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# Inservice distributions in the 2020s



# Four rules on timing of distributions



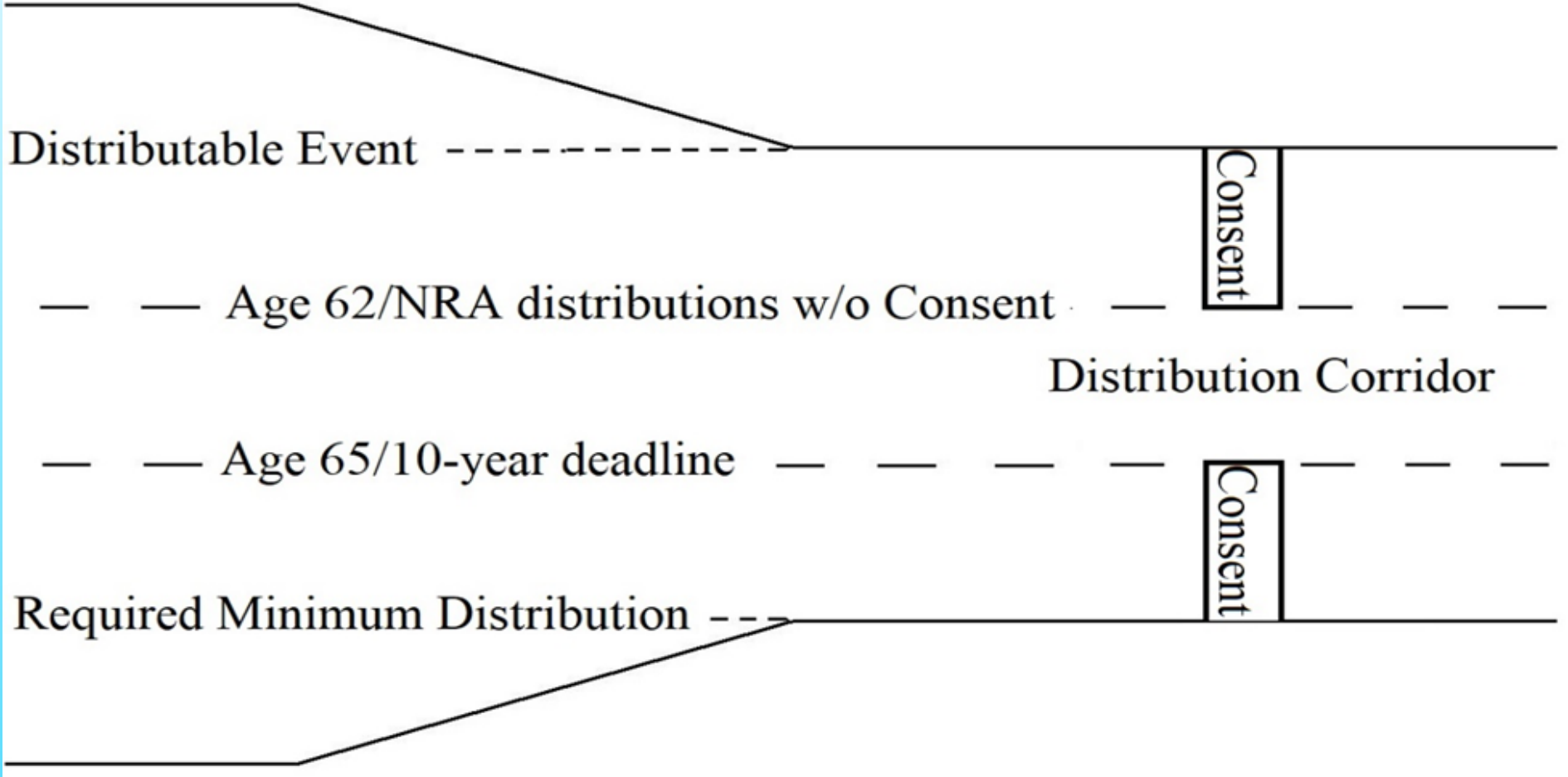
## ▶ Two rules limit when distributions can begin:

1. Distributions cannot begin in the absence of a distributable event. This is true regardless of the consent of the participant.
2. If the vested account balance (or accrued benefit) exceeds \$5,000, distributions to a participant cannot begin before the later of age 62 or normal retirement age in the absence of participant consent.
  - ▶ Increases to \$7,000 next year

