LIMITED ACCESS Is Key to Retirement Saving Success

PRE-RETIREMENT ACCESS

In a voluntary retirement savings system, it is important to provide limited pre-retirement access to retirement accumulations. In the United States, tax rules provide the framework for limited access.

- Knowing that retirement accumulations can be accessed in the event of financial hardship encourages individuals to save more.
- 401(k) plan sponsors may choose to allow in-service access through hardship withdrawals, certain other withdrawals, or plan loans. Plan participants may also take withdrawals after they separate from their employer.
- Individuals may take withdrawals from their individual retirement accounts (IRAs) at any time.
- Withdrawals taken from 401(k) plans or IRAs prior to age 59½ are typically subject to a 10 percent penalty on the taxable portion of the withdrawal.
- US policymakers have allowed exceptions from the 10 percent penalty on early withdrawals for special circumstances (e.g., for armed forces reservists called to active duty or for victims of natural disasters) or certain expenditures (e.g., IRA withdrawals used for a first-time home purchase, education expenses, or health insurance premiums while unemployed).
- US policymakers created special loan and withdrawal rules for individuals negatively affected by the COVID-19 pandemic in 2020.
- 401(k) plan sponsors are responsible for ensuring that withdrawals from the plan meet the Internal Revenue Service (IRS) rules and the terms of the plan. In some cases, plans rely on individuals to self-certify the need for or use of the withdrawal; in some cases, additional documentation is required. Individuals are responsible for determining whether or not the 10 percent penalty applies to a withdrawal, calculated in connection with their annual income tax filings.

LAWS

Regulations regarding access to retirement assets fall under the Internal Revenue Code (IRC) enforced by the IRS.

Withdrawals from 401(k) Plans While Still Employed

Generally, IRS rules restrict a participant's ability to take a distribution while still working for the employer. However, plans may allow participants to take loans from their account or to take withdrawals if the participant is experiencing a hardship (e.g., money needed to pay for certain medical expenses, tuition, or to prevent eviction from, or foreclosure on, a home). In addition, plans may allow participants to take withdrawals once they have reached age 59½, or to withdraw employer profit-sharing contributions or rollover assets (amounts a participant has rolled into the plan from another plan or IRA) while they are working.

IRS rules restrict the amount of the account balance available for either loans or withdrawals.

Withdrawals from Employer-Sponsored Retirement Plans After Job Change or Retirement

See "Portability Is Key" (forthcoming).

IRA Withdrawals

IRA withdrawal rules vary with the type of IRA (traditional versus Roth) and with the age of the taxpayer. Early withdrawals may be subject to a 10 percent penalty, unless meeting an exception.

When Can a Retirement Plan Distribute Benefits?
www.irs.gov/retirement-plans/plan-participant-employee/when-can-a-retirement-plan-distribute-benefits

Retirement Plans FAQs Regarding Hardship Distributions
www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-hardship-distributions

Retirement Topics—Exceptions to Tax on Early Distributions
www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-tax-on-early-distributions

Coronavirus-Related Relief for Retirement Plans and IRAs: Questions and Answers
www.irs.gov/newsroom/coronavirus-related-relief-for-retirement-plans-and-iras-questions-and-answers

Retirement Plans FAQs Regarding Loans
www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-loans

About Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs)
www.irs.gov/forms-pubs/about-publication-590-b

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RESULTS

Most 401(k) plan participants have access to plan loans, but fewer than one in five have loans outstanding

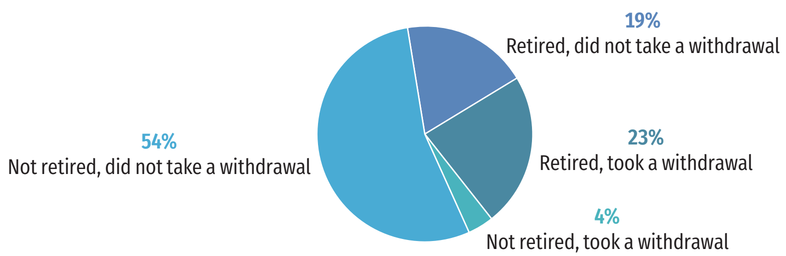
Very few defined contribution plan (DC) participants take in-service or hardship withdrawals from their plans

Percentage of DC plan participants, 2020

**Does not include coronavirus-related distributions (CRDs), which were reported for 5.8 percent of DC plan participants in 2020.*

Withdrawals from traditional IRAs tend to be retirement related

Percentage of traditional IRA–owning households, 2020



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