IN-SERVICE WITHDRAWALS FROM QUALIFIED RETIREMENT PLANS

Participants in employer-sponsored retirement plans may find themselves dissatisfied with the investment options or the financial planning flexibility offered within the plan. For these individuals, non-hardship in-service withdrawals may provide a solution. However, financial advisors should carefully review the pros and cons of a non-hardship in-service withdrawal with their clients before recommending this option.

The Basics of In-Service Withdrawals

Plan participants may believe that they cannot take a distribution from their employer-sponsored retirement plan (e.g., 401(k)) until a "triggering event" occurs – i.e. death, disability, plan termination, separation from service, or retirement. However, some qualified plans – usually, 401(k)s, 403(b)s, stock-bonus, and profit-sharing plans – may allow for withdrawals even if no triggering event has occurred.

The plan may allow for two types of "in-service" withdrawals: hardship withdrawals and non-hardship withdrawals. Hardship withdrawals are allowed at any age, but only for an immediate financial need and cannot be rolled over into an IRA. The information herein applies only to non-hardship withdrawals.

Not all qualified retirement plans allow non-hardship in-service withdrawals. Typically, only profit-sharing plans or 401(k) plans that are part of a profit-sharing plan or stock-bonus plan permit non-hardship in-service withdrawals. Clients should contact their plan administrator to determine if this type of withdrawal is permitted.

If the employer-sponsored retirement plan permits non-hardship in-service withdrawals, there are typically two limitations on the amount that can be distributed: a) distributions can only be taken from certain types of employer contributions (e.g., vested employer match and earnings thereupon, and rollover amounts from previous employer plans); and b) the monies withdrawn must have been in the plan for at least two years. If the client is over age 59½, salary deferrals may also be available for in-service withdrawals. The plan's Summary Plan Description (SPD) should specify what types of assets may be withdrawn.

Clients who take an in-service withdrawal are free to receive the money directly and keep it. However, doing so will very likely result in the recognition of ordinary income on some or all of the withdrawal. Further, if the client is under age 59½, they may also trigger the 10% early-withdrawal penalty.

Clients who would prefer to maintain tax deferral on the withdrawal may choose instead to roll the money into an IRA.

Potential Benefits of Rolling the Withdrawal into an IRA

If a non-hardship in-service withdrawal is available to a client, the following are some of the potential benefits of rolling over the assets into an IRA:

1. **Wider investment choices** – IRAs generally offer more investment options than an employer-sponsored retirement plan.
2. **Consolidation of assets** – Bringing a client's retirement assets "under one roof" allows the client to reduce the number of statements they receive and may provide greater financial planning flexibility.
3. **Manage fees and expenses** – Employees typically do not have any control over the fees and expenses incurred by their employer-sponsored retirement plans.
4. **Expanded distribution options** – Employer-sponsored retirement plans are not required to offer guaranteed lifetime income options or administer specific financial planning solutions such as 72(t) distributions or automated RMD payments. Many IRA funding options will offer and accommodate these financial planning needs for their clients and their advisors.

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Content on this piece is our summarization of IRS Publication 560, March 9, 2011.

5. **Beneficiary flexibility and control** – Employer-sponsored retirement plans are not required to offer a "stretch" distribution option to beneficiaries or accommodate specific beneficiary designations. Many IRA funding options provide an array of beneficiary distribution options that allow the client to control how death benefit distributions will be distributed.

Potential Drawbacks to the Client

While there are benefits to the client in electing a non-hardship in-service withdrawal, the following are some of the potential drawbacks that should be carefully reviewed and considered with the client:

1. Loans are often permitted from 401(k) plans. Loans are not permitted from IRAs.
2. Certain exceptions to the 10% federal tax penalty for withdrawals prior to age 59½ that apply to employer-sponsored retirement plans do not apply to IRAs.
3. Individuals who continue to work after age 70½ can defer their required minimum distributions (RMDs) on assets held in their current employer's qualified retirement plan until April 1st of the year following the year they separate from service. Assets held in an IRA are subject to RMDs by April 1st of the year following the year they turn 70½.
4. Rolling over employer stock into an IRA will prevent the utilization of the Net Unrealized Appreciation (NUA) and 10-Year Forward Averaging tax strategies.
5. Surrender charges, penalties, fees, and expenses should be carefully reviewed and compared.

A Final Note

Non-hardship in-service withdrawals can play an important role in helping your clients meet their specific financial planning needs. However, clients should seek advice from a qualified tax advisor to discuss all potential tax ramifications of taking a non-hardship in-service withdrawal, including the impact of the withdrawal on plan participation, as well as the rules and procedures for direct and indirect rollovers into an IRA. It is also important to note that the IRS allows, but does not require, employer plans to offer in-service withdrawals; doing so is at the plan sponsor's discretion. Clients should contact their plan administrator and/or review the SPD to see if an in-service withdrawal option is available to them.[1]

For more information, please contact your Internal Wholesaler:

Bank and Financial Institution Representatives: 800/777-7900; in New York: 800/464-7779
Independent and Non-Bank Broker/Dealer Representatives: 800/711-JNLD (5653)
Regional Broker/Dealer Representatives: 800/340-JNLD (5653)

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[1] A copy of the SPD should be available to the client upon request from the plan administrator.