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## Retirement Plan Distribution Withholding Rules

A commonly held belief is that a plan administrator must withhold 20% of the amount of plan distributions for federal income-tax purposes from all retirement plan distributions. But this is simply not the case. As a business owner – or as an employee – it is important to understand the rules surrounding federal income-tax withholding resulting from a request for a distribution from an employer's tax-qualified retirement plan.

### Eligible Rollover Distributions

An "eligible rollover distribution" is generally a distribution from an eligible retirement plan other than: periodic distributions, so-called "minimum required distributions" (generally, required after age 70½), or hardship distributions. Generally, an amount equal to 20% of an eligible rollover distribution must be withheld by the payor to the extent the distribution consists of previously untaxed amounts.

**Example:** Lois, a 401(k) plan participant, contributed \$40,000 over the years to the plan on a tax-deferred basis. During that time, the contributions earned \$20,000 of tax-deferred income. When Lois retired and withdrew from the plan the \$60,000 balance of untaxed contributions and earnings, the withdrawal was subject to 20% withholding.

Eligible rollover distributions are not subject to mandatory withholding for expected annual distributions of \$200 or less.

### Trustee-to-Trustee Transfers

A major exception to the mandatory 20% withholding requirement applies if the plan directly "rolls over" (via a trustee-to-trustee transfer) an eligible rollover distribution to another employer's qualified plan or to an IRA.

**Example:** Rather than take her distribution in cash, Lois directed the plan trustee to transfer her \$60,000 balance to a rollover IRA. In this case, no federal tax withholding is required.

### Periodic Payments

Periodic payments are generally considered those made at regular intervals and that endure for more than one year, such as an annuity. Then, the payor must withhold from the payment as if it were a wage payment. Plan participants can inform the plan administrator through IRS Form W-4P, *Withholding Certificate for Pension or Annuity Payments*, of the federal income tax amount to be withheld from the periodic payment (or that no tax should be withheld). Such an election may be revoked by the participant at any time. Absent such an election, the employer must withhold for periodic payments at a rate based on a married individual with three withholding exemptions.

### Nonperiodic Payments

As the name suggests, nonperiodic payments are distributions that are not usually made at set intervals and are not eligible rollover distributions. Examples include:

- Excess contributions and excess aggregate contributions repaid from a plan if made within 2½ months after the end of the plan year;
- Hardship withdrawals; and
- Loans deemed to be distributions (on failure to repay, for example).

Unlike other distributions, nonperiodic payments are generally subject to 10% tax withholding. The recipient may elect no withholding or a different amount by filing Form 4-WP with the plan administrator.

### Doeren Mayhew Can Help

Please contact Doeren Mayhew at (248) 244-3000 if you have any questions relating to the federal income tax withholding rules for distributions from an employer-sponsored retirement plan – and the planning options available regarding distributions.



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