

401(k) Resource Guide - Plan Sponsors - General Distribution Rules

Generally, distributions of elective deferrals **cannot** be made until one of the following occurs:

- The participant dies, becomes disabled, or otherwise has a severance from employment.
- The plan terminates and no successor defined contribution plan is established or maintained by the employer.
- The participant reaches age 59½ or incurs a financial hardship.

Depending on the terms of the plan, distributions may be:

- Nonperiodic, such as lump-sum distributions or
- Periodic, such as annuity or installment payments.

In certain circumstances, the plan administrator must obtain the participant's consent before making a distribution. Generally, consent is required if the participant's account balance exceeds \$5,000. Depending on the type of benefit distribution provided for under the 401(k) plan, the plan may also require the consent of the participant's spouse before making a distribution. A plan may provide that rollovers from other plans are not included in determining whether the participant's account balance exceeds the \$5,000 amount.

If a distribution in excess of \$1,000 is made, and the participant (or designated beneficiary) does not elect to (i) receive the distribution directly or (ii) make an election to roll over the amount to an eligible retirement plan, the plan administrator must transfer the distribution to an individual retirement plan of a designated trustee or issuer and must notify the participant (or beneficiary) in writing that the distribution may be transferred to another individual retirement plan.

Required distributions. A 401(k) plan must provide that each participant will either:

- Receive his or her entire interest (benefits) in the plan by the required beginning date (defined below), or
- Begin receiving regular periodic distributions by the required beginning date in annual amounts calculated to distribute the participant's entire interest (benefits) over his or her life expectancy or over the joint life expectancy of the participant and the designated beneficiary (or over a shorter period).

These required distribution rules apply individually to each qualified plan. The required distribution from a 401(k) plan cannot be satisfied by making a distribution from another plan. The plan document must provide that these rules override any inconsistent distribution options previously offered.

Minimum distribution. When the participant's account balance is to be distributed, the plan administrator must determine the minimum amount required to be distributed to the participant each calendar year. Information to help the administrator figure the minimum distribution amount is included in [Publication 575](#), Pension and Annuity Income.

The **required beginning date** is April 1 of the first year after the later of the following years:

- Calendar year in which the participant reaches age 70½.
- Calendar year in which the participant retires.

However, a plan may require that the participant begin receiving distributions by April 1 of the

year after the participant reaches age 70½, **even if the participant has not retired.**

If the participant is a 5% owner of the employer maintaining the plan, then the participant must begin receiving distributions by April 1 of the first year after the calendar year in which the participant reaches age 70½. Additional information to help determine a participant's required beginning date is included in [Publication 575](#).

Distributions after the starting year. The distribution required to be made by April 1 is treated as a distribution for the starting year. (The starting year is the year in which the participant reaches age 70 ½ or retires, whichever applies, to determine the participant's required beginning date, above.) After the starting year, the participant must receive the required distribution for each year by December 31 of that year. If no distribution is made in the starting year, required distributions for 2 years must be made in the next year (one by April 1 and one by December 31).

Distributions after participant's death. [Publication 575](#) includes information regarding the special rules covering distributions made after the death of a participant.

Hardship distributions. A 401(k) plan may allow employees to receive a hardship distribution because of an immediate and heavy financial need. Hardship distributions from a 401(k) plan are limited to the amount of the employee's **elective deferrals** and generally do not include any income earned on the deferred amounts. If the plan permits, certain employer matching contributions and employer discretionary contributions may also be included in hardship distributions. Hardship distributions cannot be rolled over to another plan or IRA.

A distribution is treated as a hardship distribution only if it is made on account of the hardship. For purposes of this rule, a distribution is made on account of hardship only if the distribution is made both on account of an **immediate and heavy financial need** of the employee and is **necessary to satisfy that financial need**. The determination of the existence of an immediate and heavy financial need and of the amount necessary to meet the need must be made in accordance with nondiscriminatory and objective standards set forth in the plan.

A distribution on account of hardship must be limited to the **distributable amount**. The distributable amount is equal to the employee's total elective contributions as of the date of distribution, reduced by the amount of previous distributions of elective contributions.

Immediate and heavy financial need. Whether an employee has an immediate and heavy financial need is to be determined based on all relevant facts and circumstances. A distribution made to an employee for the purchase of a boat or television would generally not constitute a distribution made on account of an immediate and heavy financial need. **A financial need may be immediate and heavy even if it was reasonably foreseeable or voluntarily incurred by the employee.**

A distribution is deemed to be on account of an immediate and heavy financial need of the employee if the distribution is for:

- Expenses for medical care previously incurred by the employee, the employee's spouse, or any dependents of the employee or necessary for these persons to obtain medical care;
- Costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments);
- Payment of tuition, related educational fees, and room and board expenses, for the next 12 months of postsecondary education for the employee, or the employee's spouse, children, or dependents; or
- Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence.

Note: The final 401(k) regulations were published in December 2004, and apply for plan years beginning on or after January 1, 2006. However, plan sponsors are permitted to apply these final regulations to any plan year that ends after December 29, 2004, provided the plan applies all the rules of the final regulations, to the extent applicable, for that plan year and all subsequent plan years. Caution! A decision to apply these regulations in the middle of a plan year can only be successfully implemented if the plan has been operated in accordance with the regulations for that year.

The final regulations add the following expenses to those deemed to be immediate and heavy financial needs:

- Funeral expenses
- Certain expenses relating to the repair of damage to the employee's principal residence.

