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#74

Understand Your Employer Retirement Plan

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Did you save money in a favorite piggy bank when you were a child? Do you remember the exciting day you finally got to shake out the bank, count your savings, and decide how to spend your money? As a new retiree, you're turning your bank upside down. You still need to be diligent about rebalancing , making smart investment choices, and managing expenses. But you also need to know the ins and outs of shaking loose your retirement savings so you pay minimum taxes and no penalties. This strategy explains how.

Read Up and Talk about It

First, get a copy of your plan summary document, either from your human resources department or benefits coordinator or from a download on your company Web site.

The next step is to schedule an appointment with your human resources department. Ask to have your withdrawal choices fully explained, including possible consequences — that is, taxes and penalties — based on your current age and employment status (retirement isn't necessarily the same as not working, especially if you're a baby boomer breaking all past retirement notions).

Your company's plan may or may not mirror the current tax laws regarding employer retirement plans.

This is also the right time to meet with your financial advisor. Your advisor can help you sort through the various withdrawal options for your retirement savings based your personal goals and needs.

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Answer These Questions before You Break the Bank

Especially in uncertain economic environments, you should answer these questions before tapping into your retirement savings:

- What's your current age?
- What are your hopes and dreams for retirement?
- What are your other sources of retirement income?
- How long do you need your savings to last?
- How much do you need to live comfortably every month?
- Do you have an immediate need for a lump sum of money?

Don't expect to answer these questions in five minutes. Everyone has a unique vision of the perfect retirement. A variety of online calculators and resources, such as 360 Degrees of Financial Literacy (`www.360financialliteracy.org`), can help you answer these questions.

Important ages to keep in mind when planning withdrawals include the following:

- **Age 50:** Age 50 is the same as age 55 for some types of public safety employees. (If you work in a public service capacity, check with your plan administrator or tax preparer to see whether you qualify).
- **Age 55:** If you leave your job between 55 and 59½, you don't pay a 10 percent early withdrawal penalty on 401(k)s and other qualified retirement savings (not including IRAs).
- **Age 59½:** The 10 percent early withdrawal penalty expires. (***Note:*** But to withdraw savings from a 457(b), you have to retire or turn 70½).
- **Age 62:** This is the earliest age you can obtain Social Security benefits.
- **Age 70½ + April 1:** Here, you begin required minimum distributions (RMDs) from employer plans and IRAs (except Roth IRAs). If you're still working and own less than 5 percent of the company, you can delay RMDs from your current employer's qualified plans. (***Note:*** Not all plans allow you to delay RMDs.)

Even though you avoid the 10 percent penalty with proper planning, income taxes will always be payable on retirement savings withdrawals except for Roth IRAs and Roth 401(k)s.

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Know Your Options when Leaving a Job

Most near retirees are bombarded with a laundry list of important decisions regarding the future. This can be overwhelming, but don't let that stop you from making smart choices about the savings you've accumulated in the company retirement plan. The next sections cover the three options to consider for your savings when leaving employment.

Leave your money in your employer retirement savings plan

If the plan allows and you're very satisfied with the available investment choices and performance, leave your money right where it is. You can always roll your money to an IRA later.

This is also a good choice if you need maximum protection from creditors because of potential lawsuits, bankruptcy, or other situations. Asset protection for qualified retirement plans is more comprehensive than for IRAs. Borrowing from an IRA isn't permitted, so if this is an important option for you, leave your money in your existing plan (or roll your savings into a new employer's plan).

Also take retirement age into account. At age 55, withdrawals from qualified plans aren't subject to the 10 percent early withdrawal penalty if you're no longer employed by the company. With an IRA, you have to wait until age 59$^{1}/_{2}$ to avoid this penalty.

Take a lump sum (or partial) distribution

A lump sum distribution is almost always a bad idea. Because income taxes are due on all distributions (lump sum or partial), a large lump sum distribution will likely force you into a higher tax bracket. This should be your choice of last resort. However, if this is your only way to pay a major expense, you can take a portion of your savings as a lump sum distribution and roll the balance of your savings into an IRA.

If you own highly appreciated company stock in your retirement plan, you can benefit from favorable capital gains tax rates on the net unrealized appreciation (NUA) on the stock. You pay ordinary income tax at the time of withdrawal on the cost of the stock, but when you sell the stock, the NUA is taxed at the more favorable long-term capital gains rate. NUA is a complex tax issue that you should discuss with an accountant or other professional.

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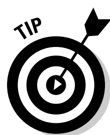
Roll your money into an IRA

Most of the time, rolling your retirement plan savings into an IRA is best. IRAs have greater flexibility both with investment choices and withdrawal options. (See Strategy #75 for info on IRA withdrawal options).

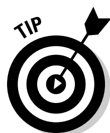


The most important thing to remember about a rollover is to request a direct trustee-to-trustee transfer. A direct trustee-to-trustee rollover saves you from unexpected and potentially nasty tax consequences. If you receive the check made out to your new IRA trustee (this happens fairly often), don't worry; this is still a direct rollover — just forward the check on to your new trustee.

Cha-ching! Shaking the Bank

You've decided where to stash your retirement savings, but how much and when should you withdraw? In an uncertain economy, that's the million-dollar question. The longer you can allow your retirement plan savings to grow tax-deferred (or tax-free in the case of Roth contributions), the better.

Many new retirees mistakenly overspend in the early years. Don't deprive yourself, but remember that your retirement could be 30 to 40 years. The cost of the health care you'll probably need in later retirement continues to increase faster than most other expenses.



Determining the correct withdrawal rate for your situation requires many considerations, but a general rule is to withdraw no more than 4 percent of your total savings in any one year. If your investment returns are poor in a particular year, you should revise this percentage downward. And conversely, you can revise your withdrawal upward if you make great returns one year.

Timing your withdrawals from one tax year to the next provides another opportunity to reduce income taxes. For example, if you have unusually high medical expenses in a particular calendar year that qualify as itemized deductions, you may want to take some of your retirement withdrawls in December instead of waiting until January as a way of balancing your income and expenses.

The benefits of tax deferral don't last forever. On April 1 of the year after you turn 70½, you have to begin *required minimum distributions* (RMDs) from employer retirement plans and IRAs. However, if you're working at age 70½ and you're not more than a 5 percent owner of the company, you can postpone RMDs in that employer's qualified retirement plan until you retire a second time, but you have to take RMDs from all other retirement accounts.