## ▶ Two rules mandate distributions begin by a particular date:

3. Distributions must begin by the age-65/10-year distribution deadline unless the participant consents in writing to a later distribution
4. Required Minimum Distributions (RMDs) must begin by the Required Beginning Date (RBD), regardless of the consent of the participant

# Distribution corridor



The law provides a set of available distributable events

Different options for different plan types

Examples:

Age 59 ½

Severance from  
employment

Hardship distribution

Plan can specify from those events which it will offer

Other than distributions plan mandates, participant can choose whether to take distribution authorized by the plan

THE LAW,  
THE PLAN,  
AND THE  
PARTICIPANT

# Universal distributable events



- ▶ The law permits these events for all types of plans:
  - ▶ Employment termination
  - ▶ Death
  - ▶ Plan termination
    - ▶ This can mean different things for different plans

# Defined benefit plans

- ▶ Universal events
  - ▶ Employment termination
  - ▶ Death
  - ▶ Plan termination
- ▶ Attainment of normal retirement age
- ▶ Attainment of age 59 ½
- ▶ Disability



# Money purchase pension/target benefit plans



- ▶ Attainment of normal retirement age
- ▶ Attainment of age 59 ½
- ▶ Disability
- ▶ Lifetime income distribution
- ▶ Qualified long-term care distribution
- ▶ Qualified disaster recovery distribution

# 401(k)/403(b) distributable events

Apply to deferrals, QNECs, QMACs, Safe Harbor

Generally apply to 403(b) custodial accounts



- ▶ Attainment of age 59½
- ▶ Hardship distributions
- ▶ Disability
- ▶ Corrective distributions
- ▶ ESOP dividend distribution
- ▶ Qualified reservist distribution
- ▶ EACA permissible withdrawal
- ▶ Deemed severance
- ▶ Qualified birth and adoption distribution
- ▶ Lifetime income distribution
- ▶ Qualified disaster recovery distribution
- ▶ Emergency personal expense distributions
- ▶ Distributions to domestic abuse victims
- ▶ Qualified long-term care distributions
- ▶ Distributions from pension-linked emergency savings accounts



# Nonelective/matching contributions in PS/401(k)



- ▶ Regulations provide stated event standard:
  - ▶ “after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as layoff, illness, disability, retirement, death, or severance of employment”
- ▶ Essentially allows any distributable event permitted for 401(k) plan
- ▶ Also allows
  - ▶ Younger age (e.g., 50)
  - ▶ 2 years after contribution
  - ▶ 60 months of participation
- ▶ Also applies to employer contributions in 403(b) annuity contracts

# 457(b) distributable event



## **Governmental and tax-exempt**

- ▶ January 1 of year attain age 70½
- ▶ Unforeseeable emergency distributions
- ▶ Corrective distributions
- ▶ Deemed severance
- ▶ De minimis distributions
- ▶ Qualified disaster recovery distributions
- ▶ Qualified long-term care distributions

## **Governmental only**

- ▶ January 1 of year attain age 59 ½
- ▶ EACA permissible withdrawal
- ▶ Lifetime income distributions
- ▶ Qualified birth and adoption distributions
- ▶ Emergency personal expense distributions
- ▶ Distributions to domestic abuse victims
- ▶ Distributions from pension-linked emergency savings accounts

# TAXES



# No free lunch



- ▶ These distributions are taxable
- ▶ They reduce retirement savings
  - ▶ Especially if they aren't rolled over
- ▶ Early distribution penalty tax applies to many of them

# Early distribution penalty tax



- ▶ Applies to taxable portion of distributions before age 59 ½
- ▶ Report on 5329 or directly on 1040, Schedule 2
- ▶ Claim exemption on 5329
- ▶ 457(b) distributions exempt
- ▶ 25% penalty applies in first two years of SIMPLE IRA participation

# Lots of exemptions



- ▶ Distribution from plan after separation from service when separation occurs in or after year you reach age 55
  - ▶ Younger age applies to certain public safety officials
- ▶ Series of substantially equal periodic payments
- ▶ Death
- ▶ Unreimbursed medical expenses  $> 7.5\%$  AGI
- ▶ QDRO distributions from plan to alternate payee
- ▶ EACA permissible withdrawals
- ▶ IRS levy

# More exemptions



- ▶ Qualified reservist distributions
- ▶ ESOP dividends
- ▶ Qualified birth/adoption distributions
- ▶ Terminal illness distributions
- ▶ Long-term care distribution
- ▶ Qualified disaster recovery distribution
- ▶ Emergency personal expense distribution
- ▶ Domestic abuse victim distribution
- ▶ Pension-linked emergency savings account distribution



