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What Is an IRA Rollover?

If you leave a job or retire, you might want to transfer the money you've invested in one or more employer-sponsored retirement plans to an individual retirement account (IRA). An IRA rollover is an effective way to keep your money accumulating tax deferred.

Using an IRA rollover, you transfer your retirement savings to an account at a private institution of your choice, and you choose how you will invest the funds. To preserve the tax-deferred status of retirement savings, the funds must be deposited in the IRA within 60 days of withdrawal from an employer's plan. To avoid potential penalties and a 20% federal income tax withholding from your former employer, you should arrange for a direct, institution-to-institution transfer.

You are able to roll over assets from an employer-sponsored plan to a traditional IRA or a Roth IRA. Because there are no income limits on Roth IRA conversions, everyone is eligible for a Roth IRA conversion; however, eligibility to contribute to a Roth IRA phases out at higher modified gross income levels. Keep in mind that ordinary income taxes are owed (in the year of the conversion) on all tax-deferred assets converted to a Roth IRA.

An IRA can be tailored to your particular needs and goals and can incorporate a variety of investment vehicles. Although IRAs typically provide more investment choices than an employer plan, your plan may offer certain investments that are not available in an IRA. Further, the cost structure for the investments offered in the plan may be more favorable than those offered in an IRA. In addition, tax-deferred retirement savings from multiple employers can later be consolidated.

Over time, IRA rollovers may make it easier to manage your retirement savings by consolidating your holdings in one place. This can help cut down on paperwork and give you greater control over the management of your retirement assets.

Keep in mind that you may be able to leave your funds in your previous employer plan, if it is allowed by the plan. You may be able to transfer the funds from your previous employer plan to a new employer plan (if it accepts rollover funds). While you can withdraw the funds from your employer plan as a lump sum, you could incur a potentially sizeable income tax liability in the tax year of the withdrawal and your funds would not be able to continue growing tax-deferred.

Distributions from traditional IRAs are taxed as ordinary income and may be subject to a 10% federal tax penalty if taken prior to reaching age 59½. Just as with employer-sponsored retirement plans, you must begin taking required minimum distributions from a traditional IRA each year after you turn age 73 (for individuals who reach age 72 after December 31, 2022). If you attained age 72 in 2022 or earlier, you are already required to take annual RMDs. The RMD age will rise to 75 in 2033.

Qualified distributions from a Roth IRA are free of federal income tax (under current tax laws) but may be subject to state, local, and alternative minimum taxes. To qualify for a tax-free and penalty-free withdrawal of earnings, a Roth IRA must meet the five-year holding requirement and the distribution must take place after age 59½ or due to death, disability, or a first-time home purchase (\$10,000 lifetime maximum). The mandatory distribution rules that apply to traditional IRAs do not apply to original Roth IRA owners; however, Roth IRA beneficiaries must take mandatory distributions.

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