

RULES CHANGE FOR IN-SERVICE 401(K) ROLLOVERS *401(k)-to-Roth rollovers are now possible before age 59½.*

Provided by Timothy C. Hucks, CEP, President, Rising Tide, Inc.

A new possibility. Sometimes employees want to pull money out of a 401(k) before they retire. It isn't always because of an emergency. Some workers want to make an in-service non-hardship withdrawal just to roll their 401(k) assets into an IRA. Why? They see lower account fees and greater investment choices ahead.

As a result of the Tax Increase Prevention Reconciliation Act (TIPRA), tax laws now permit in-service non-hardship withdrawals from 401(k), 403(b) and 457 plans to traditional IRAs and Roth IRAs before age 59½. Of course, the employee must be eligible to take a distribution from the plan, and the funds have to be eligible for a direct IRA rollover.¹

This option may be very interesting to highly compensated employees who want the tax benefits of a Roth IRA. The income limits that prevented them from having a Roth IRA have been repealed, and they may have sizable 401(k) account balances.

Does the plan allow the withdrawal? Good question. If a company's 401(k) plan has been customized, it may allow an in-service withdrawal for an IRA rollover. If the plan is pretty boilerplate, it may not.

The five-year/two-year rule also has to be satisfied. IRS Revenue Ruling 68-24 says that for an in-service withdrawal from a qualified retirement plan to take place, an employee has to have been a plan participant for five years or the funds have to have been in the plan for two years.²

401(k) plan administrators may need to amend their documents. Does the Summary Plan Description (SPD) on your company's 401(k) plan allow non-hardship withdrawals? If it doesn't, it may need to be customized to do so. This year, plan administrators nationwide are fielding employee questions about rollovers to Roth IRAs.

401(k) plan participants need to make sure the plan permits this. An employee should request a copy of the SPD. If you ask and no one seems to know where it is, then call the toll-free number on your monthly 401(k) statement and ask a live person if in-service, non-hardship withdrawal distributions are an option. In some 401(k)s, an in-service non-hardship withdrawal will prevent you from further participation; be sure to check on that.

If this is permissible and you want to make the move, you better make an IRA rollover with the assets withdrawn. If you don't, that distribution out of your qualified retirement plan will be slapped with a 20% federal withholding tax and federal and state income taxes. Oh yes, you will also incur the 10% early withdrawal penalty if you are younger than age 59½. Additionally, if you have taken a loan from your 401(k), any in-service withdrawal might cause it to be characterized as a taxable distribution in the eyes of the IRS.³

Obviously, this IRA rollover possibility is not a big hit with the national and regional retirement plan providers, who would like to see you keep participating in their 401(k) programs rather than partly or fully bail out. But many employees would like a broader and more diverse range of investment options - and some would like the chance to direct their money into vehicles designed to produce future income streams.

Don't forget to talk to the professionals. Retirement plan administrators and participants should talk to the financial consultant that has helped them with their 401(k) program before making a move. This article is simply an overview, and there will be different details to attend to with each employee. So be sure to touch base with the financial professional you trust.

Timothy C. Hucks, CEP, is a Certified Estate Planner, Registered Investment Advisor and President of Rising Tide, Inc. He may be reached at www.risingtideinc.com, 919-968-8675, or tim@risingtideinc.com. Securities offered through [Capital Investment Group, Inc.](#) Corporate Office: 17 Glenwood Avenue, Raleigh, NC 27603 • 919.831.2370. Member [FINRA/SIPC](#).

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Citations.

¹ articles.sun-sentinel.com/2009-08-16/business/0908140293_1_roth-ira-roth-conversions-simple-ira [8/16/09]

² smbhr.benefitnews.com/news/rolling-the-dice-with-a-roth-ira-rollover-2682826-1.html [1/22/10]

³ macpa.org/Content/22372.aspx [2/1/10]