# 401(K)/403(B) PLAN TERMINATION





# Termination as distributable event: 401(k)



- ▶ You can always terminate a 401(k) plan
  - ▶ Whether you can distribute assets to participants or allow them to roll over depends on whether it is a distributable event
  - ▶ If it is not a distributable event, you can transfer the assets to another plan
    - ▶ Keeping the plan in existence defeats the termination

# 401(k) termination requirements



- ▶ The distributions must be in a lump sum
- ▶ The employer does not establish or maintain an **alternative defined contribution plan** during the period
  - ▶ That begins on the effective date of termination, the later of
    - ▶ The date specified in the termination amendment, or
    - ▶ The date the amendment was signed
  - ▶ And ends 12 months after all assets are distributed
- ▶ Similar rule applies to 403(b), looking at an alternative 403(b) plan

# What is and isn't an alternative DC plan



## **IS**

- ▶ 401(k)
- ▶ Profit sharing
- ▶ Money purchase pension

## **ISN'T**

- ▶ 403(b)
- ▶ 457
- ▶ SEP
- ▶ SIMPLE IRA
- ▶ ESOP
- ▶ Defined benefit

# More on alternative DC plans



- ▶ A plan is not an alternative defined contribution plan if fewer than 2% of the employees who were eligible to defer to the terminated 401(k) plan (on the termination date) were eligible to participate in the employer's alternative defined contribution plan at any time during the 24-month period that begins 12 months before the effective date of plan termination.
- ▶ A plan is an alternative defined contribution plan only if it is established or maintained by the employer who sponsored the terminating plan.
  - ▶ For this purpose, the “employer” is determined on the effective date of termination (the termination date specified in the resolution or amendment)



# OTHER DISTRIBUTABLE EVENTS



# Qualified reservist distribution



- ▶ Limited to elective deferrals
- ▶ To an individual who is in a US military reserve unit
  - ▶ Called to active duty for at least 179 days (or indefinitely)
- ▶ Distribution made prior to end of active duty period
- ▶ Can be repaid to an IRA up to two years after the last day of the participant's active duty period
  - ▶ Nondeductible

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
No
<b>Repay?</b>
To IRA
<b>Early penalty?</b>
Exempt
<b>Effective</b>
Now

# Deemed severance



- ▶ The employee is in the US uniformed services on active duty for at least 30 days
- ▶ Barred from deferring for 6 months
  - ▶ Actual severance or qualified reservist don't have this limitation
- ▶ Helpful for employee with military differential pay

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
Yes
<b>Repay?</b>
No
<b>Early penalty?</b>
Yes
<b>Effective</b>
Now

# EACA permissible withdrawal



- ▶ EACA: Automatic enrollment feature that satisfies notice and uniformity requirements
- ▶ Employee must elect to withdraw default deferrals during 90-day period following first pay period default deferral taken
  - ▶ All or nothing
  - ▶ Plan can shorten period to 30-90 days
- ▶ Included in income in year of withdrawal
  - ▶ Forfeit match

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
Gov't
<b>Repay?</b>
No
<b>Early penalty?</b>
No
<b>Effective</b>
Now



# De minimis 457(b) withdrawal



## ► Requirements:

- Account balance (minus rollovers) is does not exceed \$5,000
  - Increases to \$7,000 next year
  - Plan can impose lower limit
- No deferral or employer contribution for the participant in the two years prior to distribution
- No prior de minimis distributions to participant
- Plan can provide distribution is automatic or upon participant request

<b>401(k)?</b>
No
<b>403(b)?</b>
No
<b>457(b)?</b>
Yes
<b>Repay?</b>
No
<b>Early penalty?</b>
No
<b>Effective</b>
Now

# Qualified birth and adoption distribution (QBAD)



- ▶ Distribution in one-year period after birth/finalized adoption
- ▶ Up to \$5,000 per child
  - ▶ Not related to expenses
  - ▶ Applies to all plans of related employers
- ▶ Can reasonably rely on employee's certification
- ▶ No 10% premature distribution penalty
- ▶ EE must include name, age, and TIN of child on return

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
Gov't
<b>Repay?</b>
Yes
<b>Early penalty?</b>
No
<b>Effective</b>
Now

# Eligible adoptee



- ▶ A child can be an eligible adoptee of a participant if
  - ▶ The child is not the child of the participant's spouse and
  - ▶ Either:
    - ▶ The child is under 18 or
    - ▶ The child is physically or mentally incapable of caring for himself or herself
      - ▶ The IRS interprets this as meaning that the child is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration.

