

SHOULD YOU STAY IN YOUR OLD 401(k)
 OR ROLL IT OVER INTO AN IRA?

Every year millions of workers who are either retiring or changing jobs struggle with a difficult decision regarding their old employer's 401(k) or similar defined-contribution retirement plan.

They know they don't want to cash in their account because of the income taxes, potential penalties, and loss of tax-deferred growth. Yet they're unsure whether to leave their money in the old plan, roll it into a new employer's defined-contribution plan if available, or roll it over into an individual retirement account. Each option has its benefits and disadvantages, depending on their personal situation.

Advantages of staying with old employer's plan or joining new plan. Roughly one in three workers leave their money behind in old employers' 401(k) plans, according to the Employee Benefits Research Institute. Often it is because they don't want to fuss with the rollover paperwork or they're afraid of making a costly mistake. Nonetheless, staying put in the old employer's plan or rolling it into a new employer's plan does offer some advantages.

One is creditor protection. Federal law prohibits creditors from invading 401(k) accounts. The law does not protect IRAs, though some states shield IRAs from creditors.

If you leave work due to termination or retirement, you usually can begin withdrawing from a 401(k) as early as age 55 without the ten-percent early withdrawal penalty. With rare exceptions, you have to wait to age 59 1/2 for penalty-free withdrawals from an IRA.

Two-thirds of 401(k) plans offer stable-value mutual funds, which are less commonly offered in IRAs. These funds appeal to conservative investors because they tend to offer healthier yields than money markets but with stable principal.

Investment choices are more limited in a 401(k). Why might this be an advantage? Some studies show that investors who trade a lot hurt their personal returns more than those who don't trade as much. IRAs typically offer a much bigger universe of investment choices than 401(k) plans. Thus, investors tempted to trade, or who are so overwhelmed by too many investment choices they do nothing, may actually be better off sticking with their

401(k). But the option to stay will depend in part on the quality of the investment options your particular 401(k) offers compared with an IRA.

You can borrow from a 401(k) if you're working for that employer, but you can't from an IRA. Financial planners generally discourage borrowing from a 401(k)—the borrowed money no longer grows tax deferred and there's a risk you won't be able to repay it in time, resulting in heavy taxes and penalties. Still, it is an option that often beats borrowing from a credit card.

If you want to leave your money in the 401(k), be sure it will stay there. Currently, employers can cash out defined-contribution accounts valued at \$5,000 or less if the employee fails to take action. That's changing beginning on March 28, 2005, however. For accounts valued from \$1,000 to \$5,000 the employer must automatically roll the money into a default IRA unless the employee wants the cash or requests a rollover.

Advantages of rolling into an IRA. For prudent investors, one of the biggest attractions of IRAs is their wider universe of investment choices, particularly if the choices are superior to those available in their old or new employer's plan. And you don't have to worry about future investment options changing, as they often do in employers' plans.

Workers who change jobs frequently may find themselves accumulating a lot of employer retirement accounts and may risk losing track of some accounts. Also, it's easier to manage a single IRA than multiple employer plans accounts. Or you might consolidate into your current employer's plan if it's good quality.

Another major benefit for the IRA option is the potential for significant tax savings. With an IRA, you can designate a younger non-spousal beneficiary and "stretch out" the minimum withdrawals over that person's lifetime. A 401(k) plan probably will insist that the account be immediately cashed out if the heir is not a spouse, resulting in a much larger tax bite and loss of further tax deferral.

With a rollover IRA, you may also be a position to convert to a Roth IRA if that conversation makes financial sense for you.

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