

Rollover Strategies and IRA Distribution Rules.



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You've worked hard. And, chances are, you've deferred the chance to enjoy the fruits of your labors by contributing a portion of your earnings to your employee-sponsored qualified retirement plan. If so, it was a wise decision. Investing your income before taxes maximizes its potential to grow and compound over time, until you need it.

But what happens if and when you change jobs? Or retire? Do you leave your plan funds in your old employer's retirement plan? Do you take the money in a lump-sum payment? Or do you roll it over into another investment vehicle, like an IRA, where it can continue to grow free of taxes until you need it? Or do you convert it to a Roth IRA, pay income taxes now so you can take tax free withdrawals if you need it?

How you manage those choices — how, when and if you decide to receive distributions from your retirement plan — can have a big impact on the money you'll have available, both today and tomorrow. By understanding your distribution options, and choosing among them wisely, you can ensure that years of savings pay off when you need your nest egg most.

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*Do you leave your funds in your old employer's retirement plan?
Do you take the money in a lump-sum payment?
Consider your options.*

Leaving Your Job, Keeping Your Plan Funds

The first distribution scenario most individuals face isn't retirement; it's severance from the employer who offers the retirement plan. Once you terminate service with an employer, you cannot make any further contributions to the retirement plan, but you don't have to leave your plan funds behind. You have several distribution choices. You can:

- Leave the funds in the current retirement plan — If you have \$5,000 or more invested in your previous employer's retirement plan, you are usually allowed to keep it there.
- Roll over the funds to a new employer retirement plan — That allows you to continue to defer federal income tax and avoid potential tax penalties.
- Take a cash payout — Although that may be tempting because it provides you with immediate access to cash, it can have significant tax consequences and penalties.
- Roll over the funds into a Rollover IRA — That allows your funds the potential for continued tax-deferred earnings, while providing you with more control over the investments and a potentially greater array of investment choices.
- Convert the funds into a Roth IRA — You will receive the same benefits as a Rollover IRA, but you pay income taxes now. In addition, distributions will generally be free of income tax and there is no requirement to take any distributions at all.

Distribution Options Pros and Cons

Leaving funds in your current retirement plan

Retirement plan participants with balances of \$5,000 or more usually have the option of leaving their funds in the qualified plan. If you are happy with the plan and don't have any current plans for your funds, this option may be the easiest and safest way to retain the potential for tax-deferred earnings.

Pros:	Cons:
<ul style="list-style-type: none">■ Avoids current income taxes, penalties, and mandatory 20% federal income tax withholding that applies if you withdraw the funds directly■ Funds have the potential to grow tax-deferred■ Ability to rollover your funds at a later date	<ul style="list-style-type: none">■ Investment choices are limited to the employer's retirement plan selections■ Maintaining multiple retirement accounts can be complicated and time consuming■ Retirement plan expenses may be deducted from the account

Rolling over your plan funds to a new employer's retirement plan

Assuming your new employer offers an eligible retirement plan, you might be able to roll your distribution into that retirement plan. Of course, check with your employer to make sure they will accept the rollover. While one benefit of this option is having your retirement plan funds consolidated in one place, it's important to investigate the new retirement plan carefully before deciding to roll over your plan funds. Your new employer's plan may offer only limited investment choices or other restrictions. In that case, you may find that you have greater flexibility and a larger array of investment options with a Rollover IRA.

Pros:	Cons:
<ul style="list-style-type: none">■ Avoids current income taxes, penalties, and mandatory 20% federal income tax withholding that applies if you withdraw the funds directly■ Funds have the potential to grow tax-deferred■ Retirement money is in one place and easier to track	<ul style="list-style-type: none">■ Investment choices are limited to the employer's retirement plan selections■ Retirement plan may prohibit or limit in-service withdrawals■ Retirement plan expenses may be deducted from the account

Withdrawing your funds in cash

There are no two ways about it: financial professionals rarely recommend this option.

Pros:	Cons:
<ul style="list-style-type: none">■ Immediate, unrestricted use of the money■ May be eligible for special tax treatment. See your tax advisor	<ul style="list-style-type: none">■ Money generally subject to ordinary income tax and loses tax-deferred status in the future■ Mandatory 20% federal income tax withholding■ May be subject to an additional 10% penalty tax on early withdrawals■ You only have 60 days to roll the distribution to an employer retirement plan or an IRA

Rolling over your plan funds into an IRA

The most popular way to avoid federal income taxes and tax penalties and to retain tax-deferred earnings potential may be to roll over plan funds directly into your own Rollover IRA. In a direct rollover, your funds are rolled over directly from a former employer’s retirement plan to an IRA. In addition to tax deferral, this option generally offers increased flexibility and control.