# Plan doesn't treat as eligible rollover distribution



- ▶ No need for special tax notice
- ▶ No mandatory 20% withholding
  - ▶ 10% voluntary withholding applies
- ▶ Don't have to cooperate with direct rollover

# Participant recontribution



- ▶ Participant can recontribute/rollover
- ▶ Rollover deadline:
  - ▶ 3 years after distribution
  - ▶ If distribution before 12/29/2022, deadline is 12/31/2025
- ▶ If participant can make rollover to distributing plan, plan required to accept recontribution
- ▶ File an amended return to exempt original distribution from tax

# ESOP dividend distribution



- ▶ Limited to ESOPs
- ▶ Distributed dividends on C Corporation employer securities held by plan
- ▶ See Code 404(k)(2)

<b>401(k)?</b>
Yes
<b>403(b)?</b>
No
<b>457(b)?</b>
No
<b>Repay?</b>
No
<b>Early penalty?</b>
No
<b>Effective</b>
Now

# Qualified long-term care distribution



- ▶ Annual calendar year limit is least of:
  - ▶ Amount employee paid or is charged for long-term care insurance for employee, spouse, or family member
  - ▶ 10% vested accrued benefit
  - ▶ \$2,500 (indexed)
- ▶ Limited to taxable distributions
- ▶ Plan does not treat as eligible rollover distribution

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
Yes
<b>Repay?</b>
No
<b>Early penalty?</b>
No
<b>Effective</b>
After 12/29/25

# Domestic abuse victim distributions



- ▶ 10% early distribution penalty won't apply to distributions to domestic abuse victims
  - ▶ Limited to lesser of \$10,000 (indexed) or 50% vested benefit
  - ▶ Made during 1-year period beginning on any date individual is victim of domestic abuse by spouse or domestic partner
- ▶ Doesn't apply to DB or QJSA plans (including PS plans subject to QJSA)
- ▶ Can repay (similar to QBADs)
- ▶ Plan does not treat as eligible rollover distribution

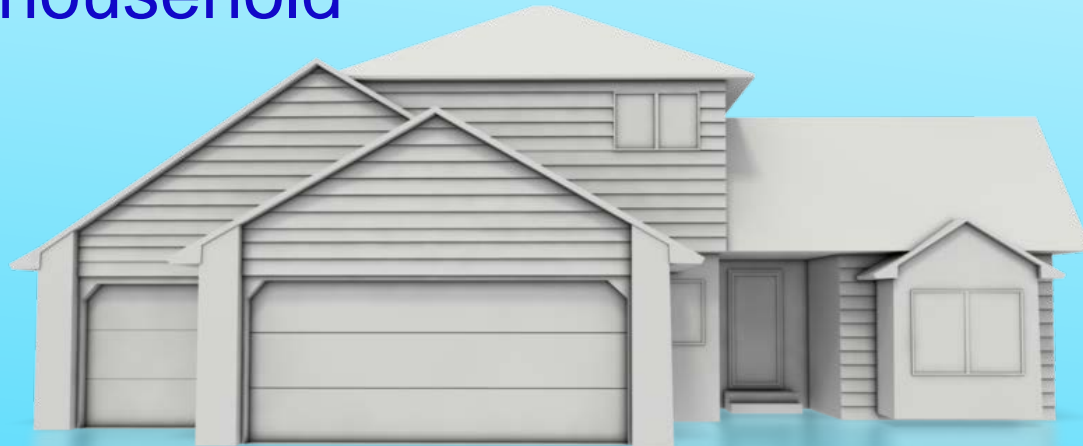
<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
Gov't
<b>Repay?</b>
Yes
<b>Early penalty?</b>
No
<b>Effective</b>
After 2023



# Domestic Abuse Definition



- ▶ Physical, psychological, sexual, emotional, economic abuse
- ▶ Includes efforts to control, isolate, humiliate, or intimidate victim or to undermine victim's ability to reason independently
  - ▶ Includes by means of abuse of victim's child or another family member living in household





# DISTRIBUTIONS BASED ON NEED

Emergency personal expense

Hardship; unforeseeable emergency

Disaster

Pension-linked emergency savings

# Emergency personal expense distributions (EPED)



- ▶ Unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses
  - ▶ Can rely on employee's written certification
- ▶ Doesn't apply to pension plans
- ▶ Can repay (similar to QBADs)
- ▶ Plan does not treat as eligible rollover distribution

Vested Balance	Maximum Amount
< \$1,000	\$0
\$1,000 - \$2,000	Vested balance - \$1,000
Over \$2,000	\$1,000

