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Quarterly Tax Newsletter

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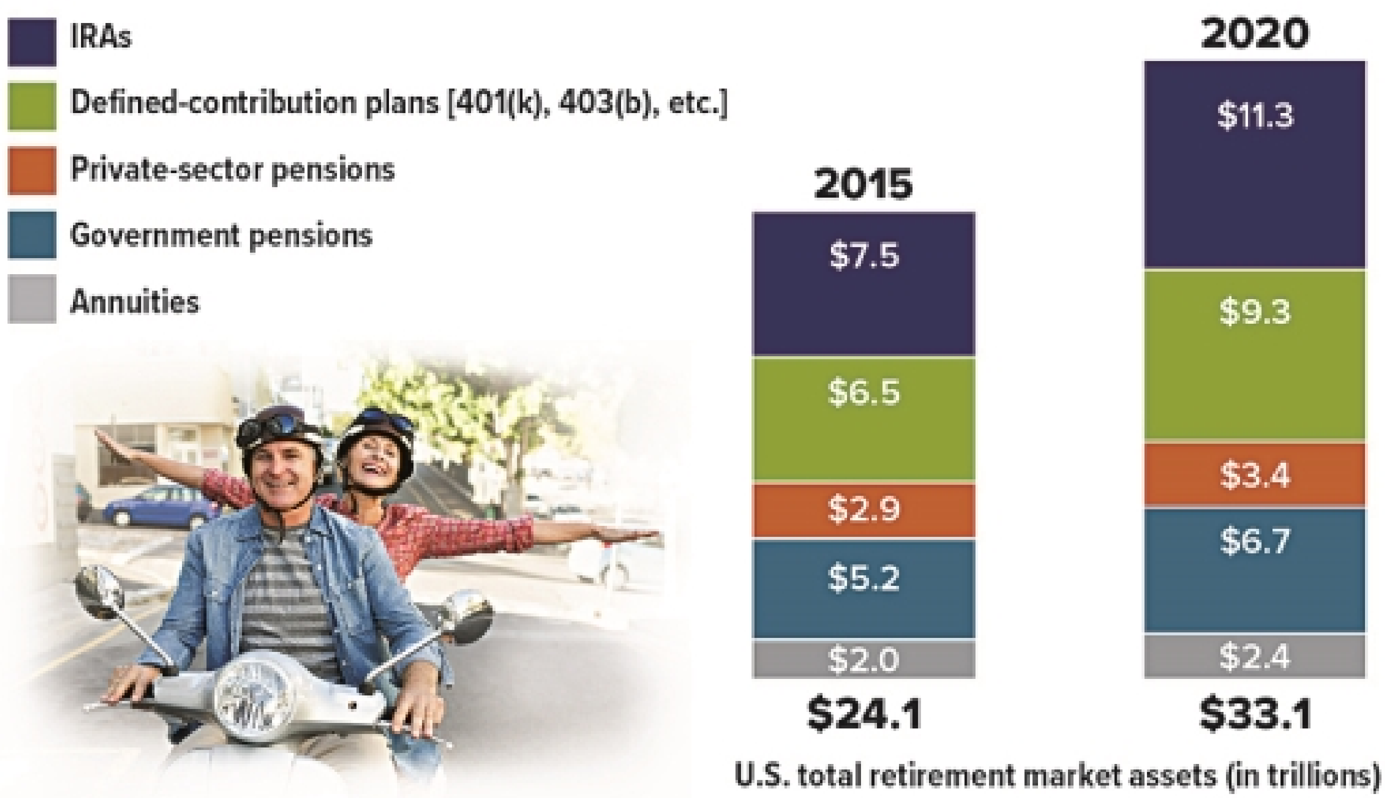
IRAs Are Top Tool for Retirement Savings

Individual retirement accounts are the largest pool of U.S. retirement assets, which totaled $33.1 trillion at the end of the third quarter of 2020.



Source: Investment Company Institute, 2020

How Well Do You Understand Retirement Plan Rules?

Qualified retirement plans, such as IRAs and 401(k)s, have many rules, and some of them can be quite complicated. Take the following quiz to see how well you understand some of the finer points.

1. You can make an unlimited number of retirement plan rollovers per year.

A. True

B. False

C. It depends

2. If you roll money from a Roth 401(k) to a Roth IRA, you can take a tax-free distribution from the Roth IRA immediately as long as you have reached age 59½.

A. True

B. False

C. It depends

3. You can withdraw money penalty-free from both your 401(k) and IRA (Roth or traditional) to help pay for your children's college tuition or to pay for health insurance in the event of a layoff.

