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Rollovers from Employer-Sponsored Retirement Plans

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In general

A rollover is generally a transfer of assets from a retirement plan maintained by your former employer (it may be possible to roll over certain in-service distributions from an existing employer's profit-sharing plan as well). Rollovers from an employer-sponsored retirement plan can take one of four forms:

1. A transfer from your old retirement plan directly to an IRA trustee (this is a type of direct rollover)
2. A transfer from your old retirement plan to you, and then, within 60 days, from you to an IRA trustee (this is a type of indirect rollover)
3. A transfer from your old retirement plan directly to the trustee of the retirement plan at a new employer (this is a type of direct rollover)
4. A transfer from your old retirement plan to you, and then from you to the trustee of a retirement plan at a new employer (this is a type of indirect rollover)

Generally, rollovers come from defined contribution plans. A defined contribution plan is a retirement plan in which contributions are based on a set formula (e.g., a percentage of the employee's pretax compensation), while the payout is based on total contributions and investment performance. The 401(k) plan is the most common type of defined contribution plan.

If a rollover is done properly and all rules are followed, there will be no taxes or penalties imposed on the retirement plan distribution. In addition, a rollover encourages retirement savings by allowing you to continue tax-deferred growth of the funds in the IRA or new plan. When you are eligible for a rollover from your plan, the plan administrator must send you a timely notice explaining your options, the rollover rules, and related tax issues.

Which plans allow rollovers?

An employer-sponsored retirement plan generally must allow direct rollovers to be made from the plan, but does not have to allow rollovers to be made into the plan. You are generally able to roll over funds between qualified retirement plans, Section 403(b) plans, 457 plans (there are rollover restrictions on Section 457 plans maintained by nongovernmental tax-exempt organizations), and traditional IRAs.

Caution: You generally can't roll over funds from an employer-sponsored retirement plan into a Roth IRA or a SIMPLE IRA. Special rules apply with regard to the 10 percent premature distribution penalty when rolling over funds into a Section 457 plan. Special rules also apply to the rollover of any after-tax dollars in an employer-sponsored retirement plan.

Tip: For distributions after December 31, 2007, the Pension Protection Act of 2006 allows direct rollovers from tax-qualified retirement plans, tax-sheltered annuities, and governmental 457(b) plans to Roth IRAs, subject to the present law rules that generally apply to rollovers from traditional IRAs to Roth IRAs. For example, a rollover from an employer-sponsored retirement plan to a Roth IRA is includable in gross income (except to the extent it represents a return of after-tax contributions), and the 10-percent early distribution tax doesn't apply. Similarly, an individual with AGI of \$100,000 or more can't make a direct rollover to a Roth IRA. (Note: the \$100,000 income limit is repealed by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) after 2009.)

Tip: Special rules apply to Roth 401(k) and Roth 403(b) plans. In general, distributions from Roth 401(k) and Roth 403(b) accounts can be rolled over to a Roth IRA, or to other Roth 401(k) and Roth

403(b) plans that accept rollovers.

What can be rolled over and what cannot be?

Rollovers consist of eligible distributions made to you from your vested interest in an employer-sponsored retirement plan. In addition, your spouse may need to consent to a rollover in writing. To find out about additional restrictions your plan may impose on rollovers, consult your plan administrator. You may not be able to roll over the entire balance in your retirement plan account. Rollovers cannot include:

- Required minimum distributions (to be taken after you reach age 70½ or, in some cases, after you retire)
- Amounts that would not be included in your gross income, such as after-tax contributions made by you (however, after-tax contributions can be directly rolled over from one qualified plan to another if the new plan separately keeps track of after-tax contributions and their earnings, and after-tax contributions can generally be rolled over from a qualified retirement plan to an IRA or to a 403(b) plan)
- Amounts that are required to be taken as substantially equal payments over 10 or more years, over your life expectancy as the plan participant, or over the joint life expectancy of you and your beneficiary
- Hardship withdrawals
- Retirement plan loans that are taxable because they exceed the allowable loan limit
- Life insurance coverage costs
- Dividends on employer stock
- Corrective distributions of excess 401(k) plan contributions and deferrals

Caution: If you roll over any part of a lump-sum distribution, the remaining part cannot qualify for the special 10-year averaging or the special capital gains treatment that is available in some cases. For more information, see Lump-Sum Distributions from Employer-Sponsored Retirement Plans.