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
Gov't
<b>Repay?</b>
Yes
<b>Early penalty?</b>
No
<b>Effective</b>
After 2023

# EPED limits



- ▶ Limited to 1/year
- ▶ Barred from EPEDs for next 3 calendar years unless fully recharged by:
  - ▶ Repaying to plan
  - ▶ Deferrals and after-tax contributions
- ▶ Presumably reported on 1099-R; normal distribution fees

# Pension-linked emergency savings accounts (PLESA)



## ▶ Plans can set up PLESAs:



- ▶ Limited to Roth accounts
- ▶ Limited to employee contributions – No employer contributions
- ▶ No new contributions if account balance attributable to contributions to account exceeds \$2,500 (subject to indexing) or lower plan-specified amount
  - ▶ Presumably, contributions net of withdrawals (i.e., not including earnings)
- ▶ HCEs can't contribute
  - ▶ But can draw from earlier contributions

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
Gov't
<b>Repay?</b>
Yes
<b>Early penalty?</b>
No
<b>Effective</b>
After 2023

# More on ESAs



- ▶ Investment can have gains and losses, although required investment intended to be very safe:
  - ▶ Interest bearing account; or
  - ▶ Investment designed to preserve capital consistent with liquidity, offered by regulated institution
- ▶ Must treat emergency savings like deferrals for purposes of match
  - ▶ Match goes in match bucket, not in ESA
  - ▶ No requirement to forfeit or suspend match on withdrawals
    - ▶ But wouldn't you want to?
  - ▶ Maximum annual match with regard to ESAs is \$2,500

# Notes on ESAs



- ▶ Contributions may count against §402(g) limit
  - ▶ §402(g) failures must be corrected first by returning that year's ESA \$
  - ▶ Since HCEs can't use ESA, §402(g) and §415 may be academic
- ▶ Can't charge account (including for Form 1099 preparation) a fee for the first 4 withdrawals/year
  - ▶ Subsequent withdrawals can have reasonable fee
  - ▶ Can charge employer or (maybe) general plan accounts
  - ▲ Must exhaust ESA before taking hardship
- ▶ Can do auto-enroll up to 3%
  - ▶ Can combine with auto enroll for regular deferrals



# More ESA Notes



- ▶ ESAs treated like another source
  - ▶ Although subject to different investment and withdrawal rules
- ▶ Distributions “at discretion of” participant
  - ▶ Sounds like no need for spousal consent
  - ▲ No minimum withdrawal
- ▶ Distribution treated as qualified Roth distribution
  - ▶ Allows tax-free distribution of earnings
  - ▶ Not subject to normal Roth 5-year clock/distributable event rules





# Termination of ESA



- ▶ Employer can terminate arrangement at any time
  - ▶ No anti-cutback right
- ▶ After termination of employment or arrangement:
  - ▶ Participant can choose to move money to another Roth account in plan
    - ▶ And roll from there to a Roth IRA or other Roth account
  - ▶ Otherwise, plan makes account available to participant
  - ▶ Participant's choice



# Hardship distributions



## ► Requires

- Immediate and heavy financial need
  - Safe harbors in regulations
- Necessity of distribution to meet the need
  - Cannot exceed amount of need
  - Participant must exhaust available plan non-hardship distributions
  - Participant must certify he or she has insufficient cash or other liquid assets reasonably available to satisfy the need

## ► Not eligible for rollover

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
No
<b>Repay?</b>
Limited
<b>Early penalty?</b>
Yes
<b>Effective</b>
Now