Pros:	Cons:
<ul style="list-style-type: none">■ Avoids current income taxes, penalties, and mandatory 20% federal income tax withholding that applies if you withdrawal the funds directly■ Funds have the potential to grow tax-deferred■ Typically broadens investment choices■ Maximize flexibility: move Rollover IRA money into another employer’s retirement plan or convert to a Roth IRA at a future date (certain restrictions may apply)	<ul style="list-style-type: none">■ Loans are not available from an IRA■ You may have to pay annual IRA fees■ Funds not protected from creditors in IRAs to same extent as in qualified employer retirement plans■ Special tax treatment on distributions, such as forward averaging and net unrealized appreciation rule, are generally unavailable under IRAs

Rolling over your plan funds into a Roth IRA

You can convert your plan funds directly into a Roth IRA. You will have to pay income taxes on the converted amount now, but tax penalties will be avoided and earnings still have the potential to grow tax-free. Furthermore, Roth IRAs do not have a required distribution but if you need to withdraw money, the distribution may be income tax-free. In a Roth conversion of plan funds, your funds are transferred directly from a former employer’s retirement plan to a Roth IRA. In addition to tax deferral and potential tax-free withdrawals, this option offers increased flexibility and control.

Pros:	Cons:
<ul style="list-style-type: none">■ Funds have the potential to grow tax-deferred■ Distributions are generally income tax-free■ No required distributions for account owner or spouse■ Typically broadens investment choices	<ul style="list-style-type: none">■ Income taxes are due on converted amount in current year■ Loans are not available from a Roth IRA■ You may have to pay annual Roth IRA fees■ Funds not protected from creditors in Roth IRAs to same extent as in qualified employer retirement plans

Which Choice Is Right for You?

If you've left or are leaving a job, making the right distribution choice clearly has a big impact on your retirement plan funds. To help you make the right choice, grade each of following statements on a scale of 1 to 5, with 5 being the most important. You and your financial professional can use the results — along with the preceding information — to discuss which distribution option may be right for you.

	Least Important			Most Important	
I want my money to enjoy tax-deferred growth for as long as possible.	1	2	3	4	5
I want all my money in one place.	1	2	3	4	5
I want my money now.	1	2	3	4	5
I want the ability to take loans against my money.	1	2	3	4	5
I want greater investment control and more investment choices.	1	2	3	4	5
I want the potential of having income tax-free distributions, even if I have to pay income tax currently.	1	2	3	4	5

An Exception to the Rule: The Special Tax Treatment of Company Stock

It's important to recognize that there are instances when an IRA rollover might not be your best course of action.

For example, investors whose 401(k) plans include qualifying employer stock might be able to take advantage of special tax treatment involving those funds. But if you roll that employer stock to an IRA, that special tax treatment opportunity is lost. See your tax advisor for more information.

Here's how it works: Distributions of funds are generally taxed as ordinary income to the extent of the fair market value of those funds when they are distributed. But when a retiree or job changer receives employer stock in certificate form, ordinary income taxes are paid only on the cost basis of the shares (the value of the shares at the time they were acquired) as opposed to the current market value. The difference between the cost basis and the stock's current value – called the net unrealized appreciation (or NUA)– is not taxed until the stock is sold later, after the distribution. And taxation on the net unrealized appreciation is at the long-term capital gains rate, which could be significantly lower than the ordinary income rate under current guidelines.

In order for the distribution to qualify as NUA, there must be a lump-sum distribution of company stock in stock-certificate form. A "lump sum" means that the entire account must be distributed over a period of one year or less.

NUA applies only to company stock in a qualified plan. It will not apply to:

- Partial distributions
- Stock that is liquidated and distributed in cash
- Stock held in an IRA
- Distributions over a period greater than one year

It's important to note that the market value and tax implications will vary significantly if an investor decides to hold on to the shares and/or sell them at different intervals. It's also important to understand that NUA treatment is not available for non-company stock held inside the retirement plan.

Understanding IRA Rollovers

If you, like many retirement plan participants, opt to roll your plan funds into an IRA, it's important to understand the difference between your two rollover options, direct and indirect. The chart below illustrates each:

Direct	Indirect
<ul style="list-style-type: none">■ Easiest and most advantageous■ Plan funds paid directly to new employer plan or Rollover IRA■ No mandatory 20% federal income tax withholding or additional 10% federal tax penalty	<ul style="list-style-type: none">■ Riskier and more complicated■ Distribution check made payable to participant, who must roll over funds within 60 days or face taxes and potential penalty■ Mandatory 20% federal income tax withholding by former employer■ Participant must come up with 20% from another source, or withheld amount is considered taxable income to participant

Understanding IRA Distributions

Before you commit funds to an IRA, which is designed as a long-term retirement vehicle, it's a good idea to familiarize yourself with the limits and penalties the government places on distributions.

