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What To Do with Your 401(k) When You Leave Your Job

Understand Your Options

No matter where you are in your career journey, proactive planning can have a major impact on your financial future, possibly even setting the stage for an earlier retirement.

Most employees have access to an employer-sponsored retirement plan, often a 401(k).[i] At some point, either because you start a new job, retire or adjust your financial plan, you may need (or want) to distribute your retirement assets into another retirement account. **This is known as a rollover.**

We often help clients prepare and make informed decisions about what to do with their 401(k) rollovers. If you're wondering what to do with yours, it's likely that you'll have the following options outlined below. We've listed out some of the pros and cons associated with each.

ROLLOVER OPTIONS

1. **Roll into a new 401(k).** If you are switching jobs and your new employer offers a 401(k), you can roll your assets directly into that plan.

   PROS: The transfer will not generate any tax liabilities, and you will continue to defer taxes on any gains generated in the account. This may also be an attractive option if you prefer to have all your retirement assets in one consolidated vehicle.

   CONS: When enrolling in a 401(k), your employer's plan dictates your investment choices. All plans are not created equal — do your due diligence, reviewing the new plan's investment options, fees and enrollment period.

TIP: If there is lag time associated with your new employer's enrollment period, you can temporarily keep your 401(k) intact with your previous employer. Note some exceptions may apply, and you will not be able to make new contributions to the plan during this period. Also, regardless of whether you transfer your existing retirement assets into your new employer's plan, check to see if there is a matching program (i.e., your employer matches a certain percentage of your contributions with additional contributions to your account). A matching program provides a strong incentive to participate in the new plan.

2. **Roll into an individual retirement account (IRA).** If you don't have access to a new 401(k) plan or are looking for a tax-advantaged retirement account that offers more investment choices, an IRA may be the right choice. You can open an IRA through a wide variety of financial services companies, including banks, brokerages and insurance companies.

   PROS: The transfer will not generate any tax liabilities, and you will continue to defer taxes on any gains generated in the account. IRAs also offer increased freedom and flexibility in making investment decisions.

   CONS: If you have access to a new 401(k) plan you may miss out on the option to take a loan from your account, a feature that many employer-sponsored plans provide. Also, if you participate in your new employer's plan, you may find it a bit more cumbersome to track two accounts rather than the one that would have resulted from rolling over your assets into your new employer's plan.

TIP: You may find that the greater investment flexibility offered by an IRA makes investment decisions more complicated. Consult with a financial advisor to help make the right choices for your unique profile (e.g., age, desired retirement age, financial goals, risk tolerance, etc.).

3. **Roll into a Roth IRA.** A Roth IRA is a retirement savings vehicle that differs from most retirement savings accounts in that contributions are made with after-tax dollars, and withdrawals are tax exempt, assuming certain requirements are met. The inverse is generally true for the already-mentioned traditional IRAs: Qualified contributions are tax deductible, but withdrawals count toward taxable income.

   PROS: Withdrawals after the age of 73 are not mandatory, which they are for traditional IRAs. Also, penalty-free withdrawals can be made under a wider set of circumstances, including if they come from contributions you have made rather than earnings on your contributions.

   CONS: You will have to pay taxes on the rollover amount upon conversion to compensate for taxes that have already been deferred. Also, the same potential cons apply as if you were to choose to roll over into a traditional IRA: if relevant, missing out on the option to take a loan, and being a bit more cumbersome to track two accounts rather than one.

TIP: If you're young and likely to be in a higher tax bracket when you retire, a Roth IRA may be an attractive option. But deciding between a Roth IRA and other retirement account types can be difficult without perfect foresight into the future; sometimes the answer is "both." Talk to a financial advisor to help guide your decision.

4. **Opt for an indirect rollover.** This can be accomplished by withdrawing the funds from your 401(k) and personally depositing those funds into a new retirement account. In this case, your employer will give you a check for the value of your account, minus 20 percent withholding. If you complete the full rollover within the time limit, the withholding will be returned to you when you file your annual tax return.[ii]

   PROS: An indirect rollover can serve the purpose of a short-term loan.

   CONS: Early withdrawal penalties will apply if the loan is not paid back within a 60-day period, and pretax contributions will be considered taxable.

> **TIP:** Be careful, and use this only if you don't have any better options for your short-term cash needs. If not executed properly, you may face significant financial consequences; you could owe both income taxes and an early withdrawal penalty.

Last Resort: Cashing Out

You also have the option to cash out of your account — i.e., request a check or wire paid to you for the value of your account (less any tax withholdings) — but this should be avoided unless your need for cash is so dire that you've ruled out all other options. You will likely face additional income taxes and an early withdrawal penalty.

YOU DON'T HAVE TO GO IT ALONE

If you are saving and investing, you are headed down the right path for financial success. But selecting the best account types, investments and other financial strategies can be confusing — not only despite, but because of an abundance of online information and viewpoints.

We're here to help. Our team of professionals is knowledgeable and has your best interests at heart. Reach out to us to explore your options and make a plan for your rollover today.

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[i] U.S. Bureau of Labor Statistics, "67 percent of private industry workers had access to retirement plans in 2020," March 1, 2021, https://www.bls.gov/opub/ted/2021/67-percent-of-private-industry-workers-had-access-to-retirement-plans-in-2020.htm. Accessed February 28, 2023.

[ii] Internal Revenue Service, "Rollovers of Retirement Plan and IRA Distributions," https://www.irs.gov/retirement-plans/plan-participant-employee/rollovers-of-retirement-plan-and-ira-distributions. Accessed February 28, 2023.