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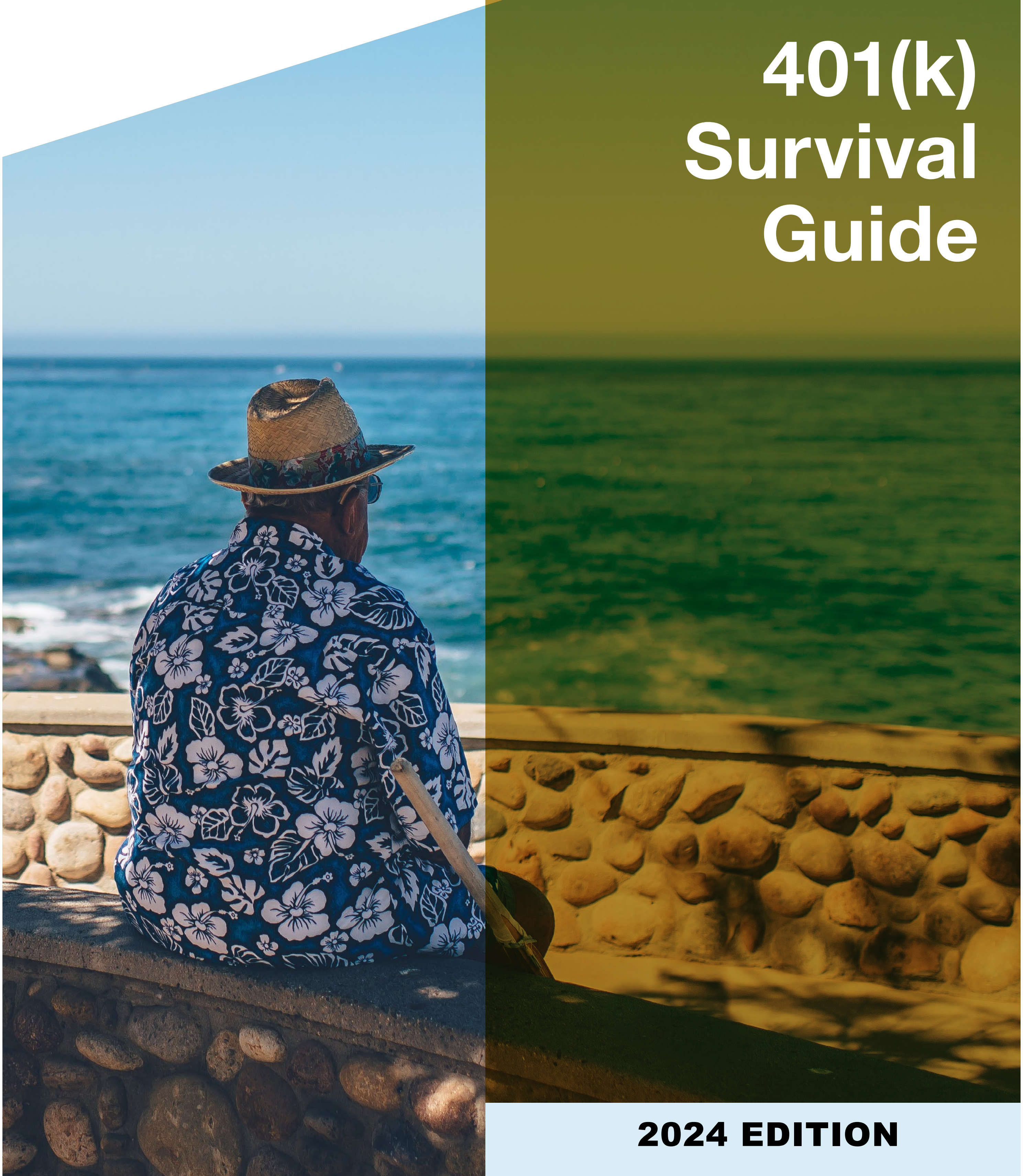

