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An IRA Dilemma: To Roll or Not to Roll

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When you become eligible to take money from your company's retirement plan — either at retirement or after changing jobs — you may have a decision to make with a sizable sum of money.

Because this money can play an important role in supporting a comfortable retirement, it's essential to understand your available options and make decisions that align with both your current needs and your long-term financial goals.

Below are some guidelines that answer some of the most frequently asked questions about lump-sum distributions, along with helpful information about IRA rollovers.

I'm leaving my job. Should I take a lump-sum distribution?

As more employers offer lump-sum distribution options, many workers may suddenly face an important financial decision. The amount involved can range from thousands to even hundreds of thousands of dollars.

Receiving such a large sum can be tempting. You might consider using it for something exciting, like a dream vacation or major purchase. However, spending the money now could mean sacrificing valuable income you may need during retirement.

If you've been contributing to a 401(k) plan, you may be able to:

- Leave the money in your current employer's plan
- Roll it over into an Individual Retirement Account (IRA)
- Transfer it to a retirement plan offered by your new employer

Each option has different tax implications, fees, and investment choices — so reviewing them carefully is essential.

KEY POINTS

When changing jobs or getting ready to retire, you will need to decide what to do with the assets in your employer-sponsored retirement plan account. A rollover IRA may be right for you as it can offer the following features and benefits:

- Continued tax-deferred investing
- A potential income stream during retirement
- Easy access to your assets in an emergency*
- A broad range of investment choices
- A convenient vehicle for consolidating retirement assets

* Current taxes will apply to your distribution and it may be subject to a 10% tax penalty unless an exception applies.

This material should be used as helpful hints only. Each person's situation is different.
You should consult your investment professional or other relevant professional before making any decisions.

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What exactly is a rollover?

A rollover is a transfer of money from one employer's qualified retirement plan or IRA to another employer's plan or IRA. Rollovers keep retirement money tax deferred until withdrawals begin.

How does a rollover IRA work?

A rollover IRA allows you to move money from an employer-sponsored retirement plan — such as a 401(k) — into an Individual Retirement Account (IRA).

One of the most common reasons people choose a rollover IRA is for greater investment flexibility. For example:

- More investment options may be available in IRAs than a typical 401(k) plan.
- You gain broader control over how your retirement savings are invested.

However, staying in your employer's plan might still be a good choice if:

- The plan offers low fees
- You are satisfied with the available investment options

Important timing rules

If the rollover is not handled directly between plans, strict deadlines apply. Missing the required time frame can trigger income taxes or result in a possible early withdrawal penalty. Because of these rules, it's often helpful to work with a financial advisor or investment professional to ensure the process is handled correctly.

Direct rollover

To avoid complications, consider a direct rollover, where the funds move straight from your old retirement plan to your new IRA (or employer plan).

- No check is made out to you
- No taxes are withheld
- No risk of missing the deadline

This method helps keep your retirement savings intact and avoids unnecessary tax consequences.

Is an IRA cheaper than my employer's plan?

Both employer plans and IRAs may involve fees and investment-related expenses. Since your employer may pay some of the plan's expenses, you may find your 401(k) is less expensive than the IRA you are considering. Or you may find the IRA to be the cheaper option. The key is to do a side-by-side comparison of the investment options, fees, expenses and services to find the option that best fits your individual needs.

A rollover might be right for me. What should I do now?

If you decide to roll over your distribution, you will need to determine how to invest your money. You should meet with your financial advisor or investment professional to compare investment options, services, fees and expenses, withdrawal options, required minimum distributions and tax treatment as well as your unique financial needs and retirement goals. Please be aware that rolling over retirement assets into one IRA account could potentially increase fees as the underlying funds may be subject to sales loads, higher management fees, 12b-1 fees and IRA account fees such as custodial fees.

I'm planning to use my distribution for current expenses. What should I consider?

It may seem practical to use part of a lump-sum distribution to cover pressing expenses, such as paying off high-interest debt or reducing your mortgage. While that can feel like a smart financial move, it's important to consider the long-term impact on your retirement security.

Think long term

Although the lump sum may appear substantial today, retirement can last 20 to 30 years — or longer. As people retire earlier and live longer, the estimated amount needed for a comfortable retirement continues to increase.

If you spend even a portion of your distribution now — even for responsible purposes like debt repayment — you could:

- Reduce the size of your retirement savings
- Lower the income available to you later in life
- Shorten the longevity of your nest egg

Don't forget about taxes

Before withdrawing funds, remember that any amount you take out is generally subject to ordinary income taxes. If you are under age 59½, you may also owe a 10% early withdrawal penalty, unless you qualify for an IRS exception.

What if I need the money before age 59½?

You may need to access your retirement savings early for a variety of reasons, such as retiring ahead of schedule, starting a business or covering expenses while between jobs. However, age 59½ is generally when you can withdraw retirement funds without paying a 10% early withdrawal penalty.

The way you take your distribution — and the account you withdraw from — can determine whether penalties apply. For example:

- If you leave your employer on or after January 1 of the year you turn 55, withdrawals from that employer's plan are typically not subject to the 10% early withdrawal penalty.
- However, if you are between 55 and 59½ and roll those funds into a new employer's plan or an IRA, you may lose access to this favorable treatment.

If you need to begin taking income from your retirement savings right away, it's wise to speak with a financial advisor, investment professional or tax advisor before making a decision. The rules can be complex, and the wrong move could result in unnecessary taxes or penalties.

How much will it cost in taxes if I take the money now?

By removing even a small amount from your nest egg, you are opening yourself up to tax liability and therefore reducing the amount of money that can remain working for you. The table shows two of the choices available to a person changing jobs who is 34 years old and in the 22% tax bracket and whose investment earns a hypothetical 6% annual return.

Cost breakdown of distribution options

Based on annual growth rate of 6%

	Taking money now	Directly rolling over distribution
Distribution	$20,000	$20,000
20% withholding tax	($4,000)	$0
10% early withdrawal penalty	($2,000)	$0
2% additional current tax owed	($400)	$0
Available for reinvestment	$13,600	$20,000
Net value in 10 years*	$22,365	$24,356
Net value in 20 years*	$36,778	$43,617
Net value in 30 years*	$60,481	$89,598

* All gains in the "Taking money now" example are adjusted for a 15% tax rate in the year the gains are earned in a taxable account, representing the current federal tax rate on long-term capital gains and dividends. The rate can vary at different income levels. The values in the "Directly rolling over distribution" example assume the taxpayer is in the 22% federal tax bracket (the 10- and 20-year examples also include a 10% penalty for early distribution) and takes a full distribution at 10, 20 or 30 years. State taxes may also apply to distributions.

These examples are for illustrative purposes only and are not intended to predict the returns of any investment choices. Rates of return will vary over time, particularly for long-term investments. There is no guarantee the selected rate of return can be achieved. The performance of the investments will fluctuate with market conditions.

Source: MFS calculation.

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Evaluating your rollover decision

Your retirement savings can play a critical role in supporting your future income needs. Carefully evaluating your options and understanding the potential long-term impact of each decision can help you keep your plan on track. A financial advisor or investment professional can help you assess your choices and determine the approach that best fits your overall financial strategy.

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