

Manage

The Nuts and Bolts of Rollover IRAs

When you retire, you'll be eligible to receive the money you've accumulated in your employer-provided retirement plan. The money might be paid to you in a single lump sum or other "eligible rollover distribution" that can be rolled over into an individual retirement account (IRA).

Why consider putting your plan distribution into a rollover IRA? Primarily to maintain certain tax advantages. In addition, there are other important reasons why you should consider a rollover IRA if you are about to retire in the not-too-distant future.

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What It Is

A rollover IRA is different from a traditional IRA in that there is no limit on the amount you are allowed to contribute. For 2009, the most you can contribute to a regular IRA is \$5,000, plus an additional "catch-up" contribution of \$1,000 if you are at least age 50. (The IRA contribution limit is subject to annual inflation adjustment.) You can contribute whatever amount you receive from your employer's plan — whether it's \$25,000, \$50,000,

\$100,000 or more — to a rollover IRA. And a rollover IRA offers the same tax advantages as a regular IRA.

Taxes and Rollover IRAs

Tax-deferral is probably the biggest advantage of a rollover IRA. When you receive an eligible rollover distribution from your employer's retirement plan, you have a choice. You can either pay tax immediately on the distribution or you can defer paying tax by rolling the distribution over into an IRA (or another eligible plan).

If you choose the IRA rollover, you can postpone paying tax until distributions begin. And you don't *have* to start receiving payments from your IRA until April 1 of the year after you reach age 70½*. Just keep in mind that if you use the rollover IRA to defer payment of tax, tax will eventually be due when you begin withdrawals from your IRA.

In addition, when you use the IRA rollover, the income generated by investing your distribution will continue growing on a tax-deferred basis. So, for example, if you have a \$100,000 distribution that grows at an annual rate of 6%, you can



accumulate an additional \$33,823 over a five-year period. (Your actual return may be more or less.)

Time Limits

The IRS requires you to complete your rollover within 60 days after receiving the distribution. Generally, however, it's more advantageous to have the money transferred *directly* from your former employer's plan to an IRA.

Here's why. There is a 20% withholding requirement on all eligible rollover distributions from qualified retirement plans that are not directly transferred to eligible retirement plans. So, if you actually take possession of the distribution, you will see 20% of it withheld for federal tax purposes.

If you then decide within 60 days of receiving your distribution that you want to roll over the full amount, you must supply the withheld 20% from other sources to put in your rollover IRA. When you file your tax return, you may receive a refund of the withheld tax. If you don't make up the difference and simply roll over the 80% you have in hand, the withheld 20% will then be considered a taxable distribution. That means you'll have to pay taxes on the 20%. By having the distribution transferred directly to your IRA, you can avoid this 20% withholding altogether. And 100% of the distribution will continue to grow on a tax-deferred basis.

* The Worker, Retiree and Employer Recovery Act waives the minimum distribution requirement for calendar year 2009 only. As a result, if you turn 70½ in 2009, you will not have to take your first distribution by April 1, 2010. The deadline for your first required minimum distribution (for 2010) will be December 31, 2010.

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