics, 22 Sept. 2016, www.bls.gov/news.release/tenure.nr0.htm.
- 3 US Census Bureau, Merarys Ríos. “Nation’s Older Population to Nearly Double.” The United States Census Bureau, 6 May 2014, America Counts Staff, “2020 Census Will Help Policymakers Prepare for the Incoming Wave of Aging Boomers,” 10 Dec 2019, <https://www.census.gov/library/stories/2019/12/by-2030-all-baby-boomers-will-be-age-65-or-older.html>
- 4 “The US Retirement Market, Second Quarter 2021.” Investment Company Institute Sep, 2021, <https://www.ici.org/research/stats/retirement>
- 5 “Retirement Topics: Termination of Employment.” Internal Revenue Service, 27 Sep. 2021, <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-termination-of-employment>
- 6 “Retirement Topics - Exceptions to Tax on Early Distributions.” Retirement Topics Tax on Early Distributions | Internal Revenue Service, 29 Dec. 2017, www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-tax-on-early-distributions.
- 7 Rollovers of Retirement Plan and IRA Distributions | Internal Revenue Service, 16, Aug, 2021, <https://www.irs.gov/retirement-plans/plan-participant-employee/rollovers-of-retirement-plan-and-ira-distributions>
- 8 IRA FAQs | Internal Revenue Service, 19.Aug, 2021, <https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-iras>

APPENDIX A – GLOSSARY OF TERMS

Beneficiary – A person or entity chosen by the IRA owner or retirement plan participant to inherit the assets after the individual dies

Roth Conversion – A taxable movement of assets from a pre-tax account (e.g., traditional IRA or 401(k) plan) to a Roth IRA or Roth 401(k) account, resulting in current inclusion in income for tax purposes

Early Distribution – A distribution taken prior to age 59 1/2 resulting in an additional 10% tax penalty

Excess Accumulation – An account owner or beneficiary who fails to take a required distribution for a year is subject to a 25% tax on the portion of the amount that should have been distributed but was not

Excess Contribution – An amount that exceeds the annual contribution limit for the year or another contribution limit imposed on an IRA or employer-sponsored retirement plan

Fiduciary – An individual or entity who provides investment advice on or manages an employee benefit plan and its assets must, under the Employee Retirement Income Security Act of 1974 (ERISA), act prudently and in the sole interests of plan participants, and handle plan assets properly

Five-Year Rule – Requires a beneficiary to distribute 100% of the IRA or plan account by December 31 of the year containing the fifth anniversary of the account owner's death

Inherited IRA – An IRA that is set up and maintained in the name of the deceased account owner for the benefit of the beneficiary

IRA – An Individual Retirement Arrangement (IRA) is a personal savings account or annuity that provides tax advantages for setting aside money for retirement

Life Expectancy – Used to measure the maximum number of years over which an account owner or beneficiary is allowed to take distributions (IRS life expectancy tables are included in IRS Publication 590-B, Distributions from Individual Retirement Arrangements)

Qualified Distribution – A distribution from a Roth IRA or a designated Roth account in a 401(k), 403(b), or governmental 457(b) plan that will be tax-free because it is made after the account owner has met a five-year holding period and has turned age 59½, become disabled, or died (or for Roth IRAs only, meets the first-time homebuyer exception)

Recharacterization – Treating a current-year contribution made to one type of IRA as having been made to a different type of IRA. Beginning in tax year 2018, recharacterization of a Roth conversion is no longer allowed

Required Beginning Date – The date by which required minimum distributions must begin: April 1 of the year following the year in which the account owner attains age 73

Required Minimum Distribution (RMD) – An amount that must be distributed to the account owner each year beginning with the year the account owner attains age 73

Rollover – A distribution from an IRA or retirement plan that is moved directly or indirectly within 60 days to a receiving IRA or retirement plan

Roth IRA – An IRA that accepts only nondeductible (after-tax) annual contributions and provides tax-free earnings if distributions are qualified; may accept rollovers from other Roth IRAs and pre-tax assets and designated Roth account assets from employer-sponsored retirement plans

Traditional IRA – The original IRA (also called an ordinary or regular IRA) to which annual contributions are generally tax-deductible; may accept rollovers from other traditional IRAs and employer-sponsored plans

Transfer – A tax-free movement of assets directly between IRAs of the same type

Withholding – Amount that a payer of an IRA or retirement plan distribution withholds from a taxable distribution and remits to the IRS as a pre-payment of income tax on the distribution

APPENDIX B – LINKS TO ADDITIONAL ROLLOVER RESOURCES

IRS resources

- Publication 590-A, Contributions to Individual Retirement Arrangements – A publication that covers the rules regarding contributions to traditional and Roth IRAs, as well as the rollover and conversion rules <http://www.irs.gov/pub/irs-pdf/p590a.pdf>
- Publication 590-B, Distributions from Individual Retirement Arrangements – A publication that covers the rules regarding distributions from traditional and Roth IRAs, as well as the rules for required minimum distributions and IRA beneficiaries <http://www.irs.gov/pub/irs-pdf/p590b.pdf>
- IRS Rollover Chart – An at-a-glance summary of all eligible rollovers between retirement plans and IRAs http://www.irs.gov/pub/irs-tege/rollover_chart.pdf
- Traditional and Roth IRA Comparison Chart – An at-a-glance comparison chart of the similarities and differences between traditional and Roth IRAs <http://www.irs.gov/Retirement-Plans/Traditional-and-Roth-IRAs>
- Required Minimum Distributions for IRA Beneficiaries – A summary of the distribution options for spouse, non-spouse, and non-individual beneficiaries <https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-required-minimum-distributions-rmds>

Department of Labor resources

- Retirement Toolkit – A publication and a timeline provided by the DOL, the Social Security Administration, and the Centers for Medicare and Medicaid Services to help individuals understand the issues to consider when deciding when to retire <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/publications/retirement-toolkit.pdf>
- Savings Fitness: A Guide to Your Money and Your Financial Future – A guide to assist individuals in learning about retirement plans and setting financial and retirement goals <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/publications/savings-fitness.pdf>
- What You Should Know About Your Retirement Plan – An overview of the information a plan is required to disclose to employees and participants <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resourcecenter/publications/what-you-should-know-about-your-retirement-plan.pdf>
- Top 10 Ways to Prepare for Retirement – Short, helpful hints to assist individuals in preparing for retirement, with links to more information <https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/publications/top-10-ways-to-prepare-for-retirement.pdf>
- Taking the Mystery Out of Retirement Planning – A guide to assist individuals in calculating how much to save for retirement and planning for expenses in retirement <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/ouractivities/resource-center/publications/taking-the-mystery-out-of-retirement-planning.pdf>

LPL resources

- For questions about your rollover options and other issues, please contact your financial advisor for assistance.

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