Caution: If your retirement plan distribution includes assets other than cash (such as employer securities), your IRA trustee or the new plan trustee may not accept those assets as part of a rollover. If you sell the assets and roll over the proceeds to a traditional IRA within 60 days of receiving a distribution, it is considered a nontaxable rollover. Consult a tax advisor for further details.

Caution: Certain withdrawals that are considered qualified hurricane distributions can be recontributed to an eligible plan within a three-year period. See Special Hurricane Katrina, Rita, and Wilma Distribution Provisions. Similarly, certain withdrawals that are considered qualified reservist distributions can be recontributed to an IRA within a two-year period. See The Pension Protection Act of 2006.

Are partial rollovers permitted?

Yes. However, only the portion that is rolled over qualifies as an income-tax-free transfer of funds. The remainder that is distributed to you is treated as a taxable distribution, subject to federal (and possibly state) income tax and perhaps a premature distribution tax if you are under age 59½. For more information on the penalty, see Premature Distribution Rule.

Direct rollovers vs. indirect rollovers

Once you decide to roll over your retirement plan assets, you need to decide how the transfer will be made. Rollovers can be direct rollovers or indirect rollovers. The distinction is important because indirect rollovers can cost you a lot of money in some cases. A direct rollover is usually a better option.

Direct rollovers

Generally, you will want to arrange for a direct rollover rather than an indirect rollover when your retirement plan assets are moving to either another employer's retirement plan or an IRA.

As the name suggests, a direct rollover involves arranging for the transfer of your retirement plan assets directly from the old plan trustee to either:

- The trustee of a retirement plan maintained by a new employer
- The trustee of a new or existing IRA in your name

With a direct rollover, you never actually take receipt of the retirement plan funds. The funds go directly from the old plan trustee to the trustee of the IRA or new plan. For this reason, a direct rollover is often referred to as a trustee-to-trustee transfer. Direct rollovers have fewer tax complications, and you are not limited to moving the funds once a year (as is the case with indirect rollovers).

Indirect rollovers

With an indirect rollover, the trustee of your old retirement plan distributes the funds to you, and then you transfer them to the trustee of your IRA or to the trustee of another employer-sponsored retirement plan. There are some complications and potential pitfalls with indirect rollovers. In general, it is best to avoid indirect rollovers and utilize direct rollovers instead.

First, with an indirect rollover, the administrator of your old plan must withhold 20 percent of the distribution to you for federal income tax. This withholding requirement exists because the IRS is concerned that you may take the money as a taxable distribution rather than complete a timely, tax-free rollover to an IRA or another plan. Because of this possibility, the IRS simply assumes that the distribution will be a taxable distribution, not a tax-free rollover.

Here is the problem with the mandatory tax withholding for indirect rollovers: In order to complete a tax-free rollover, you must roll over 100 percent of the amount distributed to you from your old plan. This means that you need to have additional funds available to replace the 20 percent withheld at the time of distribution.

Tip: You will eventually get the 20 percent back as a credit for federal income tax withheld when you file your income tax return the following year.

Caution: If you do not make up the 20 percent with additional funds, the 20 percent withheld will actually be considered a taxable distribution. If you fail to complete the rollover within 60 days, the entire distribution may be treated as a taxable distribution. Further, if you are under age 59½ and do not qualify for an exception, you will be subject to a 10 percent federal premature distribution tax (and perhaps a state penalty, too).

