RETIREMENT PLANNING WHITE PAPER

401(k) Mistakes When Leaving an Employer

A practical guide to rollover choices, taxes, timing, plan rules, and retirement-income consequences.

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Published
August 2026
Client Education Series

Executive Summary

Leaving a job, retiring, or facing a layoff creates a financial transition point. The biggest mistake is often not choosing the 'wrong product' - it is acting before the plan rules, tax consequences, liquidity needs, and long-term income strategy are understood.

A 401(k) decision should begin with the available choices. Depending on the plan, a participant may be able to leave money in the former employer's plan, roll eligible assets to a new employer plan, roll them to an IRA, or take a taxable distribution. Each route can affect fees, investment choices, services, creditor protections, withdrawal flexibility, and future income planning.

Planning principle

The right decision depends on the household's complete circumstances. Use this guide to identify the questions that should be answered before money is moved, benefits are claimed, or long-term income choices are locked in.

Mistake #1: Cashing out too quickly

A cash distribution can create immediate taxable income. If the distribution is paid directly to the participant, an eligible rollover distribution from a retirement plan is generally subject to 20% mandatory federal withholding. The participant may still complete a 60-day rollover, but must replace the amount withheld from other funds to roll over the full distribution.

For people under age 59½, an additional 10% tax may apply unless an exception is available. Age-based exceptions, separation-from-service rules, plan loans, and company stock can make the analysis more complicated, so the tax result should be confirmed before money is distributed.

Mistake #2: Confusing a direct rollover with a 60-day rollover

In a direct rollover, the plan sends the eligible amount directly to the receiving retirement plan or IRA, or issues a check payable to the receiving trustee/custodian for the participant's benefit. The IRS states that mandatory 20% withholding does not apply to a direct rollover.

When a distribution is paid to the participant instead, the 60-day clock and withholding rules matter. Missing the deadline can turn an intended rollover into taxable income unless a waiver or self-certification rule applies.

What to remember

Retirement planning is a coordination exercise. Taxes, liquidity, market risk, longevity, income guarantees, and survivor needs should be evaluated together rather than one account at a time.

Mistake #3: Moving the account without comparing what is being given up

An IRA may offer broader investment and insurance choices, consolidated statements, and different service options. An employer plan may offer institutional pricing, unique investments, plan-level fiduciary oversight, loan features, or creditor protections that are different from an IRA. A rollover should compare both sides rather than assume one structure is always better.

If employer stock is held inside the plan, special tax rules may apply. Net unrealized appreciation (NUA) treatment can be lost if company shares are rolled to an IRA before the strategy is evaluated.

Mistake #4: Ignoring the retirement-income job of the account

Once retirement begins, the account is no longer only an accumulation vehicle. It may need to fund monthly spending, bridge the years before Social Security, provide emergency liquidity, support a surviving spouse, and absorb market volatility.

Before moving assets, ask which dollars will be used first, how much income must be dependable, how taxes may change after retirement, and whether the new structure preserves enough liquidity for unexpected expenses.

A better decision process

Start with the plan's Summary Plan Description and distribution paperwork. Identify vested balance, outstanding loans, company stock, after-tax or Roth sources, available installment options, fees, and any special withdrawal rules.

Then compare the four practical destinations - stay in the existing plan, move to a new employer plan, roll to an IRA, or distribute cash - against your retirement-income needs rather than choosing based only on convenience.

Questions to Ask Before You Act

- ✓ What are my exact distribution options under the current plan?
- ✓ Is a direct rollover available and where should the check be payable?
- ✓ Are there plan loans, employer stock, Roth money, or after-tax contributions that require special handling?
- ✓ What fees, services, investment choices, and creditor protections would change after a rollover?
- ✓ How does this account fit the first 5-10 years of retirement income?
- ✓ Have tax and legal questions been reviewed before paperwork is submitted?

A useful next step

Bring recent statements, plan documents, Social Security estimates, pension information, tax returns when relevant, and your expected monthly spending to a retirement-income review. The goal is to understand what you already own, what the money needs to accomplish, and which risks need to be addressed before a transaction is made.

Schedule a Retirement Income Review

Visit **www.retirementincomesolutionsnc.com** to request a review.

Sources and Further Reading

Internal Revenue Service - Rollovers of retirement plan and IRA distributions
https://www.irs.gov/retirement-plans/plan-participant-employee/rollovers-of-retirement-plan-and-ira-distributions

Internal Revenue Service - 401(k) Resource Guide - General Distribution Rules
https://www.irs.gov/retirement-plans/plan-participant-employee/401k-resource-guide-plan-participants-general-distribution-rules

FINRA - Selecting Retirement Payout Methods
https://www.finra.org/investors/learn-to-invest/types-investments/retirement/managing-retirement-income/selecting-retirement-payout-methods

Disclosure

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