Retirement Plan

Update

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Because the time is now...

It's not a windfall, it's your savings

What happens to the money in your retirement plan account when you switch jobs? That's up to you. Typically, one of your options may be to take your savings in a single sum. Sounds like a windfall, right? Wrong. Here's why you should think long and hard about cashing out your retirement savings.

Less money now

Before you drain your account, make sure you understand how a cash-out works. You may be in for some surprises. The first one is that you won't get to keep the full amount. Since the money in your retirement savings account generally has not been taxed, you'll have to include the distribution when filing your federal (and possibly state) income tax return.[1]

Additional income means you'll owe additional federal (and possibly state) income tax. The retirement plan is required to withhold 20% to send to the IRS as a "down payment" of sorts on your overall federal income tax liability for the year. And the final surprise: You may also owe an additional 10% tax on the early withdrawal.[2]

Less money later, too

Not only will you get less when you cash out, but taking a distribution and spending it now or not reinvesting the money for retirement could also mean you could shortchange your future. Will you be able to rebuild your account balance? Even if it's still early in your career, taking a distribution, paying the taxes that apply, and spending what's left could make it harder to reach your retirement savings goals.

Keep the tax deferral going

Instead of cashing out, consider keeping your savings in a tax-deferred account. Here are the possible options:

- Leave your savings in your old employer's plan (if permitted).
- Roll over your money into your new employer's plan (assuming rollovers are accepted).
- Roll over your money into an individual retirement account (IRA).

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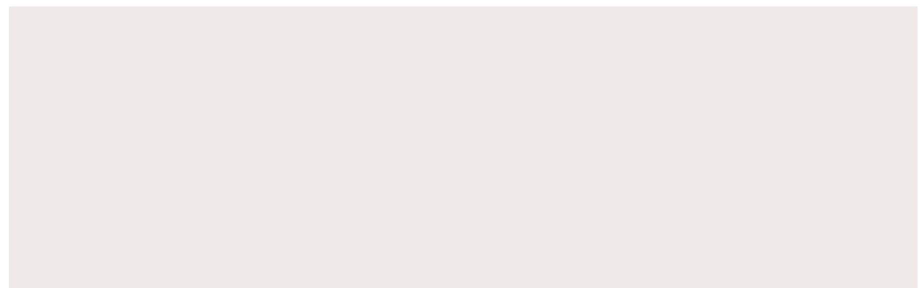

Rollover rules

Generally, the simplest way to handle a rollover is to have your savings transferred directly from your plan to the new tax-deferred account with a trustee-to-trustee transfer. Since the distribution isn't paid to you, no income taxes are due and no penalty applies.

Things can get complicated if you decide to take an eligible distribution and roll it over yourself. First, the rollover must be completed within 60 days. And the mandatory 20% income tax withholding applies. To complete the rollover, you'll have to replace that 20% with money from another source. If you don't replace it, the 20% is considered a taxable distribution (and the 10% additional tax may apply).

Some for you, some for the IRS

Here's what cashing out a $20,000 retirement plan account might look like.

Amount to cash out	$20,000
24% federal taxes	$4,800
10% early withdrawal penalty	$2,000
Cash remaining	$13,200

Source: DST Systems, Inc. This hypothetical example is for illustrative purposes only and assumes a federal income tax rate of 24%. Your tax rate may be different, and you may be eligible for an exception to the 10% additional tax on early withdrawals.

Continued savings

Ima Saver and her friend Al Spendit both had $15,000 in their retirement accounts when they changed jobs. Ima rolled over her balance into her new employer's plan and contributed $200 a month for the next 25 years. Al cashed out and started over. He also joined his new employer's plan and, like Ima, contributed $200 a month for 25 years. However, his balance never caught up. Even though they contributed the same amount and had identical earnings, Ima's account balance is significantly more than Al's because she kept her savings going.

Ima Saver's account balance	$205,573
Al Spendit's account balance	$138,599

Source: DST Systems, Inc. This hypothetical example is for illustrative purposes only. It assumes a monthly contribution of $200 and an average annual return of 6% (compounded monthly). It does not represent any specific investment product offered by your plan and does not include any investment fees and expenses. Your investment returns will differ, and it is unlikely that your contribution amount will remain the same over a long period. Pretax contributions and related plan earnings will be subject to ordinary income taxes and a possible early withdrawal tax upon distribution.

1. Some retirement plans also offer a Roth contribution option. Unlike pretax contributions, Roth contributions do not offer immediate tax savings. However, qualified Roth distributions are not subject to federal income taxes when all requirements are met.
2. The additional tax is not deducted from the gross amount of the distribution but is payable when you file your tax return, unless you qualify for an exception.

Clash of the goals: Save for college or retirement?

Retirement for you or college for your kids? Which financial goal should you focus on the most? Many parents feel conflicted because they want to help their kids get a good college education but know they need to save for their own retirement years. While it may not be easy to pull off, it's important to tackle both goals at once and not put off saving for retirement.

High stakes battle

If your kids go to college before you retire, they're going to need the money first. So it might seem like common sense to save for college first and then save for retirement after they're done with school. However, that's a risky approach.

It's no secret that it costs a lot of money to go to college these days. And who knows how much tuitions will increase by the time your kids are ready to enroll. But even so, you're probably going to need a lot more money for your retirement. Your retirement could last well over 20 years, inflation will likely increase your costs during that period, and your retirement health care costs could be significant. If you put saving for college first, you may not have enough time to save for retirement once the tuition bills are paid. Instead, set aside money for both college and retirement.

Your plan can be your ally

Your employer's retirement savings plan can help you to save for both goals. Since your plan contributions are deducted from your pay before you receive it, saving for retirement is convenient. You don't owe federal income taxes on your pretax contributions or on any earnings from investing those funds until you withdraw money from the plan.[1] And since you're saving for retirement through your plan, you can focus your saving outside the plan on future college costs.

Set your sights on your savings goal

If you save, in 30 years you could accumulate:

- $68.92 a week – $300,000
- $137.84 a week – $600,000
- $206.76 a week – $900,000

Source: DST Systems, Inc. This is a hypothetical example used for illustrative purposes only and does not represent any specific investment product. It assumes a 6% average annual total return, monthly deposits into the plan, and monthly compounding. Your investment performance will be different. Tax-deferred amounts accumulated in a retirement plan are taxable upon withdrawal, unless they represent qualified Roth distributions.

Focus on your target

Even while you're saving for your kids' college costs, it's important to save as much as possible for retirement. While your kids will have a number of potential sources of college funding, such as scholarships, grants, loans, and part-time employment, you may be on your own with limited resources for retirement. Your Social Security benefits probably won't be enough to live on comfortably, and few employers offer pensions. Your plan account may be a very important source of retirement income.

Contributing more to your retirement plan may help you achieve your goals.

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