401(k) Survival Guide

2024 EDITION

What's Inside

What To Do With Your 401(k) When You Retire Or Are Nearing Retirement

You've worked for what seems like your entire life. For years, the alarm buzzed before even the sun began to shine and at times, you didn't arrive back home until the stars were out. Despite paying all the bills for you and your family's expenses, you've still managed to save and put money away in your employer's 401(k) plan. For many people, they believe that the hardest stage to accomplish is the "saving" phase but the truth is, that's just half the battle. Once you retire, a plan for withdrawing those funds that provides a constant source of income that isn't eaten up by taxes and other costly traps must be constructed. The biggest challenge? To figure out which plan is the best one for your specific situation as all of the available options have their pros and cons.

For most people your 401(k) will represent the largest asset you have for retirement. Decisions on what to do with this account will have a major impact on your retirement success. There is a major focus on fees associated with 401(k) and IRA accounts and while fees are an important aspect of your decision, they should not be the sole focus. Remember this, no one in the investment world works for free and they never will.

You will always pay someone somehow, so the important thing is to clearly understand what you are paying for and what you will receive at the end of the day for that fee. If everyone only had one investment to choose from and the only difference from one provider to another was the amount they charged for that same investment, then fees would be the only differentiator. The investment world is much more complex than that so it's important you understand the pros and cons of all of your choices prior to making a decision to either leave your money in your old employer's 401(k) or to roll it to an IRA.

This report is designed to give you a base level understanding of what to look for but is in no way intended to be the guide to your final decision. Remember, financial planning for your retirement is not a one-time set it and forget it type of event. It's a complex system that must be reviewed on a regular basis and if needed, adjusted to fit an ever-changing life.

Tax considerations should be at the top of your mind when it comes to your 401(k). Most people have never paid any tax on any of the money in their 401(k) accounts. Some people have money they put in on an after-tax basis which is treated differently when you take the money out. While only about 6% of participants make after-tax contributions, it is important to understand how this works. Simply put, the contribution is made after you have paid taxes on it so that the contribution amount should never be taxed again. When rolling your 401(k) to an IRA you will be faced with choices of what to do with the after-tax money. ❖

FYI

Decisions on what to do with this account will have a major impact on your retirement success. You will always pay someone somehow, so the important thing is to clearly understand what you are paying for.

Options To Consider When It Comes To Your 401(k)

OPTION 1

Your first option is to take your 401(k) and roll it into your traditional IRA so that when you begin taking withdrawals from your IRA, you will have a portion that is not taxed. So if you rollover a 401(k) that is worth $200,000, consisting of $180,000 in pretax amounts and $20,000 in after-tax amounts, then you would assume 10% of the amount withdrawn in the first year will be free of tax. However, if you own any other IRAs, the value of those IRAs must be included when calculating the tax-free percentage which results in a lower percentage of the withdrawal being tax-free. In our example, if you own no other IRAs, if $10,000 was withdrawn this year then $1,000 of that would not be taxed. The following year you have to recalculate the percentage of "after-tax money." In my opinion, this is the least attractive option because it forces additional tax forms as well as additional record keeping responsibility to the individual investor.

OPTION 2

Your second option is to take the after-tax money directly and than pay no taxes on it. If you need immediate liquidity, this can be an attractive option. It is important to note that if you take this money and then invest it outside of an IRA, all future earnings may be subject to tax.

OPTION 3

Your third option is to roll this after-tax amount directly to a Roth IRA where all future earnings will be tax-free as long as you hold the Roth for 5 years and attain the age of 59 1/2. This is perhaps the most attractive option for some individuals since it allows all the earnings from the "after-tax contributions" to be rolled directly into the traditional IRA and the contributions to be rolled to the Roth. This can present other tax planning opportunities down the road as well.