Example(s): Carol's vested balance in her former employer's plan is \$100,000. Instead of arranging a direct rollover of funds from her old plan to her new employer's plan, Carol decides to do the rollover herself. Since it is an indirect rollover, her old plan administrator withholds 20 percent (\$20,000) for federal income tax. Carol receives a check for \$80,000. However, she must roll over \$100,000 (the entire balance of her old plan account) to avoid tax consequences. This means that Carol has to use \$20,000 of her own funds to make up the difference. Otherwise, if she rolls over only \$80,000, she will be subject to income tax (and perhaps penalties) on the \$20,000 shortfall.

With an indirect rollover, you may end up paying income tax (and perhaps penalties) on the entire distribution to be rolled over unless you roll over the amount of the plan distribution within 60 days (beginning with the date you received the funds) to a traditional IRA or another employer's plan.

The only real benefit of an indirect rollover is that you have the equivalent of a 60-day "loan" from your retirement plan. But there is always the danger of missing the 60-day deadline and becoming subject to income tax (and perhaps penalties) on the distribution. By using a direct rollover, you generally avoid this risk because the money never enters your hands. In addition, direct rollovers are not subject to the federal withholding requirement that applies to indirect rollovers.

Tip: The IRS is authorized to grant waivers on the 60-day rule in cases of "equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to this requirement." Consult a tax advisor for further guidance.

Conduit IRAs

In general

You may need to do a rollover from your old employer's plan to an IRA as an interim step. Your new employer's plan may accept rollovers from an IRA, but not from a former employer's plan. Or, you may be in between jobs and not have a new employer's plan in place to accept a rollover from your old plan. In either instance, a rollover to a conduit IRA may be the answer for you.

A conduit IRA is not technically a specific type of IRA. It is a traditional IRA that is being used for a specific purpose--as the term "conduit" suggests, to temporarily hold funds that you have rolled over from a former employer's retirement plan. With the funds in a conduit IRA, you may have the opportunity to roll over those funds to another employer's plan at a later date. If this opportunity never arises or you prefer to have the funds in an IRA, you can simply leave them in the conduit IRA.

A rollover to a conduit IRA can be done as a direct rollover or an indirect rollover, just as with rollovers to other employers' retirement plans. Remember, if you do an indirect rollover, 20 percent of the distributed amount will be withheld for federal income tax. Should you fail to complete the rollover within 60 days of receiving the distribution, you will be subject to income tax and perhaps penalties on all or part of the distribution.

The 2001 Tax Act and conduit IRAs

Prior to 2002, a conduit IRA had a special restriction--it could only contain funds rolled over from an employer-sponsored retirement plan, and the investment earnings on those funds. You were not allowed to commingle those rolled over funds with regular IRA contributions and their earnings. If you violated this rule, you lost the right to later move the rolled over funds and their earnings from the conduit IRA to another employer's retirement plan.

As part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Congress passed provisions to make it easier to roll over funds between IRAs and different types of employer-sponsored retirement plans. For distributions received after December 31, 2001, the benefits from a qualified retirement plan, a 403(b) tax-sheltered annuity, or a Section 457 plan generally may be rolled over to any such plan. (The expanded rollover rules do not apply to Section 457 plans maintained by certain tax-exempt organizations.) Also, after December 31, 2001, any pretax funds in an IRA may be rolled over from the IRA to a qualified plan, regardless of whether the IRA is a conduit IRA.

Caution: Generally, nondeductible (after-tax) contributions in an IRA may not be rolled over from the IRA to a qualified plan. IRA funds may be rolled over to a qualified plan only to the extent that those funds include tax-deductible (pretax) contributions and investment earnings. However, direct rollovers (but not indirect rollovers) of after-tax contributions from one qualified plan to another qualified plan, or to a 403(b) plan, are permitted if the new plan separately keeps track of after-tax contributions and subsequent earnings.

