

Rollover IRAs Offer a Wide Range of Benefits

IRA assets can generally be divided among multiple beneficiaries in an estate plan.

As compared with employer-sponsored retirement accounts, a rollover IRA can provide you with the broadest range of investment choices and the greatest flexibility for distribution planning. Also, a rollover IRA can typically be operated with fewer restrictions. This brief overview highlights some of the key benefits of a rollover IRA compared with an employer-sponsored plan.

- **More control:** As the IRA account owner, you make the key decisions that affect management and administrative costs, overall level of service, investment direction, and asset allocation. You can develop the precise mixture of investments that best reflects your own personal risk tolerance, investment philosophy, and financial goals. You can create IRAs that access the investment expertise of any available fund complex, and can hire and fire your investment managers by buying or selling their funds. You also control account administration through your choice of IRA custodians.
- **More flexibility:** IRAs can be more useful in estate planning than employer-sponsored plans. IRA assets can generally be divided among multiple beneficiaries in an estate plan. Each of those beneficiaries can make use of planning structures such as the Stretch IRA concept to maintain tax-advantaged investment management during their lifetimes. Beneficiary distributions from employer-sponsored plans, in contrast, are generally taken in lump sums as cash payments. Also, except in states with explicit community property laws, IRA account holders have sole control over their beneficiary designations.

Efficient Rollovers Require Careful Planning

One common goal of planning for a lump-sum distribution is averting unnecessary tax withholding. Under federal tax rules, any lump-sum distribution that is not transferred directly from one retirement account to another is subject to a special withholding of 20%. This withholding will apply as long as the employer's check is made out to you -- even if you plan to place equivalent cash in an IRA immediately. To avert the withholding, you must first create your rollover IRA, and then request that your employer transfer your assets directly to the custodian of that IRA.

Keep in mind that the 20% withholding is not your ultimate tax liability. If you spend the lump-sum distribution rather than reinvest it in another tax-qualified retirement account, you'll have to declare the full value of the lump sum as income and pay the full tax at filing time. In addition, the IRS generally imposes a 10% penalty tax on withdrawals taken before age 59 1/2.

Also, if you plan to roll over the entire sum, but have the check made out to you rather than your new IRA custodian, your employer will be required to withhold the 20%. In that event, you can get the 20% refunded if you complete the rollover within 60 days. You must deposit the full amount of your distribution in your new IRA, making up the withheld 20% out of other resources. When you file your tax return for the year, you can then include a request for refund of the lump-sum withholding.

If you have after-tax contributions in your employer plan, you may opt to withdraw them without penalty when you roll over your assets. However, if you wish to leave those funds in your retirement account in order to continue tax deferral, you can include them in your rollover. When you begin regular distributions from your IRA, a prorated portion will be deemed nontaxable to reimburse you for the after-tax contributions.

Potential Downsides of IRA Rollovers

While there are many advantages to consolidated IRA rollovers, there are some potential drawbacks to keep in mind. Assets greater than \$1 million in an IRA may be taken to satisfy your debts in certain personal bankruptcy scenarios. Assets in an employer-sponsored plan cannot be readily taken in many circumstances. Also, you must begin taking distributions from an IRA by April 1 of the year after you reach 70 1/2 whether or not you continue working, but employer-sponsored plans do not require distributions if you continue working past that age.

Remember, the laws governing retirement assets and taxation are complex. In addition, there are many exceptions and limitations that may apply to your situation. Therefore, you should obtain qualified professional advice before taking any action.

© 2011 McGraw-Hill Financial Communications. All rights reserved.

June 2011 — This column is provided through the Financial Planning Association, the membership organization for the financial planning community, and is brought to you by **Capital Strategies, Inc.**, a local member of FPA.