IRA Rollover of Qualified Plan Values vs. Lump-Sum Tax Treatment

At retirement, many individuals are faced with the choice of whether to take a lump sum distribution from their qualified plan and pay the income tax or roll the funds into an IRA[1] and pay the tax only as funds are withdrawn.

Consideration	Rollover IRA	Lump-Sum Distribution from Qualified Plan[2]
Generally	Lump sum[3] distributions from qualified plans may be transferred to an arrangement called a "rollover" IRA. To avoid the mandatory 20% federal income tax withholding rule, the payment must be made directly to the rollover IRA.	The taxpayer may choose to take all of a qualified retirement plan distribution outright and pay the tax.[4] IRC Sec. 402(d). There will be a mandatory 20% federal income tax withholding. Some states may also require income tax withholding.
Taxation at distribution	No tax is due at the time of the transfer to the IRA, but later distributions are taxed as ordinary income. The IRA must begin distribution by April 1 following the year in which the individual attains age 70½.	Taxpayers age 50 or more on 1/1/86 will have a choice at retirement age to: (1) Pay tax at capital gains rates (up to 20%) on pre-1974 portion and at ordinary income rates for the post-1973 portion, or (2) Elect 10-year averaging for the post-1973 portion or the entire amount (at 1986 rates).

[1] The comments in this report refer to a traditional IRA and not the Roth IRA.

[2] Individuals must be at least age 59½ to avoid the 10% income tax penalty for early withdrawals, subject to certain exceptions.

[3] There are special requirements for lump-sum distributions.

[4] If a lump-sum distribution from a qualified plan includes appreciated employer securities, the tax on the net unrealized appreciation may be deferred until the securities are disposed of in a taxable transaction. See IRC Sec. 402(e)(4)(B).