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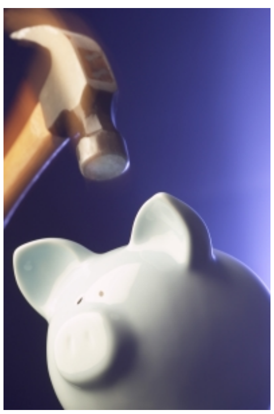
BUILDING AND SAFEGUARDING YOUR FINANCIAL WORLD

In-Service Withdrawals from 401(k) Plans



A qualified reservist distribution is a distribution (1) to a reservist or national guardsman ordered or called to active duty after September 11, 2001, for a period in excess of 179 days or for an indefinite period, and (2) that's made during the period beginning on the date of such order or call to duty and ending at the close of the active duty period.

You may be familiar with the rules for putting money into a 401(k) plan. But are you familiar with the rules for taking your money out? Federal law limits the withdrawal options that a 401(k) plan can offer. But a 401(k) plan may offer fewer withdrawal options than the law allows, and may even provide that you can't take any money out at all until you leave employment. However, many 401(k) plans are more flexible.

First, consider a plan loan

Many 401(k) plans allow you to borrow money from your own account. A loan may be attractive if you don't qualify for a withdrawal, you don't want to incur the taxes and penalties that may apply to a withdrawal, or you don't want to permanently deplete your retirement assets.

In general, you can borrow up to one half of your vested account balance (including your contributions, your employer's contributions, and earnings), but not more than $50,000. You can borrow the funds for up to five years (longer if the loan is to purchase your principal residence). In most cases you repay the loan through payroll deduction, with principal and interest flowing back into your account. But keep in mind that when you borrow, the unpaid principal of your loan is no longer in your 401(k) account working for you.

Withdrawing your own contributions

If you've made after-tax (non-Roth) contributions, your 401(k) plan can let you withdraw those dollars (and any investment earnings on them) for any reason, at any time. However, you can withdraw your pre-tax and Roth contributions (that is, your "elective deferrals") and earnings on them only for one of the following reasons (and in some cases, only if your plan allows):

- You attain age 59½
- You become disabled
- The distribution is a "qualified reservist distribution"
- You incur a hardship (i.e., a "hardship withdrawal")

Hardship withdrawals are allowed only if you have an immediate and heavy financial need, and only up to the amount necessary to meet that need. In most plans, you must require the money to:

- Purchase your principal residence, or perform repairs that would qualify as deductible casualty losses
- Prevent eviction or foreclosure
- Pay medical bills for yourself, your spouse, children, dependents, or primary beneficiary
- Pay certain funeral expenses for you, your spouse, children, dependents, or primary beneficiary
- Pay certain education expenses for yourself, your spouse, children, dependents, or primary beneficiary
- Pay income tax and/or penalties due on the hardship withdrawal itself
- Pay or reimburse for expenses or losses (including loss of income) incurred due to a federally declared disaster, assuming your principal residence or place of employment is located in the disaster area

You must take all other types of distributions available to you before taking a hardship withdrawal. In addition, your plan may require that you exhaust all loan options as well. Keep in mind that hardship withdrawals can't be rolled over. So think carefully before making a hardship withdrawal.

Withdrawing employer contributions

Some plans may allow you to withdraw at least some vested employer contributions before you terminate employment. "Vested" means that you own the contributions and they can't be forfeited for any reason. In general, a 401(k) plan can allow you to withdraw vested company matching and profit-sharing contributions if:

- You become disabled
- You incur a hardship (your employer has some discretion in how hardship is defined for this purpose, and what types of contributions may be

When considering a rollover, to either an IRA or to another employer's retirement plan, you should consider carefully the investment options, fees and expenses, services, ability to make penalty-free withdrawals, degree of creditor protection, and distribution requirements associated with each option. Also note that you can always leave the funds in your current plan, if allowed.

available for withdrawal)

- You attain a specified age (for example, 59½)
- You participate in the plan for at least five years, or
- The employer contribution has been in the account for a specified period of time

Taxation

Your own pre-tax contributions, company contributions, and investment earnings are subject to income tax when you withdraw them from the plan. If you've made any after-tax contributions, they'll be nontaxable when withdrawn. Each withdrawal you make is deemed to carry out a pro-rata portion of taxable and any nontaxable dollars.

Your Roth contributions, and investment earnings on them, are taxed separately: if your distribution is "qualified," then your withdrawal will be entirely free from federal income taxes. If your withdrawal is "nonqualified," then each withdrawal will be deemed to carry out a pro-rata amount of your nontaxable Roth contributions and taxable investment earnings. A distribution is qualified if you satisfy a five-year holding period, and your distribution is made either after you've reached age 59½, or after you've become disabled. The five-year period begins on the first day of the first calendar year you make your first Roth 401(k) contribution to the plan.

The taxable portion of your distribution may be subject to a 10% premature distribution tax, in addition to any income tax due, unless an exception applies. Exceptions to the penalty include distributions after age 59½, distributions on account of disability, qualified reservist distributions, and distributions to pay medical expenses.

Rollovers and conversions

Rollover of non-Roth funds

If your in-service withdrawal qualifies as an "eligible rollover distribution" (and most, except hardship withdrawals and required minimum distributions, do), you can roll over all or part of the withdrawal tax free to a traditional IRA or to another employer's plan that accepts rollovers. In this case, your plan administrator will give you a "402(f) notice" explaining the rollover rules, the withholding rules, and other related tax issues. (Your plan administrator will withhold 20% of the taxable portion of your eligible rollover distribution for federal income tax purposes if you don't directly roll the funds over to another plan or IRA.)

You can also roll over ("convert") an eligible rollover distribution of non-Roth funds to a Roth IRA. And some 401(k) plans even allow you to make an "in-plan conversion" — that is, you can request an in-service withdrawal of non-Roth funds, and have those dollars transferred into a Roth account within the same 401(k) plan. In either case, you'll pay income tax on the amount you convert (less any nontaxable after-tax contributions you've made).

Rollover of Roth funds

If you withdraw funds from your Roth 401(k) account, those dollars can only be rolled over to a Roth IRA, or to another Roth 401(k)/403(b)/457(b) plan that accepts rollovers. But be sure to understand how a rollover will affect the taxation of future distributions from the IRA or plan. For example, if you roll over a nonqualified distribution from a Roth 401(k) account to a Roth IRA, the Roth IRA five-year holding period will apply when determining if any future distributions from the IRA are tax-free qualified distributions. That is, you won't get credit for the time those dollars resided in the 401(k) plan.

Be informed

You should become familiar with the terms of your employer's 401(k) plan to understand your particular withdrawal rights. A good place to start is the plan's summary plan description (SPD). Your employer will give you a copy of the SPD within 90 days after you join the plan.