A. True

B. False

C. It depends

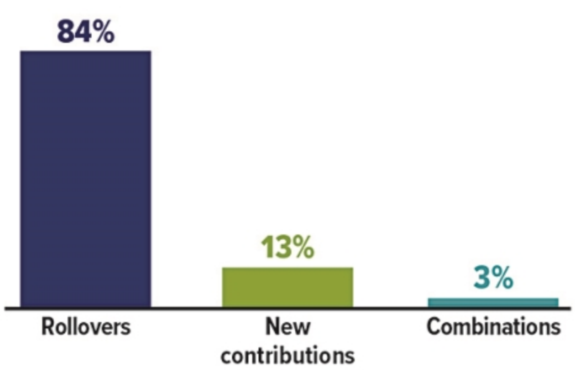
4. If you retire or otherwise leave your employer after age 55, you can take penalty-free distributions from your 401(k) plan. You can't do that if you roll 401(k) assets into an IRA.

A. True

B. False

C. It depends

Shares of Traditional IRA Assets Opened with...



Source: Investment Company Institute, 2020 (data reflects IRAs opened in 2016)

1. C. It depends. Rollovers can be made in two ways — through a direct rollover, also known as a trustee-to-trustee transfer, in which you authorize the funds to be transferred directly from one account or institution to another, or through an indirect rollover, in which you receive a check in your name (less a required tax withholding) and then reinvest the full amount (including the amount withheld) in a tax-deferred account within 60 days. If the full amount is not reinvested, the outstanding amounts will be considered a distribution and taxed accordingly, including any applicable penalty. Generally, individuals can make an unlimited number of rollovers in a 12-month period, either direct or indirect, involving employer-sponsored plans, as well as an unlimited number of direct rollovers between IRAs; however, only one indirect (60-day) rollover between two IRAs is permitted within a 12-month period.

2. C. It depends. Beware of the five-year rule as it applies to Roth IRAs. If you establish your first Roth IRA with your Roth 401(k) rollover dollars, you will have to wait five years to make a qualified withdrawal from the Roth IRA, regardless of how long you've held the money in your Roth 401(k) account, even if you are over 59½. However, if you have already met the five-year holding requirement with *any* Roth IRA, you may take a tax-free, qualified withdrawal.

3. B. False. You can take penalty-free withdrawals from an IRA, but not from a 401(k) plan, to pay for a child's qualifying education expenses or to pay for health insurance premiums in the event of a job loss. Note that ordinary income taxes will still apply to the taxable portion of the distribution, unless it's from a Roth account that is otherwise qualified for tax-free withdrawals.

4. A. True. If you leave your employer after you reach age 55, you may want to consider carefully whether to roll your money into an IRA. Although IRAs may offer some advantages over employer-sponsored plans — such as a potentially broader offering of investment vehicles — you generally cannot take penalty-free distributions from an IRA between age 55 and 59½, as you can from a 401(k) plan if you separate from service. If you might need to access funds before age 59½, you could leave at least some of your money in your employer plan, if allowed.

When leaving an employer, you generally have several options for your 401(k) plan dollars. In addition to rolling money into an IRA and leaving the money in your current plan (if the plan balance is more than $5,000), you may be able to roll the money into a new employer's plan or take a cash distribution, which could result in a 10% tax penalty (in addition to ordinary income taxes) on the taxable portion, unless an exception applies.

Decisions, Decisions: Weighing the Pros and Cons of an IRA Rollover

If you lose a job, switch employers, or step into retirement, you might consider rolling your retirement plan savings into an IRA. But this isn't your only option; it could make more sense to keep the money in your previous employer's plan or move it to your new employer's plan (if allowed by the plan).

You could also cash out, but that's rarely a good idea. Withdrawals from tax-deferred retirement accounts are taxed as ordinary income, and you could be hit with a 10% tax penalty if you are younger than 59½, unless an exception applies.

Some employer plans permit in-service distributions, which allow employees to take a partial distribution from the plan and roll the money into an IRA. When deciding what to do with your retirement assets, be aware that IRAs are subject to different rules and restrictions than employer plans such as 401(k)s.

What IRAs Have to Offer

There are many reasons to consider an IRA rollover.

Investment choice. The universe of investment options in an IRA is typically much larger than the selection offered by most employer plans. An IRA can include individual securities and alternative investments as well.