These new rules provide increased flexibility for those who roll over plan funds to an IRA. Now that any pretax

IRA funds can be rolled over to a qualified plan, it is no longer as critical to have a separate conduit IRA for funds rolled over from an employer's plan. You can commingle your rolled over funds with your regular IRA funds in the same IRA, and still be able to later roll over your pretax funds from that IRA to a new employer's qualified plan if you want. However, there are still cases where maintaining a separate conduit IRA may be advisable.

Caution: Certain lump-sum distributions from an employer-sponsored retirement plan (but not from an IRA) qualify for special income tax benefits. The benefits may include 10-year averaging (for participants born before 1936) and capital gains treatment (for distributions attributable to pre-1974 participation in an employer plan). See Lump-Sum Distributions from Employer-Sponsored Retirement Plans. If you want to preserve the possibility of these income tax benefits, you may need to maintain a separate conduit IRA for your plan funds until you complete a rollover to another employer's retirement plan. Consult a tax professional.

Advantages of doing a rollover

A rollover is not a taxable distribution

A properly completed rollover (direct or indirect) is a tax-free transfer of assets, not a taxable distribution. This means that if you complete the rollover within 60 days of receiving the distribution and follow other federal rollover rules, you will not be subject to income tax or early withdrawal penalties on the money. You will not have to pay federal or state income tax on the money until you begin taking taxable distributions from the IRA or new plan. By that time, you may be retired and in a lower income tax bracket. Also, if you are 59½ or older when you take distributions, you will not have to worry about premature distribution penalties.

A rollover allows continued tax-deferred growth

When you do a rollover, you are simply moving your retirement money from one tax-favored savings vehicle to another. This allows the money to continue growing tax deferred in the IRA or new plan, with little or no interruption. Tax-deferred growth allows your retirement money to potentially grow more rapidly than it might outside an IRA or retirement plan. To understand why, consider the power of compounding. As your IRA or plan investments earn money, those earnings compound on top of your principal and any earnings that have already accrued. As this is happening, no tax is due while the funds remain in the IRA or plan. Depending on investment performance, the long-term effect on your savings can be dramatic. In most cases, this benefit is lost if you receive a distribution from your employer's plan and do not roll it over.

A rollover may be an option every time you leave a job

You may be able to roll over your vested benefits in a former employer's retirement plan every time you leave a job (whether voluntarily or involuntarily). You generally have the option of rolling over benefits from an old employer's plan to a new or existing traditional IRA (but not a Roth IRA). In addition, if you join another employer's retirement plan and the plan accepts rollovers, you can roll over your benefits from the old plan to the new plan. There is no limit on the number of rollovers from an employer-sponsored retirement plan you can do, which is an advantage for those who change jobs frequently.

Disadvantages of doing a rollover

You cannot revoke a rollover election

Once you have elected in writing to roll over your retirement plan benefits to an IRA or another plan and received payment, you typically cannot change your mind and revoke the election. If you do try to revoke it, you will generally be subject to income tax and penalties on all or part of the distribution. Before you elect the rollover option, be absolutely certain that this is what you want.

You cannot roll over certain amounts

As mentioned, you generally may not roll over any distribution that is not includible in your taxable income (direct rollovers of after-tax contributions from one qualified plan to another qualified plan and to a traditional IRA are

permitted in some cases). Also, you cannot roll over amounts to be taken as required minimum distributions or as substantially equal payments.

An indirect rollover can be costly

If you are considering an indirect rollover, bear in mind the 20 percent mandatory withholding requirement. To complete the rollover, you must make up the 20 percent out of your own funds, or be subject to income tax and possibly penalties on the shortfall. This can be a problem if you do not have cash available to replace the 20 percent. Also, with an indirect rollover, you generally have only 60 days to complete the rollover. The 60-day period begins with the date on which you receive the distribution from the former employer's retirement plan. If you fail to complete the rollover within this time frame, all or part of the distribution to you will be taxable and perhaps penalized.

