When you leave an employer, you have various options for what to do with your retirement account. (UBS)

What should you do with your old 401(k) plan?

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When you leave a job, you may be wondering what happens to the money you worked hard to save in that employer's retirement plan and what action, if any, needs to be taken. It isn't always clear where exactly it should be moved to next or if it should be left where it is. While there’s no right answer for everyone, it’s important to make sure you have a complete understanding of your options. Read on for an overview of the four options you can pick from and key considerations.

Option 1: Withdraw the money as a lump sum

When you cash out of a retirement account, the money is sent to you directly. This means that you can deposit the funds in your bank account and spend the money however you'd like. But, you won't be able to spend it all. That's because, generally speaking, your employer plan will be required to withhold 20% as a prepayment of federal income taxes, and you may be subject to a 10% penalty if you weren't at least age 55 when you left that job. What's more, you may end up owing more money to the IRS when you file your taxes depending on your income level.

Option 2: Leave the money in your plan

Generally speaking, if your balance is over USD 7,000 in your employer-sponsored retirement plan, then you're able to keep the money where it is. Balances left in a plan that are below this threshold are typically “forced out,” which means the funds would generally be rolled over to an IRA. If your vested balance is below USD 1,000, your previous employer may cash out your account and send you a check in the mail—if not rolled over to an IRA or your new employer's plan, this would likely result in the same taxes and penalty mentioned above in Option 1.

Option 3: Roll over to your new employer plan

If you've moved to a new job and are eligible to participate in their 401(k) plan, you may be able to roll your existing account into the new plan. While the money would be cashed out of your plan, you won't be subject to the taxes and penalties described above (Option 1) as long as the funds are rolled directly over to the new plan. This means the dollars will be able to maintain their tax-deferred status in the new plan until they are distributed in retirement. Before taking any action, it's important to understand your new employer's rollover rules to confirm that the rollover would be accepted.

Option 4: Roll over to a Traditional IRA or Roth IRA

Similar to rolling your 401(k) account from a previous employer's plan to a new employer's plan, rolling it into a Traditional IRA allows the funds to maintain the same tax-deferred status. And, if you roll a Roth 401(k) from a previous employer into a Roth IRA, the assets will continue to grow in a tax-free environment.

You also have the option to roll a Traditional 401(k) into a Roth IRA. However, this is considered a Roth conversion and is a taxable event. The tax burden of a Roth conversion is based on the taxable portion of your Traditional IRA or 401(k), which is the amount in excess of any nondeductible (after-tax) contributions.

What should you do?

If you're considering leaving the money in the plan, keep in mind that your vesting is based on your length of service, not how long the money has been in the account—if you aren't fully vested when you leave that job, then you forfeit the dollars that are unvested. Even still, there are many reasons why you may decide to leave your money in the plan, such as lower fees or the plan's investment line-up. In the instance you have not identified any such reason, you may wish to consider your other options.

Additionally, it's important to note that as a former employee, you won't be able to continue contributing to the plan. This doesn't mean that you cannot or should not contribute to a new employer's plan or an IRA (if applicable)—these are among the best ways to grow your wealth on a tax-advantaged basis. But your 401(k) contributions, up until you separated from service, occurred automatically (as a payroll election that was deducted from your paychecks). To continue saving automatically and stay on track for retirement, you may want to consider setting up new automatic savings contributions (and investment elections) in another IRA and/or 401(k) account.

Read the full report **Modern Retirement Monthly: What should you do with your old 401(k) plan?** 26 June 2024.

Watch the **video summary** of three steps to take with your retirement savings when you leave a job.

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