Retirement income. Some employer plans may require you to take a lump-sum distribution when you reach the plan's retirement age, and your distribution options could be limited if you can leave your assets in the plan. With an IRA, it's likely that there will be more possibilities for generating income, and the timing and amount of distributions are generally your decision [until you must start taking required minimum distributions (RMDs) at age 72].

Top Reasons for Most Recent IRA Rollover

- **69%** Didn't want to leave assets with former employer
- **65%** Wanted to preserve tax treatment of savings
- **57%** Wanted to consolidate assets
- **55%** Wanted more investment options
- **44%** Was required to remove the money from former employer's plan

Source: Investment Company Institute, 2021 (more than one reason allowed per respondent)

Account consolidation. Consolidating your investments into a single IRA may provide a clearer picture of your portfolio's asset allocation. This could make it easier to adjust your holdings as needed and calculate RMDs.

Different exceptions. There are circumstances when IRA owners may be able to withdraw money penalty-free prior to age 59½, options that are not available to employer plan participants. First-time homebuyers (including those who haven't owned a home in the previous two years) may be able to withdraw up to $10,000 (lifetime limit) toward the purchase of a home. IRA funds can also be withdrawn to pay qualified higher-education expenses for yourself, a spouse, children, or grandchildren. IRA funds can even be used to pay for health insurance premiums if you are unemployed.

When to Think Twice

For some people, there may be advantages to leaving the money in an employer plan.

Specific investment options. Your employer's plan may offer investments that are not available in an IRA, and/or the costs for the investments offered in the plan may be lower than those offered in an IRA.

Stronger creditor protection. Most qualified employer plans receive virtually unlimited protection from creditors under federal law. Your creditors cannot attach your plan funds to satisfy any of your debts and obligations, regardless of whether you've declared bankruptcy. On the other hand, IRAs are generally protected under federal law (up to $1,362,800) only if you declare bankruptcy. Any additional protection will depend on your state's laws.

The opportunity to borrow from yourself. Many employer plans offer loan provisions, but you cannot borrow money from an IRA. The maximum amount that employer plan participants may borrow is 50% of their vested account balance or $50,000, whichever is less.

Penalty exception for separation from service. Distributions from your employer plan won't be subject to the 10% tax penalty if you retire during the year you reach age 55 or later (age 50 for qualified public safety employees). There is no such exception for IRAs.

Postponement of RMDs. If you work past age 72, are still participating in your employer plan, and are not a 5% owner, you can delay your first RMD from that plan until April 1 following the year in which you retire.

Your Business: Minimum-Wage Laws in the Spotlight

In the November 2020 election, Florida voters approved an initiative to increase the minimum wage incrementally to $15 per hour by 2026. Eight states (plus the District of Columbia) have passed legislation to raise the minimum wage in steps to $15, but Florida is the first state to do so through a ballot measure.[1]

State labor laws vary widely, but affected small businesses may face challenges as minimum wage increases take effect over the next few years.

Twenty-nine states and the District of Columbia have minimum wages higher than the federal wage floor of $7.25, which hasn't been adjusted since 2009.[2] Some cities have enacted minimums that exceed state levels. Moreover, a few large employers have increased pay for employees nationwide, making it more expensive for smaller businesses to compete for the same types of labor.[3]

Economic Impact

Proponents of raising the minimum wage say it helps reduce poverty and income inequality, boosts consumers' buying power, and stimulates economic growth. Opponents believe that steep increases might cause jobs to be eliminated, especially in lower-wage areas. A 2021 report by the nonpartisan Congressional Budget Office estimated that raising the federal minimum wage to $15 would lift 0.9 million Americans out of poverty and cause 1.4 million job losses.[4]

Rising wage costs can be particularly hard on the balance sheets of small businesses, many of which are already struggling to stay above water during the pandemic. Increases in the minimum wage influence labor costs throughout a business, because more experienced employees generally expect to be compensated accordingly.

Survival Tips

Preparing for pending wage increases may put you in a better position to absorb the cost and limit the impact on your workforce.

- Start by cutting extraneous expenses and looking closely at your energy consumption, surplus inventory, and service contracts.
- Consider reducing your hours or streamlining your operations in other ways.
- If you must raise prices, do so carefully by researching what competitors charge, and communicate openly with customers to manage expectations.
- Before you reduce staff, focus on cross-training and retaining your most dependable employees, and hold off on hiring until you are sure you can afford the additional payroll costs.

1) *The Wall Street Journal* , November 27, 2020

2) U.S. Department of Labor, 2020

3) *Bloomberg Businessweek* , November 17, 2020

4) Congressional Budget Office, 2021