Loss of lump sum averaging and capital gain treatment

If you roll over all or part of a distribution from a qualified employer retirement plan into an IRA, neither that distribution, nor any future lump sum distribution you receive from the qualified plan, will be eligible for special 10-year averaging or capital gains treatment. See Lump Sum Distributions from Employer-Sponsored Retirement Plans.

Is it better to roll over to an IRA or to another employer's plan?

One of the most common questions people ask is: Should I roll over my retirement money to an IRA or to another employer's retirement plan? Assuming both options are available to you, there is no right or wrong answer to this question. There are strong arguments to be made on both sides. You need to weigh all of the factors, and make a decision based on your own needs and priorities. It is best to have a professional assist you with this, since the decision you make may have significant consequences--both now and in the future.

Reasons to roll over to an IRA

- You generally have more investment choices with an IRA than with an employer's plan. You typically may freely move your money around to the various investments offered by your IRA trustee, and you may divide up your balance among as many of those investments as you want. By contrast, employer-sponsored plans typically give you a limited menu of investments (usually mutual funds) from which to choose.
- You can freely move your IRA dollars among different IRA trustees/custodians. Unlike indirect rollovers, there is no limit on how many direct, trustee-to-trustee IRA transfers you can do in a year. This gives you flexibility to change trustees often if you are dissatisfied with investment performance or customer service. It can also allow you to have IRA accounts with more than one institution for added diversification. With an employer's plan, you cannot move the funds to a different trustee unless you leave your job and roll over the funds.
- An IRA may give you more flexibility with distributions. With some employer-sponsored plans, if you are married and your spouse does not sign a waiver, the usual form of distribution is a joint and survivor annuity (see Periodic Payments from Employer-Sponsored Retirement Plans). With an IRA, the timing and amount of distributions is generally at your discretion (until you reach age 70½ and must start taking required minimum distributions).
- You will not be "cashed out" of an IRA if you have a small balance. By contrast, some employer-sponsored plans may cash you out prior to the plan's normal retirement age if your vested benefits are \$5,000 or less. Until your vested benefits are over \$5,000, there is a risk that a new employer's plan could cash you out if you leave employment. If cashed out, the funds would have to be either rolled over to an IRA or taken as a taxable distribution.

Reasons to roll over to another employer's retirement plan

- Many employer-sponsored plans have loan provisions. If you roll over your retirement funds to a new employer's plan that permits loans, you can generally borrow against your vested balance in the new plan if you need money (see Loans from Employer-Sponsored Retirement Plans). You cannot borrow from an IRA--you can only access the money in an IRA by taking a distribution, which may be subject to income tax and penalties.
- Under provisions of the Employee Retirement Income Security Act (ERISA), funds held in a qualified employer-sponsored plan receive unlimited creditor protection. Your creditors generally cannot attach your plan funds to satisfy your debts and obligations. IRAs are generally treated less favorably. Federal law provides protection for up to \$1,095,000 (as of 4/1/07) (and in some cases more) of your aggregate Roth and traditional IRA assets if you declare bankruptcy. Any additional bankruptcy protection, and protection from the claims of your creditors in cases outside of bankruptcy, will depend on the laws of your particular state.
- Employer-sponsored retirement plans usually impose lower administrative costs and investment fees (e.g., minimum fees) on investors than IRAs.
- You may be able to postpone required minimum distributions. These distributions usually must begin by April 1 following the year you reach age 70½. However, if you work past that age and are still participating in your employer's retirement plan, you can delay your first distribution from that plan until April 1 following the year of your retirement. (You also must own no more than 5 percent of the company.) This deferral exception is not available for IRAs.
- You may prefer the investment options of an employer's plan. The choices and flexibility that IRAs provide can be a benefit for some people, but a drawback for others. If you lack investment knowledge and experience, you may make poor decisions when left to your own judgment. In this case, you may welcome the limited investment selection (and investment advice, in some cases) that many employer-sponsored plans offer.

