

If you're laid off, what happens to your retirement money? Well, you have three basic choices with your 401(k). One gives you more freedom and control than the other two.

You could just leave your 401(k) alone. The money will remain invested, and the financial firm handling your 401(k) will keep mailing you quarterly statements telling you how it is doing. Any future growth will be tax-deferred.¹

But this passive choice comes with an opportunity cost. If you just leave the 401(k) assets in the plan, you're giving up control and flexibility. Your investment choices may be limited, the plan fees may be high, and you may not be able to quickly access your money or do what you want with it. If you have a trail of old 401(k)s left with a bunch of former employers, things can get really complicated when you retire – especially when you have to take Required Minimum Distributions (RMDs). Leaving the money in the plan may not be the wisest choice.

You could withdraw the money. This is a terrible choice – a last resort. It comes with a severe financial penalty. You will not get all the money you have invested back – far from it. You will lose 20% of your 401(k) assets to withholding taxes, and if you are under 55 on the day you leave your employer, the IRS will levy an additional 10% penalty for early withdrawal of the assets. By the way, distributions from a 401(k) are considered taxable income – so expect a big tax bill in the year you cash out.¹ The federal government does not want to see you wipe out your retirement savings. Neither does your financial professional.

If you really need money, you could consider borrowing from your 401(k). The problem here is that most companies want the loan balance paid off when you leave – whether you leave work by choice or not.

You could roll it over into an IRA. This is the choice that usually makes the most sense. You can move the money into an IRA through a rollover or trustee-to-trustee transfer. Or, you could direct the money into a so-called “conduit IRA,” a traditional IRA created to hold your old 401(k) assets until you move the money into another qualified retirement plan. (You can't contribute to a conduit IRA.)²

There's no tax penalty when you do an IRA rollover or trustee-to-trustee transfer. After you do it, you have total control of the money, continued tax-deferred growth, expanded investment choices, and possibly lower account management fees.¹

Rolling over the money into a Roth IRA might be a great move, provided you can meet two conditions. First, your adjusted gross income has to be less than \$100,000 for the year in which you make the rollover. Second, you'll have to pay taxes on the assets you convert.¹ The upside is considerable: you get tax-free compounding, tax-free withdrawals if you are older than age 59½ and have owned your account for at least five years, and the potential to make contributions to your IRA after age 70½ without having to take RMDs. Contributions to a Roth IRA are not tax-deductible, but there are fewer restrictions on withdrawals.^{3,4}

In 2009, you can fund a Roth IRA with after-tax contributions to a 401(k), 403(b) or 457 retirement savings plan – you can take those contributions and convert them to a Roth IRA tax-free, provided your AGI is \$100,000 or lower. There is no limit on the conversion amount. Incidentally, in 2010, anyone can convert a traditional IRA to a Roth IRA – the AGI restriction on such conversions disappears.⁵

What if you have to shiver through a 401(k) freeze? A “freeze” is when your employer reduces or suspends matching contributions to your retirement plan. FedEx, General Motors and Motorola have all recently chosen to do this.⁶ The answer: don't let up on your personal contributions. If you can manage it, adjust your 401(k) contribution to a level where you effectively replace what your employer contributed. Saving for retirement should remain one of your highest priorities.

These are the views of Peter Montoya Inc., not the named Representative nor Broker/Dealer, and should not be construed as investment advice. Neither the named Representative nor Broker/Dealer gives tax or legal advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The publisher is not engaged in rendering legal, accounting or other professional services. If other expert assistance is needed, the reader is advised to engage the services of a competent professional. Please consult your Financial Advisor for further information.

Citations.

¹ articles.moneycentral.msn.com/RetirementandWills/InvestForRetirement/jobless-what-to-do-with-your-401k.aspx [2/13/09]

² investopedia.com/terms/c/conduitira.asp [2/13/09]

³ fool.com/Money/AllAboutIRAs/allaboutiras03.htm [11/19/08]

⁴ irs.gov/publications/p590/ch02.html#d0e9236 [11/19/08]

⁵ kiplinger.com/magazine/archives/2009/01/sweet-deal-on-roth-ira-conversion.html [1/09]

⁶ biz.yahoo.com/ibd/090102/funds.html?.v=1 [1/2/09]