Handling a Lump-sum Retirement Plan Payout

If you plan to retire or leave your current employer, you may have important decisions to make about your retirement plan account. Proceed carefully, since the choices you make can have an effect on your financial well-being down the road.

Taking the Cash

Taking the vested amount in your plan account as a cash distribution may be tempting. However, you'll be liable for federal (and perhaps state) income taxes on the taxable portion of what's distributed to you in the year you receive the payout. In fact, your employer is required to withhold 20% of your taxable distribution to be applied to your federal income-tax liability. Depending on the circumstances, an additional 10% tax penalty for early withdrawal may also apply.

If you spend your savings, you may be putting your future retirement security in jeopardy. That money could make the difference between a retirement in which you can afford to do all the things you planned and one in which you are just getting by financially.

A Better Alternative

Instead, consider ways to keep your money working 24/7 and tax deferred on your behalf. Here are three ways you can do that.

Roll Over to an IRA. You may avoid a current income-tax liability and a potential penalty and maintain the advantage of tax-deferred compounding if you roll your plan assets into an individual retirement account (IRA). Just be sure you arrange a direct transfer of your plan assets to the trustee of the IRA. Under this arrangement, your plan trustee transfers the assets in your plan account directly to the trustee of the financial institution that sponsors the IRA. You'll maintain the tax-deferred status of your account and no tax withholding will apply.*

Roll Over to New Employer's Plan. If you are going to work for a new employer and your new employer's plan accepts rollovers, consider arranging a direct trustee-to-trustee rollover to the new plan. This approach avoids tax withholding and your money has the ability to keep growing tax deferred.

Keep Money in Old Plan. You may be able to keep your plan assets in your current retirement plan.

Talk to Us

Deciding how to handle a retirement distribution is a big decision — one you shouldn't have to make on your own. We would be happy to discuss your options with you in more detail.

* You have 60 days to roll over an eligible distribution paid to you. However, tax withholding will apply, and you will owe taxes (and a potential penalty) on any taxable amount you do not roll over within the 60-day window.