How to do a rollover

In general

There are seven steps that you should follow to complete a rollover:

1. If rolling over to another employer's plan, check with the new plan administrator to make sure the plan accepts rollovers.
2. Consult your tax advisor before selecting a rollover to make sure this is the right option for you. Rollovers can have a long-term impact on your retirement planning, as well as your tax liabilities.
3. Review the notice from your old plan administrator explaining the rollover rules, the direct rollover option, the consequences of an indirect rollover, the withholding rules, and the possible reduction or deferral of taxes.
4. Decide whether you want to do a direct rollover or an indirect rollover. Then, make the necessary arrangements with your old plan administrator, and either the new plan administrator or the IRA custodian/trustee.
5. Obtain your spouse's consent, if required. Some plans require written spousal consent.

6. Make sure that a check (made out properly, and in the correct amount) is sent from your old employer's plan to the new employer's plan, the IRA custodian, or you personally, depending upon the method of distribution you selected.
7. If you receive the funds personally, make sure that you roll over those funds within 60 days to an IRA or another employer's plan to avoid taxes and penalties. In general, you should avoid a distribution directly to you in order to avoid the 20 percent federal withholding requirement.

Types of rollovers: how to do it

How you accomplish a rollover depends upon the type of rollover you want to do.

Direct Rollover: Qualified Plan to Qualified Plan	You usually need to complete paperwork with the existing plan, indicating that a direct rollover is to be made and providing the name of the receiving plan administrator. The check must be made out to the trustee of the new plan, or to the new trustee for the benefit of you as the participant. If it's not, don't endorse it or deposit it. Have a new check prepared with the correct payee.
Direct Rollover: Qualified Plan to traditional IRA	You would fill out forms with the existing plan trustee, indicating that you want a direct rollover and naming the IRA custodian. You would also fill out forms with the IRA custodian. The check from your old plan must be made out to the IRA custodian, or to the new IRA custodian for the benefit of you as the participant. If it is not, do not endorse it or deposit it.
Direct Rollover: Conduit IRA to Qualified Plan	You would fill out paperwork with the new plan trustee to be sent to the old IRA custodian. The IRA custodian may also require that you fill out a form.
Indirect Rollover: Qualified Plan to Qualified Plan Qualified Plan to traditional IRA Conduit IRA to Qualified Plan	This type of rollover should generally be avoided because you must make up the 20 percent mandatory withholding or be taxed, and perhaps penalized, on that 20 percent. (There is no mandatory withholding on funds coming out of an IRA.)

Income tax consequences of doing a rollover

As discussed, a timely and properly completed rollover is treated as a tax-free transfer of retirement assets. However, if the rollover is not completed within 60 days, the portion of the distribution that is not rolled over will generally be treated as taxable income to you (excluding any after-tax contributions you made to your plan). In addition, if you are under age 59½ and do not qualify for an exception, you may be subject to a 10 percent federal premature distribution penalty tax on the distribution (and possibly a state penalty as well).

Estate and gift tax consequences of doing a rollover

Any amounts remaining in your retirement plans and IRAs at the time of your death are treated like the rest of your assets for federal estate tax (and possibly state death tax) purposes--they are included in your taxable estate to determine if estate tax is due.

Qualified plan automatic rollover rule

Qualified retirement plans, Section 403(b) plans, and governmental 457(b) plans often contain a provision that requires the mandatory cash out of small benefits--generally vested benefits with a present value of \$5,000 or less--when an employee terminates employment before attaining the plan's normal retirement age. For distributions of more than \$1,000 made on or after March 28, 2005, plans must pay these mandatory distributions into an IRA established for the employee, unless the employee affirmatively elects to receive the payment in cash, or to roll it over into a different IRA or employer retirement plan. The rule doesn't apply to distributions to beneficiaries or alternate payees, to plan loan offset amounts, or to distributions that don't qualify as eligible rollover distributions.

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