In general, the IRS levies a 10% early withdrawal penalty — also known as the premature distribution penalty — against any IRA distributions to participants younger than age 59½. There are some exceptions to the application of the penalty, for example in instances of death or disability, a first-time home purchase, or if a participant is using the money to meet higher education expenses.

But at the same time, the IRS also offers IRA participants a number of planning opportunities that increase withdrawal flexibility, create early retirement opportunities and can maximize the life of your IRA.

They are:

72(t): Retire Early, Avoid Penalties

As mentioned above, IRA funds can be withdrawn penalty-free before age 59½ for a few specific uses. But what if you want to retire early but don't want your funds subject to the premature distribution penalty? 72(t) may be the answer.

Under Section 72(t) of the Internal Revenue Code, you can avoid a 10% federal tax penalty on early withdrawals from IRAs by setting up distributions as what are known as "substantially equal periodic payments", also known as SEPP, using one of three IRS-approved calculation methods. Under the old rules, once payments began you couldn't stop or alter the calculation method you selected until you reached age 59½, or until you had taken withdrawals for five years, whichever was longer. Now, the IRS allows you a one-time switch from either of the fixed-dollar ("amortization" or "annuitization") methods to the variable ("life expectancy") method without triggering the 10% federal tax penalty or interest charges.

Required Minimum Distributions

Be aware — the term "required minimum distribution" (RMD) refers to the amount that IRA owners and qualified plan participants must begin distributing from their retirement arrangements by April 1 following the year they reach age 70½. However, it is important to note that Roth IRAs are exempt from this requirement.

A Fund to Pass On

An IRA isn't just an important vehicle for funding your retirement years; it can also be an important part of the legacy you leave to your loved ones. The challenge is to leave that legacy without saddling your loved ones with a potentially huge tax burden.

Fortunately, the law provides several different options your beneficiary can choose to help ease — or eliminate — that burden. Both spouse and non-spouse beneficiaries have different options that allow them to avoid immediate taxation on what could be a huge sum of money. For example, a spouse may be able to defer taxation by rolling the IRA proceeds to his or her own IRA.

Non-spouse beneficiaries don't enjoy that option but they can choose to receive the money in the IRA slowly, via distributions over their own life expectancies, which serve to spread out the tax burden over a longer period of time.

Distribution Options for Beneficiaries:

	Before 70½	After 70½
Spouse Beneficiary	<ul style="list-style-type: none"> ■ Rollover to their own IRA ■ Postpone RMDs until owner would have reached age 70 ½ ■ Start withdrawals based on beneficiary's life expectancy recalculated each year while alive ■ Five year rule ■ Lump sum 	<ul style="list-style-type: none"> ■ Rollover to their own IRA - Postpone RMDs until spouse reaches age 70 ½ ■ Start withdrawals based on beneficiary's life expectancy ■ Lump sum
Non-Spouse Beneficiary	<ul style="list-style-type: none"> ■ Take withdrawals based on beneficiary's life or life expectancy non-recalculated ■ Five year rule ■ Lump sum 	<ul style="list-style-type: none"> ■ Continue withdrawals based on the longer of the owner's theoretical life expectancy or the beneficiary's life expectancy ■ Lump sum
Non-individual (e.g. estate or charity; certain trusts may be entitled to other distribution options.)	<ul style="list-style-type: none"> ■ Five year rule ■ Lump sum ■ RMD life expectancy is not an option* 	<ul style="list-style-type: none"> ■ Continue withdrawals based on the owner's theoretical life expectancy ■ Lump sum

*Certain trusts can choose life expectancy payout using single trust beneficiary life expectancy or using oldest individual's life expectancy when there are multiple beneficiaries.

Although persons other than your spouse have more limited distribution choices, they can still extend the life of your IRA. For example, non-individual beneficiaries such as estates or charities may continue withdrawals based on the remaining non-recalculated life expectancy of the IRA owner (where an IRA owner dies after age 70½).

A non-recalculated life expectancy determines the time period in the year following death, and subsequently decreases by one each year.

