

# Qualified Plans

## Rollovers & Direct Rollovers

*401(k)-to-traditional IRA*

*401(k)-to-Roth IRA*

*401(k)-to-Inherited traditional IRA*

*401(k)-to-Inherited Roth IRA*

Questions & Answers

Purpose. More and more participants of retirement plans are concerned with understanding their ability to roll over or directly roll over their 401(k) or other qualified plan funds to an IRA. The purpose of this brochure is to explain these rules. You may either be a plan participant or you may be a beneficiary of a plan participant.

This brochure does NOT discuss rolling over funds from an IRA to a qualified plan or other retirement plan and this brochure does not discuss rollover to an IRA from a section 403(b), section 457 or section 403(a) annuity plan.

## **What options does the law mandate I be given by the plan administrator?**

You must be given the following three (3) options when you are entitled to be paid your vested account balance. Some employers fail to offer the third option, but the law does require them to offer the option.

1. Directly roll over your entire vested account balance. The mandatory withholding rules (20%) do not apply.
2. Be paid your entire vested account balance. However, 20% generally will be withheld for federal income tax purposes.
3. You may have a portion directly rolled over and you may have a portion paid to you.

## **What form am I entitled to receive from my plan administrator?**

A plan administrator shall, before making a distribution that qualifies to be rolled over, provide a written explanation to the recipient (you the participant, your beneficiary or an alternate payee) —

1. of the provisions in the plan document under which the recipient may have the distribution directly transferred to another eligible plan.
2. of the provision in the plan document which requires the withholding of tax on the distribution if it is paid to you, the recipient (not directly transferred).
3. of the provisions of the federal tax law under which the distribution will not be subject to tax if rolled over to another eligible plan within 60 days after the date on which the recipient received the distribution.
4. if applicable, an explanation of 10-year averaging, and capital gain tax treatment.

After being furnished this information, you can decide whether to be paid these funds (and to have automatic withholding of 20%), to directly roll over the payment to another

eligible plan, or to have a portion paid to you with the remainder rolled over. The plan administrator can require that the amount to be directly rolled over be at least \$500. The plan administrator is also permitted to limit you to a single direct rollover for each eligible rollover distribution.

## **When must the plan administrator furnish me this special explanation?**

The plan administrator must provide you with this written explanation no earlier than 180 days and no later than 30 days before the distribution is made. However, you can choose to have a distribution made less than 30 days after the explanation is provided as long as both of the following requirements are met. First, you are given at least 30 days after the notice is provided to consider whether you want to elect a direct rollover. Second, you are given information that clearly states that you have this 30-day period to make the decision.

## **Warning**

The law generally requires that if you do not return your payment instruction form by the 30-day deadline and your vested account balance is \$5,000 or less, then the plan will establish an IRA for you and roll over your vested balance into this IRA.

## **What distributions are eligible to be rolled over or directly rolled over to an IRA?**

Generally, the distribution of any portion of your qualified plan will be eligible. However, some distributions do not qualify.

Required distributions are ineligible to be rolled over. You are also not eligible to roll over a life insurance contract distributed from a 401(k) or other qualified plan. You are also not eligible to roll over hardship distributions from 401(k) plans and certain 403(b) plans. Also, you are not eligible to roll over annuities paid over life, or life expectancy (single or joint) or any distribution which is one of a series of substantially equal periodic payments (i.e. installments) for a period spanning ten years or more.

## **What is a direct rollover?**

A "direct rollover" is a distribution from a pension plan that would be eligible to be rolled over, but is instead paid directly to another retirement plan, including a traditional IRA. The transaction must be executed for the benefit of the person entitled to receive the distribution from the pension plan.

A direct rollover may be accomplished by any reasonable means of direct payment to an eligible retirement plan. If payment is made by check, the check must be negotiable only by the trustee of the eligible retirement plan. For example, "ABC Bank as trustee of the IRA of Maria Evert," or the "Trustee of XYZ Corporation Profit Sharing Plan FBO Jim Davis." Payment should not be made by wire transfer. It is permissible that the plan furnish you with a check if you are instructed to deliver the check to the trustee, and the check is made payable, as indicated above, solely to the IRA custodian or trustee.