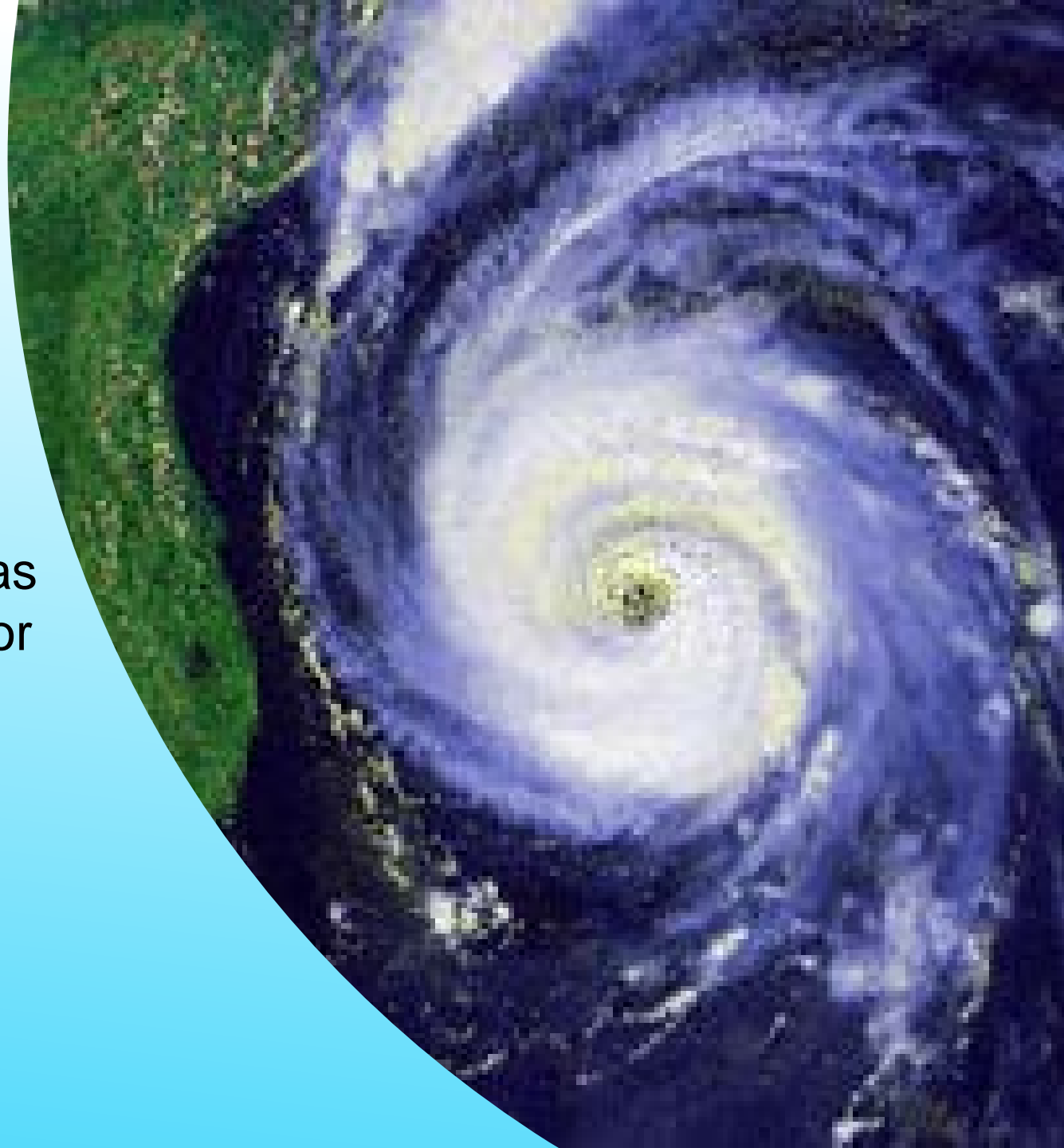
# Safe harbor needs



- ▶ Participant's primary residence
  - ▶ Purchase
  - ▶ Prevent eviction/foreclosure
  - ▶ Casualty loss (IRS Publication 547 – Not limited to disasters)
- ▶ Participant, spouse, family, dependents, beneficiary
  - ▶ Medical
  - ▶ Post-secondary education
  - ▶ Funeral
- ▶ Participant's disaster

# Disaster Loss

Expenses and losses (including loss of income) incurred by the employee on account of a disaster declared by . . . FEMA . . . , provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for individual assistance with respect to the disaster.



# Key Points



- ▶ Limited to disaster qualifying for FEMA **individual** assistance
- ▶ Only applies if **participant's** home or business is in disaster area
  - ▶ No distribution if just spouse, children, parents in disaster area
- ▶ Losses not limited to residential damage. Could include:
  - ▶ Temporary rent
  - ▶ Loss of personal property
  - ▶ Loss of earnings



# Clarification on Safe Harbor Hardships



- ▶ Plan is within safe harbor if it limits hardship needs more narrowly than regulations
  - ▶ **Example: Plan doesn't allow educational hardship distributions**
    - ▶ Plan is still in safe harbor hardship rules
  - ▶ **Example: Plan allows hardship distributions for medical expense of participant, spouse, and children**
    - ▶ Does not allow distributions for expenses of other dependents or the participant's primary beneficiary
    - ▶ Plan is still in safe harbor hardship rules

# Sources



- ▶ 401(k): All funds are available

- ▶ 403(b)