Whether you have "after-tax money" or not, remember that a large portion of your IRA will likely go to the IRS. If you go by what has been drilled into you over the years that you will be in a lower tax bracket in retirement then you will likely be surprised at how much you actually pay on distributions. The tax code is complicated in retirement and you will likely need the help of a good CPA to help plan your distributions. Your IRA distributions are taxed at ordinary income tax rates and at the same time can cause large amounts of your Social Security to be taxed that may have otherwise been tax free. It can also cause long term capital gains and qualified dividends to become taxable that may have otherwise been tax free. Here is an example of an IRA distribution that causes over a 30% tax even when the taxpayer is in the 15% tax bracket. ❖

Case Study

Male: Age 69

Female: Age 70

Current income:

- $50,020 from Social Security
- $23,000 from Qualified Dividends
- $10,000 from Long Term Capital Gains
- $25,000 from Pension

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This gives total Adjusted Gross Income of just $97,150 because only $39,150 of the Social Security is taxable and there is a 0% tax rate on the qualified dividends and capital gains since the taxpayer is in the 15% tax bracket. The total Federal tax bill for this couple is just $5,219.

The problem arises when this couple hits their required beginning date. That's when they reach 70 1⁄2 and they have to take distributions (RMD's) from their IRA even if they don't need the income to live on. For this example we will assume that the couple needs to take $15,000 from their IRA. You would assume that since they are in the 15% bracket they would pay just 15% tax on the RMD. The outcome is very different from that. The AGI after the RMD is now $115,500 because now $42,500 of the Social Security is taxable and $17,000 of the qualified dividends and long-term capital gains are now taxable as well. So the additional tax on a $15,000 RMD will be $5,302 or **35.35% effective tax on that $15,000 RMD**.

The effect of higher taxes due to a lack of understanding of how the tax code work in retirement is one of the largest mistakes that retirees make. In many cases people are overpaying their taxes due to this lack of knowledge. Make sure before you decide to keep your money in your old 401(k) or roll it to an IRA that your advisor and/or your CPA is able to clearly explain the tax impact to your overall retirement plan.

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Another important thing to consider when it comes to your decision of what to do with your 401(k) is **investment choices and flexibility**.

The old 401(k) will likely have limited options compared with an IRA. Your 401(k) plan should have good choices since it is the responsibility of your employer as the fiduciary to ensure your choices meet all the guidelines. Also keep in mind that your employer plan likely does not provide active advice on how you should have your money positioned. So all the investment choices and risks are on you. Consider your desire and/or ability to choose the correct allocations through all market cycles. One misstep could dramatically change your overall retirement picture. ❖

You Have Many Choices When It Comes To Your IRA

When it comes to your 401(k) plan, there are multiple options to consider. You can go it alone on a self-directed 401(k) and build your portfolio with just about any asset. You can use Stocks, Bonds, Mutual Funds, ETF's, Options, Alternative investments and even real estate if you follow the rules. Now if you're doing the work by yourself, you will likely have lower fees but it's also imperative to remember that there is no one in the financial world that works for free. You will have expenses and you need to understand what they are. They will vary based on the custodian you have holding your IRA.

You can simply hire an investment manager who will likely want to understand your tolerance for risk and then design a portfolio that matches that risk tolerance while also keeping your portfolio allocated appropriately. However, if you hire just an investment manager, don't expect help on how you get the money out, proper beneficiary designations, tax help or any of the other complex issues that come into play when it comes to withdrawing your source of income during retirement. The investment manager will likely have an additional fee on top of any internal expenses related to the holdings in your IRA. Some investment managers may receive a commission and some will simply receive fees based on your account values.

It's always a good idea to ask and make sure you understand all fees involved.

You can hire a financial planner who will help you create a well thought out retirement game plan that will include investment management of your IRA. This will likely look much different than the Investment manager-only relationship previously mentioned. A good financial planner will not only help you with the proper asset allocation but will also work with you to help ensure you are paying as little tax as possible on your distributions and your risk level is as low as it can be while also helping ensure your lifestyle is what you envision. Financial planners can also be paid either by commission or fees. Some financial planners will charge an additional fee for preparing the plan and keeping it up to date. Not all planners charge the same way so it will be important to understand how your planner gets paid and all applicable fees that are your responsibility.