## **If I am paid funds from a retirement plan, how will I be taxed?**

The general rule is that the funds paid to you will be included in income and taxed at ordinary income tax rates. When the plan administrator submits Form 1099-R, he or she will inform the IRS of the gross distribution amount, taxable amount, amount of any withholding, and the reason code of the distribution. In some situations, lump-sum distributions from qualified plans will qualify for 10-year averaging, or capital gain treatment. In some situations, if you have not attained age 59½, you will owe an additional 10% tax.

## **What is a rollover?**

A rollover is an exception to the general rule that distributions are taxed. Even though you were paid funds, you will not have to include the amount received as gross income if the rules summarized in this brochure are met. These "rolled over" funds will not be taxed until a future taxable distribution occurs. Note that the movement of funds in a rollover is as follows: the original retirement plan pays the funds to the plan participant, who then redeposits these funds into another eligible plan, normally an IRA. This rollover deposit will be reported by the new IRA custodian/trustee on IRS Form 5498. The IRS will "match or compare" your rollover amount to the amount shown on Form 1099-R to determine if you have paid the proper taxes.

A recipient is only allowed to exclude a distribution from his or her gross income if the rollover is made within 60 days following the day of receipt. By doing so you will avoid current taxes which are the normal result when a distribution is taken. You will also avoid paying the 10% excise tax which would apply if you are not yet age 59½ (unless you are using the pre-age 59½ special exception).

These recontributed funds plus their earnings will continue to compound or grow tax-deferred until distribution com-

mences—by choice after age 59½, or as required after age 70½.

## **Am I eligible to roll over nontaxable amounts on or after January 1, 2002?**

Yes. You may be able to roll over the nontaxable part of a distribution (such as your after-tax contributions) made to another qualified retirement plan or traditional IRA. The transfer must be made either through a direct rollover to a qualified plan that separately accounts for the taxable and nontaxable parts of the rollover, or through a rollover to a traditional IRA.

If you roll over only part of a distribution that includes both taxable and nontaxable amounts, the amount you roll over is treated as coming first from the taxable part of the distribution.

The fact that you may roll over your after-tax contributions does not mean you should or must do so. You will need to decide if the ability to earn tax-deferred earnings on the after-tax contributions is worth the additional tax duties of applying the pro rata tax rules to future distributions.

You will want to talk with your tax advisor before completing the distribution form to Directly roll over your nontaxable account balance. This means when you receive your distribution form from your employer or plan administrator you will need to inform them you will be completing the form in the next couple days after you have talked with your tax advisor. You will want to do this because once you rollover your nontaxable funds from the plan to the IRA, you must live with this decision.

## **If my distribution qualifies to be rolled over, how do I elect to have the QP distribution paid directly to an IRA?**

Your plan administrator will furnish you with a form that will authorize the direct rollover to your IRA. If your plan administrator does not furnish you with this form, we can furnish you a form which will start the process.

## **What are the 20% withholding and direct rollover rules?**

The rules mandate that the plan administrator must withhold 20% of the amount of any distribution which is eligible to be rolled over.

The rules also provide that if the funds are directly rolled over to certain types of plans, then the withholding rules do not apply.

## **Might there be withholding at a rate other than 20%?**

Yes. The 20% withholding requirement does not apply to distributions that are not eligible rollover distributions. However, other withholding rules apply to these distributions. The rules that apply depend on whether the distribution is a periodic distribution or a nonperiodic distribution. For either of these distributions, you can still choose not to have tax withheld.

## **Might there not be any withholding?**

Yes. The payer does not have to withhold from an eligible rollover distribution paid to you in the following situations. The distribution and all previous eligible rollover distributions you received during your tax year from the same plan (or, at the payer's option, from all your employer's plans) total less than \$200. The distribution consists solely of employer securities, plus cash of \$200 or less in lieu of fractional shares.

## **What can be done if I originally had the employer withhold the 20% because I did not want to roll over the distribution, but now I do?**

You are still eligible to roll over the entire distribution amount as long as you complete the rollover within the 60-day time limit.

For example, if your vested account balance was \$10,000, and the plan administrator paid you \$8,000 (\$10,000 less \$2,000 of withholding), you are still eligible to roll over \$10,000. You will have to come up with the additional \$2,000 to roll over in addition to the \$8,000 you were paid. You then will claim the \$2,000 withheld as a credit on your tax return and, all other things being correct, it should be refunded to you.

