

BUSINESS

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Avoid foolish, costly moves with retirement accounts

WORKERS today are unlikely to remain with one employer throughout a career. Many will be confronted from time to time with the decision of what to do with a 401(k) or other retirement account when switching jobs.

The choices are simple: They may be able to keep the account where it is, or transfer it to a new employer's plan.

Or, they can roll the money over into an individual retirement account, or just pocket the cash.

As easy as it sounds, workers need to tread with care. Whatever they decide will have an impact on their retirement. And even those with the best intentions of preserving a nest egg could unintentionally trigger taxes and penalties, financial experts said.

So, for those jumping jobs,



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here are options to consider and pitfalls to avoid:

Cashing out

One of the worst errors workers can make is cashing out a retirement account when leaving a job, said Douglas Robinson, a financial planner in Bel Air.

It's not just that employees will have to pay regular income tax on the money, and that younger workers also will be hit with a 10 [See Ambrose, 4D]

Direct transfer usually best for moving 401(k) money

[Ambrose, from Page 1b]

percent penalty for early withdrawals, Robinson said. More serious, he said, is these workers are jeopardizing their retirement.

"One of the biggest challenges we face as younger Americans going forward is saving for retirement," he said. "Without a pension, all you have is Social Security and your 401(k) plan."

But plenty of workers opt to take the cash, especially when balances are small.

A Hewitt Associates survey released last year found that 42 percent of 160,000 workers leaving their jobs cashed out their 401(k)s. Among those with balances of \$5,000 to \$10,000, nearly three-quarters took the cash.

If workers need convincing to roll over a 401(k) into another retirement account, consider this scenario:

Cashing out a \$20,000 account would leave a worker with \$12,250, once taxes and penalties are paid, said Stuart Ritter, a financial planner with T. Rowe Price Associates in Baltimore. But if that \$20,000 was rolled into an IRA and grows at an annual rate of 8 percent for 35 years, the worker would reap \$227,000 after taxes, he said.

Congress, concerned about employees depleting nest eggs, also changed the tax law in 2001 to make it easier for job hoppers to leave money in retirement accounts.

Workers now can roll their old retirement account into a new employer's plan, even if it's a different kind, as long as the new plan permits such transfers. For example, a 401(k) account could be moved to a 403(b) plan.

Some employers used to automatically cash out smaller accounts belonging to former employees. Now, employees can elect to keep their account with their old employer, provided the balance is more than \$5,000.

Another tax change seeks to protect smaller balances of \$1,000 to \$5,000 from being cashed out. Employers that typically cash out small accounts will be required to roll them over to an IRA when workers leave the job without saying what should be done with the money. Regulations related to this



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Cashing out a retirement account when leaving a job is usually a big mistake, says Bel Air financial planner Douglas Robinson.

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change are being drawn up by the Department of Labor and could take effect next year.

IRA rollovers

Financial planners generally advise workers to roll their accounts into an IRA, where the money can continue growing tax-deferred and investment choices are much broader than in the typical 401(k).

Also, frequent job changers can end up with several retirement accounts, and consolidating them into a single IRA makes it easier to manage a portfolio, Robinson said.

Transferring money out of one retirement account to another should be easy, but terminology can cause confusion and some unintended consequences, said Ed Slott, an IRA expert and author of *The Retirement Savings Time Bomb and How to Defuse It*.

The simplest way — and the best for avoiding problems — is asking for a "trustee-to-trustee transfer" or a "direct transfer," where money goes from one account directly to the financial institution holding the new IRA account, Slott said. That way the transfer is immediate, and there's no chance that the money will get into the hands of the worker and be mistakenly construed as a final distribution, he said.

Some employers, though, don't do direct transfers but will make out a check to whomever the worker designates, Slott added.

If that's the case, make sure the check is made out to the new IRA, he advised.

Avoid having the check made payable to you. If the check is in your name, you will have to follow rollover rules, such as depositing the check in an IRA within 60 days.

Failure to do so could trigger the same taxes and penalties as if you cashed out the account.

There's another reason for not having the check in your name when money comes from a 401(k) or similar plan: Employers must withhold 20 percent of the amount for taxes.

So, essentially, a worker with a \$100,000 account would receive a check for \$80,000. Workers would get the \$20,000 in a refund after filing their tax returns, Robinson said.

But under rollover rules, workers must deposit the full \$100,000 in the IRA with 60 days. If they don't have \$20,000 handy to make up the shortfall, it will be assumed that they took a distribution, and would owe taxes and penalties on the \$20,000.

Bottom line: Avoid the headaches, and do a direct transfer to an IRA or have the check made out to the IRA custodian.

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