- ▶ Annuity contract: All funds are available

- ▶ Custodial account: Employer contributions aren't available other than

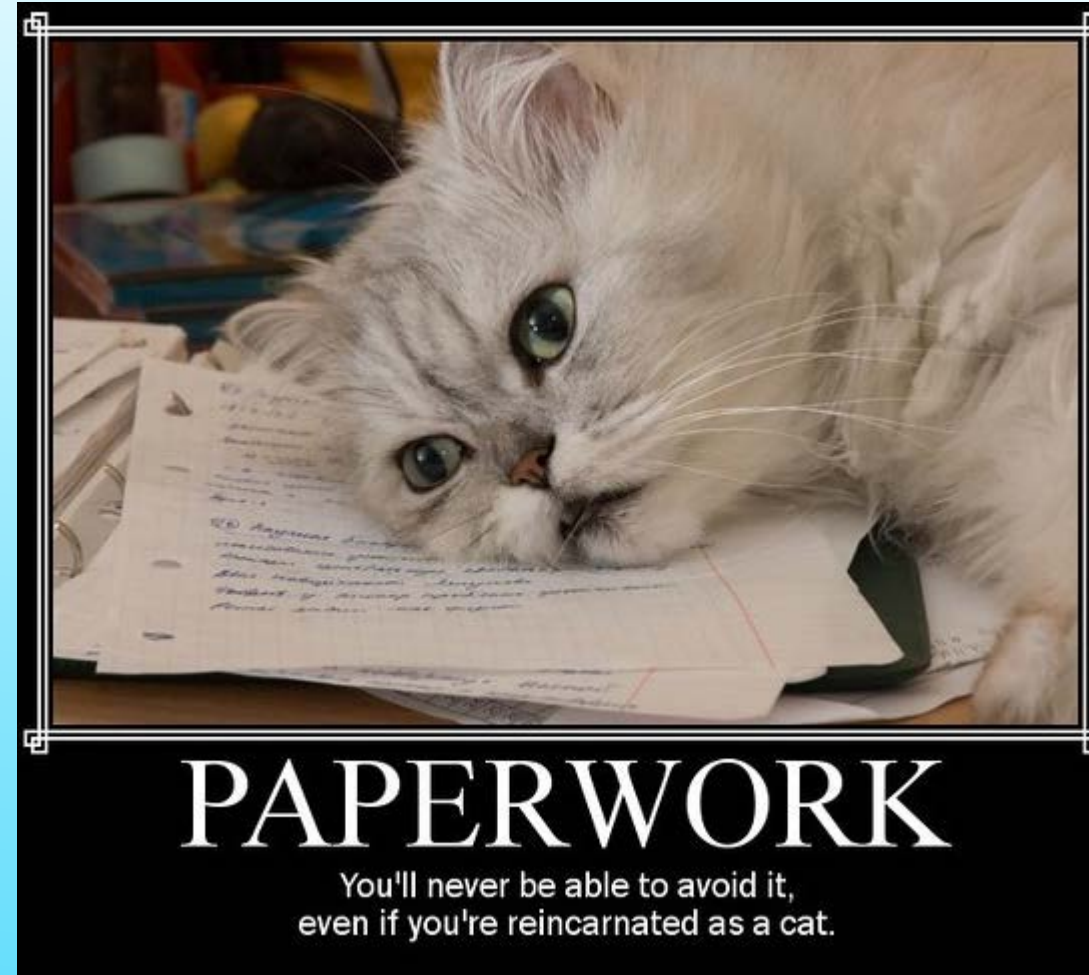
- ▶ QNECs

- ▶ QMACs

- ▶ Safe harbor contributions

# Documentation

- ▶ Three options
  - ▶ Plan requests and retains documentation
    - ▶ Need
    - ▶ Amount
  - ▶ IRS summary verification system
  - ▶ Plan reasonably relies on participant certification





# Limited repayment option



- ▶ Distribution for purchase or construction of principal residence in a Qualified Disaster Area
  - ▶ Plan issues 1099-R as it does for all distributions
- ▶ Because of the Qualified Disaster, it was not so used, and
- ▶ Distribution received during the period starting 180 days before the first day of the Incident Period and ending 30 days after the last day of the Incident Period
- ▶ Can contribute during the period beginning on the first day of the Incident Period and ending 180 days after the Applicable Date
  - ▶ If recontributed, participant reports on Form 8915-F
  - ▶ Treated as rollover