Non-spouse beneficiaries may be able to take distributions based on their own non-recalculated life expectancies — stretching out distributions for over 30 or 40 years in some cases. Here’s an example of the stretch concept:

Say a father leaves a \$400,000 IRA to his daughter, Sarah, who is age 43. Sarah opts to receive the required minimum distributions (RMDs) each year. Assuming Sarah’s IRA earns 5% annually and Sarah takes withdrawals for the next 25 years, she will receive \$469,062 (pre-tax) by the time she is 68. And there will still be more than \$497,632 left in the IRA¹.

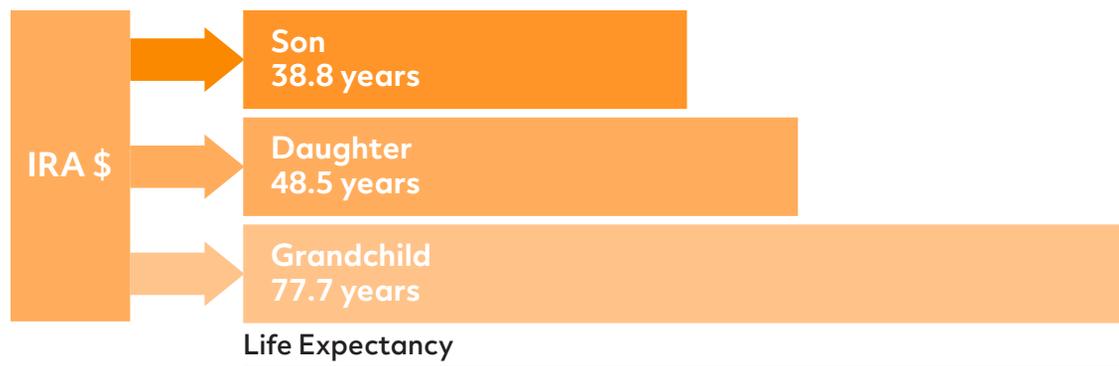
The above example is hypothetical and for illustrative purposes only. It is not intended to represent any particular investment or predict future results.

The “Separate” Beneficiary IRA

IRA owner dies before reaching age 70½ with three beneficiaries named:

- Son, age 45
- Daughter, age 35
- Grandchild, age 5

Beneficiaries can separate their shares into “inherited” IRAs and take distributions based on their individual ages.



How to Make Your IRA Last Longer¹

- Make sure to name both primary and contingent beneficiaries. Naming both provides a clear line of succession in case something happens to your primary beneficiaries. It also provides part of a legacy strategy. After your death, your primary beneficiaries can take distributions, cash out the entire amount, or disclaim the plan funds altogether. Conversely, failing to name a beneficiary may result in your funds going to your estate. This could have negative tax implications and may limit your beneficiaries' options.
- When you have multiple beneficiaries, each may have different stretch opportunities. If there is a large age difference between your beneficiaries, talk to your financial professional about how they each have the ability to stretch out distributions over his or her own life expectancy.
- Revisit your investment strategy. If your goal for your IRA is to enable your children or grandchildren to receive the IRA plan funds over their lifetimes, your plan funds may end up being invested with the potential to grow tax-deferred for another 40 or 50 years, depending on the ages of the beneficiaries. Therefore, your plan funds allocation strategy may be different than that of people expecting to use their funds in retirement in the near future.

Make the Most of Your IRA Opportunity

Rolling qualified retirement plan distributions into an IRA isn't simply a way to keep your nest egg potentially growing and compounding pre-tax, it also may create a lasting fund for your beneficiaries for many years to come.

With that in mind, here is a list of dos and don'ts that can help put you and your loved ones on a path to financial security. Some dos and don'ts are:

<p>DO invest as much as possible in your 401(k) or 403(b) plan</p> <p>DO roll your retirement plan funds into another employer-sponsored retirement plan or into an IRA, which might give you more investment flexibility</p> <p>DO be aware of special rules if your retirement plan contains qualified employer stock</p> <p>DO work to ensure your IRA is able to have the greatest financial benefits and lowest tax burden on the beneficiaries you name</p>	<p>DON'T take a lump-sum payout from your retirement plan when you leave your job. If you are under age 59½, your money will lose its tax-deferred status and you may incur additional penalties</p> <p>DON'T withdraw money from your IRA before age 59½ unless you meet one of the IRS exceptions. Your money will be taxed at the ordinary income tax rate and you'll incur an additional 10% penalty</p> <p>DON'T forget to name beneficiaries for your IRA</p>
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¹ The strategy is generally designed for investors who will not use this IRA for their own retirement needs. Changes in future tax laws may substantially reduce or eliminate the benefits of this strategy.

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