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MAJOR 401(K) MISTAKES

If you have recently changed to a new employer, it is likely that you have some retirement savings that you accumulated while at your former job. Regardless of how much your 401(k) balance is, you need to consider what you are going to do with it going forward.

One option is to do a “rollover.” A rollover is moving your account to your new employer’s retirement plan or to an Individual Retirement Account (IRA). Before you go this route, be sure to have a good understanding of the potential “pitfalls” that you could encounter in the process.

1) Rolling Your 401(k) Funds Indirectly

You will be hit with a 20% IRS withholding tax if you cash in your account. The same is true if you move it to your own personal savings or investment account. In most cases, if you are under the age of 59 ½, you will also pay a 10% early withdrawal penalty.

You can still put the money in an IRA but,

- you would have to do so within 60 days.
- you would have to come up with the 20% that was withheld for taxes.
- you could not have done a 60 day rollover within the previous twelve months.

However, if you roll your money directly from your former 401(k) plan to the plan at your new employer or to your IRA account, you can avoid the withholding taxes and potential penalties.

2) Leaving an Old 401(k) Behind

You may be able to leave your 401(k) account with your previous employer but, there are several disadvantages to doing so.

- Your account will remain subject to the Plan rules
- You will continue to have limited investment options
- You simply have another account to keep up with

The better option may be to roll your old 401(k) to the new employer plan or, to your own personal IRA. Rolling to your own IRA may be beneficial for many reasons including:

- You now are the account owner rather than a participant in a plan

- Virtually unlimited investment options
- Tax withholding is not required if you needed a distribution
- More control over naming or changing your beneficiaries
- You can consolidate more than one old 401(k) account into one IRA.

3) Doing a Rollover “Too Soon”

Rolling over your 401(k) account to an IRA “too soon” is also something that may create a problem. If you plan to retire before reaching age 59 ½, taking money out of an IRA account will result in regular income tax on your withdrawals and, an additional 10% IRS early withdrawal penalty.

However, by leaving your money inside of your 401(k) plan, you may be able to take advantage of the “over 55 rule.” If you are age 55 or over in the year that you leave your job, you will not be subject to the 10% early withdrawal penalty when you make distributions.

4) Rolling Over Company Stock

You also need to be careful when rolling over your 401(k) if it contains shares of your former employer’s stock that has appreciated over the years. In fact, in some cases, rolling over the stock into an IRA could be a **big** mistake.

Typically, 401(k) plan distributions are subject to ordinary income taxes. However, there is a special rule that applies when you receive a distribution of employer stock from your plan. This rule is referred to as the Net Unrealized Appreciation or, NUA rule.

You would only pay ordinary income tax on the cost basis of the stock.
Cost basis is the stock price at the time that it was purchased for you by the plan. Any appreciation in the stock will receive more favorable long-term capital gains treatment. The NUA rule does not, however, apply if you roll the stock over to an IRA. Keep in mind that to take advantage of NUA rules, it has to be done as part of a full and final rollover from an employer plan.

5) Failing to Update Your Beneficiary Designations

When doing a 401(k) rollover, it is absolutely critical that you rename and keep your beneficiary designations up to date. This is particularly true if you have incurred any major life changes, such as:

- Marriage or divorce
- The death of a spouse or other loved ones
- The birth or adoption of a child

By not having your beneficiary designations updated at all times, you run the risk of "disinheriting" someone who is close to you. Also, someone you no longer have in your life, such as an ex-spouse, may inherit a great deal of money from you!

By being aware of these 5 rollover pitfalls, you can make sure to avoid irreversible and costly mistakes. Getting the help of an independent fiduciary based adviser may benefit you.

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