Regardless if you decide to go it alone or use the help of a professional you will have a much broader choice of investments to choose from. In some cases your fees will be higher than your old 401(k) but not always. Remember though, don't just look at fees but look at what you get for the fee and determine if it represents a good value. Don't get stuck in long-term commitments with your investment manager or Financial Planner. You should be free to leave any time you are dissatisfied with the relationship.

PRE-AGE 59 1/2 CONSIDERATIONS ARE ALSO IMPORTANT

If you are over the age of 55 but under 59 1/2 and you separate service from an employer it will likely make sense to leave at least a portion of your money in the old 401(k). If you separate service after the age of 55 you will have access to your 401(k) assets from that employer without the 10% penalty. If you roll everything to an IRA and want to take withdrawals, you will be severely restricted on how to get the money out prior to the age of 59 1/2 without the 10% penalty. So if you need access to the funds for living expenses, consider leaving at least the amount you think you will need in the 401(k), even if you don't like the old company.

CREDITOR PROTECTION

If you're concerned about creditor protection you will most likely want to leave your money in the 401(k). The 401(k) offers creditor protection that your IRA will not.

DISTRIBUTION RULES ON YOUR OLD 401(K) CAN ALSO BE A BIG FACTOR IN YOUR DECISION

Not all plan documents are created equally and many plans won't allow for monthly distributions to live on. Some even say it's an all or nothing proposition when it comes to getting the money out. Your IRA should give you all the flexibility you need to get to your money on your terms.

RMD RULES ALSO COMPLICATE YOUR DECISION

Remember earlier when we discussed that at age 70 1/2 you have to start making distributions? Well this can get to be a record keeping nightmare if you have money in many different IRA and old 401(k) accounts. The IRS requires each IRA and 401(k) custodian to send a report each year to the IRS that includes your account value. If you happen to miss an account or don't take enough out, you will be subject to a 50% excise tax.

If your IRA accounts are consolidated with a single custodian, it will greatly reduce the potential for error and also reduce your record keeping responsibilities. Remember, you can have many different investment strategies in your IRA accounts even if they are all held at the same custodian.

TAX PLANNING AND ROTH CONVERSIONS

This is likely one of the most overlooked opportunities of today's retiree's. The reason it is overlooked is because it is extremely complex and cannot be summed up in a simple break even analysis or excel spreadsheet. It truly requires a good CPA who has a thorough understanding of your entire financial picture. This CPA must then do a forward looking analysis that will go out many years into the future to see the true impact of the conversion. In many cases this single move can have a tremendous impact on how much you and your heirs ultimately pay in taxes. Once you leave your 401(k) behind your options for this conversion are very limited at the plan level and will usually require you to roll it out to an IRA.

You won't get help in this area from your 401(k) plan administrator or your investment only advisor. This area requires special training and advanced planning skills. If you take the time to do a thorough analysis you will be glad you did. We have included a page in this report that shows the pros and cons of both IRAs, Roth IRAs, and 401(k)s.

NUA

This is part of the tax planning that needs to be done. If you have large positions of company stock in your 401(k) plan you may be eligible for NUA "Net Unrealized Appreciation" which will allow for some exciting tax savings opportunities but only in the IRA world. You cannot get this if you leave your money in a 401(k) and begin taking distributions. If you have this situation, make sure to talk to a good financial planner or CPA who truly understands this. It is very complex and requires special training. ❖

Conclusion

At the end of the day, what to do with your 401(k) is a big decision and one that can't be taken lightly. Thousands of pages in the tax code are written specifically for IRA and 401(k) accounts. The rules and regulations that surround this major part of your retirement can make or break you. You did a good job saving and sacrificing your entire career and now it is time to ask your money to go to work for you so you can enjoy your retirement. Don't leave anything to chance and don't follow the crowd with "rule of thumb" planning. Do your homework and make a great decision. ❖

Notes

Questions?

If you would like to gain more insight on your available 401(k) options, the advisors at are happy to discuss your personal situation and help you determine your best course of action. As Fiduciaries, it is our job to put your interests ahead of ours at all times. We look forward to the opportunity to serve you.

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