Topics in Retirement Planning

Transferring Retirement Savings?

Consider an IRA for the funds in your former employer's plan

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At some point, you may leave a job that offers an employer-sponsored retirement plan such as a 401(k). Whether you are pursuing a new career opportunity, have been laid off or are retiring, you need to think about what to do with the retirement funds in your employer's plan.

You could leave the money where it's been all along (if this is an option), take a lump sum distribution or periodic withdrawals, or roll over the savings into your new employer's plan (if one exists). Each of these options has its drawbacks — mainly, limited investment choices or current tax and penalties on the distribution. But there is another way to keep your retirement savings growing — by rolling over your retirement funds into an IRA.

Rollover IRA Benefits

When considering your retirement planning choices, you may have dismissed IRAs because your income disqualifies you from making deductible annual contributions. It's true that eligibility to deduct annual contributions phases out when adjusted gross income (AGI) totals at least $55,000 if you're single or $75,000 if you're married, filing jointly. But these limits apply only to receiving an income tax deduction — there are no AGI limits for transferring retirement funds to rollover IRAs.

Rolling over your retirement funds into an IRA offers the following advantages:

- All the dividends, interest and capital gains you earn in the account are sheltered from federal income tax until you withdraw them — which means your money has greater growth potential than it would in a comparable taxable investment. (See the chart, *The Benefit of Tax-Deferred Compounding*, on page 2.)
- When you do take withdrawals after retirement, you may be in a lower tax bracket.
- An employer's plan may only give you limited investment options. With an IRA, you have greater investment flexibility and control.

Charitable Donations

If you are inclined toward charitable giving, an IRA can offer you additional benefits. Although you currently must take distributions and pay the applicable taxes before making a lifetime gift to charity, this strategy may make sense from a tax perspective — at least until the estate tax is fully repealed in 2010. Why? Your IRA is subject to estate tax, and withdrawals are taxed as income; donating IRAs to charity may reduce both income and estate taxes.

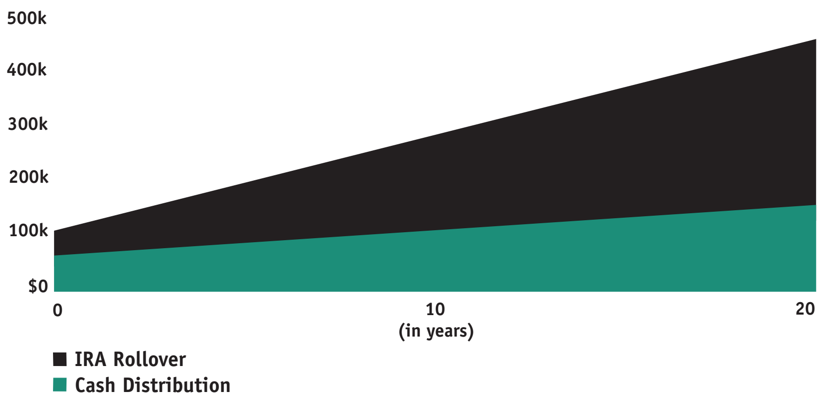
Taxes can take more than half of a traditional IRA's assets when left to someone other than a spouse. Donating an IRA to charity instead can give you significant tax leverage in exchange for the gift. Two gifting possibilities exist:

1. **Lifetime charitable gifts.** This involves taking a taxable distribution from your IRA before donating to charity. The gift, however, is deductible up to 50% of AGI for gifts to public charities and operating private foundations, or up to 30% for nonoperating private foundations. This helps offset income taxes on the distribution. And, once you make the gift, the assets are no longer

Northern Trust

THE BENEFIT OF TAX-DEFERRED COMPOUNDING

*These results are based on a 45-year-old who receives a $100,000 distribution vs. one who rolls over the same amount into an IRA.**



* *The IRA rollover's 8% earnings compound annually; the cash distribution's 8% earnings are taxed at 31% annually, resulting in a real return of 5.52%. The cash distribution reflects 20% tax withholding, 10% early distribution penalty and additional federal taxes at year end, leaving $59,000 to invest.*

part of your estate, which will help minimize your estate tax burden when you die.

2. **Testamentary gifts.** These gifts allow you access to IRA funds during your lifetime; at death, the remainder will pass to charity and 100% of the gift will qualify for both income and estate tax charitable deductions. As a result, in a large estate where more than 75% of the IRA value could be lost to double taxation, the real cost of giving away one IRA dollar to charity is effectively 25 cents.

In-Kind Rollovers

Like many corporate employees, you may hold highly appreciated shares of your employer's stock in your plan. These shares may have you feeling at a loss for what to do.

On the one hand, you may want to sell some or all of these shares to more evenly balance your retirement investments. But you can't do that within your existing plan and you don't want to take a lump-sum distribution. The taxes you will owe coupled with the early withdrawal penalties could leave you facing a steep tax bill.

On the other hand, you may not want to sell these shares at all because you believe they still have significant appreciation possibilities.

Fortunately, many IRAs can accept in-kind distributions from a qualified retirement plan as part of a rollover. This means that rather than selling the securities and rolling over the proceeds, you are able to transfer the shares themselves.

If you feel your IRA is too heavily invested in your former employer's securities, you can sell a portion (or all) of those securities within your plan and diversify into other holdings after you complete the rollover. And because transactions within the IRA are tax-free, you can continue to take advantage of tax-deferred growth.

An in-kind rollover is even more beneficial if you want to continue holding these shares. Because you are transferring the stock certificates, you don't have to be out of the market during the transfer. This allows you to continue to reap the benefits of future appreciation along with tax-deferred growth and compounding.

However, before you do an in-kind rollover, check with your tax professional. There are times when it may be advantageous to receive your former employer's stock and not roll it over into an IRA, especially if the stock was purchased at a low price and is now highly appreciated.

Know Your Options to Maximize Planning Efforts

Being aware of all your options can enhance your retirement planning efforts and allow you to take advantage of tax deferrals that can maximize your retirement dollars.

If you have money in a former employer's retirement plan and have questions about the advantages of rolling over those funds into an IRA, please call us. Our retirement planning professionals would be happy to work with you and your professional advisor on your specific situation.