# Unforeseeable emergency distributions



## ► Requires

- Severe financial hardship of the participant or beneficiary
- Necessity of distribution to meet the need
  - Cannot exceed amount of need
  - Participant must exhaust available plan non-hardship distributions
  - Participant must certify he or she has insufficient cash or other assets (including reasonable liquidation) available to satisfy the need

## ► Governmental plan can allow self-certification

- Not tax-exempt plan

<b>401(k)?</b>
No
<b>403(b)?</b>
No
<b>457(b)?</b>
Yes
<b>Repay?</b>
No
<b>Early penalty?</b>
No
<b>Effective</b>
Now

# Unforeseeable emergencies



## ▶ These qualify:

- ▶ Medical expenses (including prescription drugs) resulting from illness or accident, not reimbursed by insurance or otherwise
- ▶ Imminent foreclosure or eviction from primary residence,
- ▶ Funeral expenses,
- ▶ Uninsured casualty losses, including losses following a natural disaster,
- ▶ "Other similar extraordinary and unforeseeable circumstances arising as a result of events beyond" the participant's or beneficiary's control

## ▶ These don't

- ▶ Tuition
- ▶ Home purchase

# Qualified disaster recovery distributions (QDRD)



- ▶ Qualified Disaster: Major disaster declared by President; on FEMA website
- ▶ Qualified Disaster Area: Disaster Area shown on FEMA website
  - ▶ Public or individual assistance
- ▶ Incident Period: When disaster happened; on FEMA website
- ▶ Declaration Date: When President declared disaster
- ▶ Qualified Individual:
  - ▶ Principal residence during Incident Period was in Qualified Disaster Area
  - ▶ Suffered economic loss by reason of Qualified Disaster

<b>401(k)?</b>
Yes
<b>403(b)?</b>
Yes
<b>457(b)?</b>
Yes
<b>Repay?</b>
Yes
<b>Early penalty?</b>
No
<b>Effective</b>
Now

# Disaster example



## California Severe Winter Storms, Flooding, Landslides, and Mudslides

DR-4683-CA



**Incident Period:** Dec 27, 2022 - Jan 31, 2023

**Declaration Date:** Jan 14, 2023

### Quick Links

- **Recovery resources:** [State & Local](#) | [National](#)
- **Connect:** [Social Media](#) | [Mobile App & Text](#)
- **24/7 counseling:** [Disaster Distress Helpline](#)

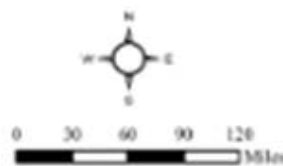
# FEMA-4683-DR, California Disaster Declaration as of 02/22/2023



**Data Layer/Map Description:**  
The types of assistance that have been designated for selected areas in the State of California.

All municipalities in the State of California are eligible to apply for assistance under the Hazard Mitigation Grant Program.

- Designated Counties**
- No Designation
  - Individual Assistance and Public Assistance (Categories A - G)
  - Public Assistance (Categories A - G)



**Data Source:**  
FEMA, ESRI;  
Initial Declaration: 01/14/2023  
Disaster Federal Registry Notice:  
Amendment 09: 02/22/2023  
Datum: North American 1983  
Projection: Lambert Conformal Conic



# QDRD specifics



- ▶ A QDRD is a distribution to a Qualified Individual
  - ▶ That does not exceed \$22,000
    - ▶ Amount of participant's loss is irrelevant
  - ▶ Made during period beginning on first day of Incident Period and ending 179 days after Applicable Date
- ▶ Applicable Date is the latest of:
  - ▶ December 29, 2022 (The date SECURE 2.0 was enacted),
  - ▶ The first day of the Incident Period, or
  - ▶ The Declaration Date

# QDRD Notes



- ▶ Plan does not treat as eligible rollover distribution
- ▶ Plan can rely on participant's certification
- ▶ Participant:
  - ▶ Reports on 8915-F
  - ▶ Has option to spread tax over 3 years
  - ▶ Can recontribute within 3 years if otherwise qualifies as eligible rollover distribution
    - ▶ Plan treats as rollover
    - ▶ Can't recontribute to tax-exempt 457(b); use an IRA instead
  - ▶ Not subject to early distribution penalty



# Comparison



Type	Maximum amount	Can repay to plan?	Premature penalty tax?	Available
QDRD	\$22,000	Yes	No	Now
Hardship	Vested balance; can't exceed need	No	Yes	Now
Pension Linked Emergency Savings	Account balance limited to \$2,500	Yes	No	2024
Emergency personal expense distribution	\$1,000	Yes	No	2024