Distribution necessary to satisfy financial need. A distribution may not be treated as necessary to satisfy an immediate and heavy financial need of an employee to the extent the amount of the distribution is in excess of the amount required to relieve the financial need or to the extent the need may be satisfied from other resources that are reasonably available to the employee.

This determination generally is to be made on the basis of all relevant facts and circumstances. The employee's resources are deemed to include those assets of the employee's spouse and minor children that are reasonably available to the employee. Thus, for example, a vacation home owned by the employee and the employee's spouse, whether as community property, joint tenants, tenants by the entirety, or tenants in common, generally will be deemed a resource of the employee. **The amount of an immediate and heavy financial need may include any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution.**

An immediate and heavy financial need generally may be treated as not capable of being relieved from other resources reasonably available to the employee if the employer relies upon the employee's written representation, unless the employer has actual knowledge to the contrary, that the need cannot reasonably be relieved:

- Through reimbursement or compensation by insurance or otherwise;
- By liquidation of the employee's assets;
- By cessation of elective contributions or employee contributions under the plan; or
- By other distributions or nontaxable (at the time of the loan) loans from plans maintained by the employer or by any other employer, or by borrowing from commercial sources on reasonable commercial terms in an amount sufficient to satisfy the need.

A need cannot reasonably be relieved by one of the actions listed above if the effect would be to increase the amount of the need. For example, the need for funds to purchase a principal residence cannot reasonably be relieved by a plan loan if the loan would disqualify the employee from obtaining other necessary financing.

A distribution is deemed necessary to satisfy an immediate and heavy financial need of an employee if all of the following requirements are satisfied:

- The distribution is not in excess of the amount of the immediate and heavy financial need of the employee.
- The employee has obtained all distributions, other than hardship distributions, and all nontaxable (at the time of the loan) loans currently available under all plans maintained by the employer.
- The employee is prohibited, under the terms of the plan or an otherwise legally

enforceable agreement, from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 6 months after receipt of the hardship distribution.

Rollovers from a 401(k) plan. A rollover occurs when the participant receives a distribution of cash or other assets from one qualified retirement plan and contributes all or part of the distribution within 60 days to another qualified retirement plan or traditional IRA. This transaction is not **taxable** but it is **reportable** on [Form 1099-R](#) and the participant's federal tax return. A participant can roll over most distributions **except** for:

- A distribution that is one of a series of payments based on life expectancy or paid over a period of ten years or more,
- A required minimum distribution,
- A corrective distribution of excess deferrals or contributions (including income allocable to these amounts),
- A hardship distribution, or
- Dividends on employer securities.

After-tax employee contributions can only be rolled over to a traditional IRA or to certain defined contribution plans.

Any taxable amount that is not rolled over must be included in income in the year received. If the distribution is paid to the participant, he or she has 60 days from the date received to roll it over. Any taxable distribution paid to a participant that is eligible for rollover is subject to mandatory withholding of 20%, even **if the participant indicates that he or she intends to roll the distribution over later.**

If the participant is under age 59 ½ at the time of the distribution, any taxable portion not rolled over may be subject to a 10% additional tax on early distributions (described below).

For further information about rollovers and transfers, refer to [Publication 575](#), and [Publication 560](#), Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans).

Tax on early distributions. If a distribution is made to a participant before he or she reaches age 59½, the participant may be liable for a 10% additional tax on the distribution. This tax applies to the amount received that the employee must include in income.

Exceptions. The 10% tax will not apply if distributions before age 59½ are made in any of the following circumstances:

- Made to a beneficiary (or to the estate of the participant) on or after the death of the participant.
- Made because the participant has a qualifying disability.
- Made as part of a series of substantially equal periodic payments beginning after separation from service and made at least annually for the life or life expectancy of the participant or the joint lives or life expectancies of the participant and his or her designated beneficiary. (The payments under this exception, except in the case of death or disability, must continue for at least 5 years or until the employee reaches age 59½, whichever is the longer period.)
- Made to a participant after separation from service if the separation occurred during or after the calendar year in which the participant reached age 55.
- Made to an alternate payee under a qualified domestic relations order ([QDRO](#)).
- Made to a participant for medical care up to the amount allowable as a medical expense deduction (determined without regard to whether the participant itemizes deductions).
- Timely made to reduce excess contributions.

- Timely made to reduce excess employee or matching employer contributions.
- Timely made to reduce excess elective deferrals.
- Made because of an IRS levy on the plan., or
- Made on account of certain [disasters](#) for which IRS relief has been granted.

Reporting the tax. To report the tax on early distributions, a participant may have to file [Form 5329](#), Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts. See the [Form 5329 instructions](#) for additional information about this tax.

Loans from 401(k) plans. Some 401(k) plans permit participants to borrow from the plan. The plan document must specify if loans are permitted. A loan from the 401(k) plan is **not taxable if it meets the criteria below.**

Generally, if permitted by the plan, a participant may borrow up to **50%** of his or her vested account balance up to a maximum of \$50,000. The loan must be **repaid within 5 years**, unless the loan is used to buy the participant's main home. The loan repayments must be made in **substantially level payments**, at least quarterly, over the life of the loan.

The participant must reduce the \$50,000 amount, above, if he or she already had an outstanding loan from the plan (or any other plan of the employer or related employer) during the **1-year period ending the day before the loan**. The amount of the reduction is the participant's highest outstanding loan balance during that period minus the outstanding balance on the date of the new loan.

Certain participant loans may be treated as taxable distributions. For more information, refer to the section, "Loans Treated as Distributions," in [Publication 575](#).