## **What happens if, in the above situation, I roll over the \$8,000, but not the \$2,000?**

You will have to include in income the amount of \$2,000 and pay the appropriate tax amount. In addition, if you have not attained age 59½ and none of the exceptions apply, you will owe the 10% additional tax. A majority of the \$2,000 should be refunded to you.

## **How do I show my rollover or direct rollover on my tax return?**

Enter the total amount of the distribution on line 16a of Form 1040 or line 11a of Form 1040A. If the total amount of the dis-

tribution was rolled over, then enter "0" on line 16b of Form 1040 or line 11b of Form 1040A. Otherwise, enter the amount of the taxable portion of the amount not rolled over on line 16b of Form 1040 or line 11b of Form 1040A.

### **Is there any chance for special tax relief if I missed the 60-day requirement for some reason?**

Yes. The Economic Growth and Tax Relief Reconciliation Act of 2001 authorizes the IRS to waive the 60-day rollover period if the failure to do so would be "against equity or good conscience, including casualty, disaster or other events beyond the reasonable control of the person subject to the requirement."

### **What is the maximum amount which may be rolled over or directly rolled over to an IRA?**

You are able to roll over the entire account balance except to the extent the distribution is not eligible to be rolled over.

### **What is the minimum amount I must roll over?**

You do not have to roll over the entire distribution or any portion of it. You can roll over as much or as little as you want. Any taxable portion you do not roll over is taxable immediately and may be subject to the IRS' 10% excise tax for distributions prior to age 59½, unless a special exception applies.

### **May I roll over the same assets (cash and property) distributed to me?**

Yes. If you roll over the same assets distributed to you, you will qualify under the rollover rules.

### **Must I roll over the same assets distributed to me?**

No. You are entitled to sell the property and roll over the proceeds. However, you may not sell it to yourself (i.e. you cannot substitute your own funds for the property you received).

### **If I roll over the proceeds from the sale of the property, will I have to recognize any gain or loss?**

No. If you sell the distributed property and roll over all the proceeds into a traditional IRA, no gain or loss is recognized. The sale proceeds (including any increase in value) are treated as part of the distribution and are not included in your gross income.

## **May I convert or directly roll over funds from a 401(k) or other qualified plan to a Roth IRA?**

Such direct rollovers will be permissible after December 31, 2007. This movement of fund will result in you making a conversion contribution to your Roth IRA. You will include this amount in your taxable income as if you had received them. All of the standard Roth conversion tax rules must be met.

Your (and your spouse's, if applicable,) modified adjusted gross income must be \$100,000 or less. If you are married, you must file a joint return unless you have lived apart for the entire year.

## **If I am a former spouse of a 401(k) participant, am I entitled to roll over funds to an IRA?**

Yes. If you are the spouse or former spouse of an employee and you receive a distribution from a qualified employer plan as a result of divorce or similar proceedings, you may be able to roll over all or part of it into a traditional IRA. To qualify, the distribution must be: (1) One that would have been an eligible rollover distribution (defined earlier) if it had been made to the employee, and (2) Made under a qualified domestic relations order.

## **If I am a surviving spouse of a 401(k) participant, am I entitled to roll over funds to an IRA?**

Yes.

## **If I am a non-spouse beneficiary of a 401(k) participant, am I entitled to roll over funds to an inherited traditional IRA or Roth inherited IRA?**

Funds within a 401(k) may now either be "standard" 401(k) funds or they may be designated Roth IRA funds. The standard 401(k) funds can only be directly rolled over to an inherited traditional IRA. The designated Roth IRA funds can only be directly rolled over to an inherited Roth IRA. Any distribution to a beneficiary on or after January 1, 2007, is eligible, to be rolled over to an inherited traditional IRA or inherited Roth IRA, as long as the various plan documents authorize such a rollover.

*You are strongly advised to talk with your tax or legal advisor before taking any distribution from the 401(k) plan. The information provided in this brochure is not intended to be legal or tax advice. You should consult your attorney or tax advisor for information that relates to your specific circumstances.*

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