Unbiased Financial Information Provided by Financial Wisdom.

Handling Your First Retirement Plan Distribution When Changing Jobs

If you have participated in a company retirement plan like a 401(k) plan and change jobs, you will probably receive a distribution of the funds you have accumulated in your plan. The distributions are often called lump sum distributions. If you have participated for several years, the distribution could be quite substantial. Over the course of your working career, you may receive several lump sum distributions and what you do with those funds and how you handle the distribution is important.

While you may be tempted to just take the money and spend it, remember that there would be income taxes and probably an additional tax penalty. After all, the funds are for your retirement. By avoiding that temptation, you have the opportunity to build your wealth and make a large step forward on your path to a financially secure retirement.

Reviewing Your Options for a Retirement Plan Distribution

Before you officially leave the company, you will probably meet with someone from your Human Resources department to finalize the details of your termination. This will probably include discussing a final paycheck, determining any unused vacation or sick days and your options for taking a distribution of your retirement plan account. It can take 30 to 90 days to finalize the distribution, but there are decisions you must make at that time and when you finally receive the distribution check.

1. Do you want to pay tax on the distribution now or have it remain tax-deferred?
2. Do you want to leave your funds with your prior employer's plan, move them it to your new employer's plan or transfer them to an IRA?
3. How do you want the money invested?

If you have been a participant in a plan for a long time and have accumulated a large sum of money, these decisions can have a very large impact on your financial future and that of your family. Considering the decisions carefully is critical. Be sure you fully understand your options and get professional help if you need it.

Pay taxes or not

While your funds were within the qualified plan, any earnings were tax deferred. When you receive the distribution, you have 60 days to roll over your funds to your new employer’s plan (if allowed) or into an Individual Retirement Account. If you don’t act within 60 days, your distribution will be subject to regular income taxes and an additional 10% early withdrawal penalty tax if your are under the age of 59 ½.

Unless you absolutely need the money immediately, it is usually advisable to maintain the tax deferral status. When you receive the distribution check and if you plan to move it into an IRA or your new employer’s plan, make sure you do that quickly. If you do not get it deposited within 60 days, you will owe tax on it and a 10% penalty.

Where to keep your funds
To maintain tax deferral, the funds must stay in some form of qualified retirement account. Many retirement plans offer the opportunity to leave funds in the plan after employment termination. You may also be eligible to transfer the distribution to a new employer's plan. The third option is to transfer the funds to an IRA. The choice of where to have your money should be based on the amount of investment control you wish. An IRA probably provides the most flexibility, but also forces you to make more decisions. The costs of administration and asset management fees should also be considered.

Even if you are currently unsure of your long-term plans, you may want to have the funds transferred into an IRA. You can always make withdrawals later if you choose.

Investing your funds
Your retirement plan distribution may be the largest single sum of money you have received. The investment of those funds should be handled very carefully. Be sure to consider how these funds fit into your overall financial planning efforts.

Be sure to consider your time horizon and risk tolerance when making your investment decisions. If you transfer your distribution to your new employer's retirement plan, consider the investment options and choose appropriately. If you go the self-directed IRA route, most institutions offer accounts that enable you to choose stocks, bonds, mutual funds, money market funds and other investments.

Don't feel that you have to make all the investment decisions immediately. As long as the funds are within another qualified plan or IRA, there should be no taxes due and you can make informed and careful investment choices.

Conclusion
Receiving a lump sum distribution is a major financial event. The choices you make will affect your financial security for years to come. Be sure to evaluate all your options, seek guidance if needed and decide wisely. Your future financial security depends on it.