

Accounting for Success



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Quick Reference Guide to the Taxation of Retirement Plan Distributions

A major benefit to employees who are participating in a qualified retirement plan is the deferral of taxes. Pre-tax deferrals, employer contributions, and the related earnings grow tax-free until the amounts are distributed from the plan. Unfortunately, when a participant takes a distribution upon retirement or an early distribution that is not rolled over, the federal government expects to receive its fair share. The taxation of retirement plan distributions is complex, so it is easiest to keep them straight by following the chart we provided on the next page. To supplement the chart, let's discuss a few concepts on the taxation of distributions.

The taxation of the distribution depends on the type of distribution, when the distribution takes place, whether the distribution is eligible for rollover, and the age of the participant or beneficiary.

No Taxes Withheld

It is important to note that distributions of \$200 or less are not required to have federal taxes withheld. Additionally, distributions that are rolled over to an IRA or another qualified plan are tax-free. In this case, federal taxes are deferred until distributed from that IRA or qualified plan.

10% Tax* at the Individual Taxation Level

The Federal government imposes a 10% early withdrawal tax generally if a participant has not reached age 59 ½. There are exceptions including death, disability, substantially equal periodic payments for the participant's life expectancy or joint life expectancy including the beneficiary, or separation of service at age 55 or older. See Tax Topic 558 from the IRS and the chart below for exceptions.

Mandatory 20% Withholding or Optional 10% Withholding

Mandatory 20% federal tax withholding depends on whether a distribution is considered an eligible rollover distribution. Those eligible rollover distributions are noted below in the chart and generally include distributions due to normal retirement age, early retirement at 59 ½,

termination from the plan sponsor, disability, and a Qualified Domestic Relations Order (QDRO). If a distribution is not an eligible rollover distribution, then 10% federal tax is withheld unless the participant or beneficiary elects to waive such withholding. Some examples of distributions that are not eligible to be rolled over include hardship distributions and required minimum distributions.

*Recently the tax court has held that the Code Section 72(t)(1) 10% early distribution requirement is a tax, not a penalty. Code Section 72(t)(1), clearly labels this as a tax. Other tax court cases have found this to be the case.

Chart Footnotes.

** Non-spousal beneficiaries may ask to have benefits distributed by the plan in a plan-to-plan transfer to an inherited IRA.*

~ Generally, distributions made prior to age 59 1/2 will be assessed an additional 10% early distribution tax.

^ 10% early withdrawal tax does not apply if from an IRA provided the funds are used to buy a first home, pay for college, or needed due to financial hardship.

10% early withdrawal tax applies to distributions made before age 59 1/2 if the distribution came from a 401(k) or 403(b) Plan, even if the money is used to buy a first home, to pay for college, or needed due to financial hardship.

(1) Distributions \$200 or less are not subject to Federal withholding.

(2) Based on the assumption that distribution is paid to participant. If the participant rolls over the distribution to an IRA or another qualified plan, the distribution is tax free (see (a))

(b) Distribution treated as though it were paid in a direct rollover to an eligible retirement plan if the distribution is eligible for tax-free rollover treatment and is recontributed to an eligible retirement plan within the 3-year period beginning on the day after the date on which the distribution was received.

Distributions			Federal Tax (1)(2)		
	Eligible Rollover Distribution?	10% Early Distribution Tax~	Mandatory 20% Withholding	10% Withholding	Participant May Waive Withholding of Taxes
General					
Tax-free Rollover (a)	Y	N	N	N	N/A
Distribution due to IRS Levy under Section 6331	N	N	Y	N	N
Distribution to Alternate Payee due to QDRO	Y	N	Y	N	N
In-Service					
Part of a Series of Substantially Equal Periodic Payments made for the Life (or Life Expectancy) of the Employee or the Joint Lives of Such Employee and Designated Beneficiary	N	N	N	Y	Y
Qualified Reservist Distribution	N	N	N		
Hardship Withdrawals (except as noted below)	N	Y	N	Y	Y
Medical Reasons (to the extent you pay deductible medical expenses exceeding 7½% of you AGI even if you don't itemize your deductions)	N	N	N	Y	Y
College Costs or Primary-Residence made before 59½	N	Y^	N	Y	Y
Corrective Distribution	N	N	N	Y	Y
Coronavirus Related Distributions	Y(b)	N	N	Y	Y
Distributions due to certain emergencies and disasters	N	N	N	Y	Y
Distributions up to \$5,000 for a qualified birth or adoption distribution	N	N	N	Y	Y
Permissive withdrawals from Automatic Enrollment Plan	N	N	N	N	N
Separation of Service					
Terminating (during or after reaching age 55)	Y	N	Y	N	N
Death					
Death Distributors - Spousal Beneficiary	Y	N	Y	N	N
Death Distributors - Non -Spousal Beneficiary	N*	N	N	Y	Y
Disability					
Distributions due to Disability	Y	N	Y	N	N
Retirement					
Normal Retirement (NRA)	Y	N	Y	N	N
Required Minimum Distribution (RMD)	N	N	N	Y	Y
Early Age 59½	Y	N	Y	N	N
Retirement - Early Age 55 or Older	Y	N^	N	Y	Y
Plan Termination					
Plan Termination	Y	N	Y	N	N
Conversions					
In-Plan Roth Conversion to Designated Roth Account	N/A	N	N	N	N/A