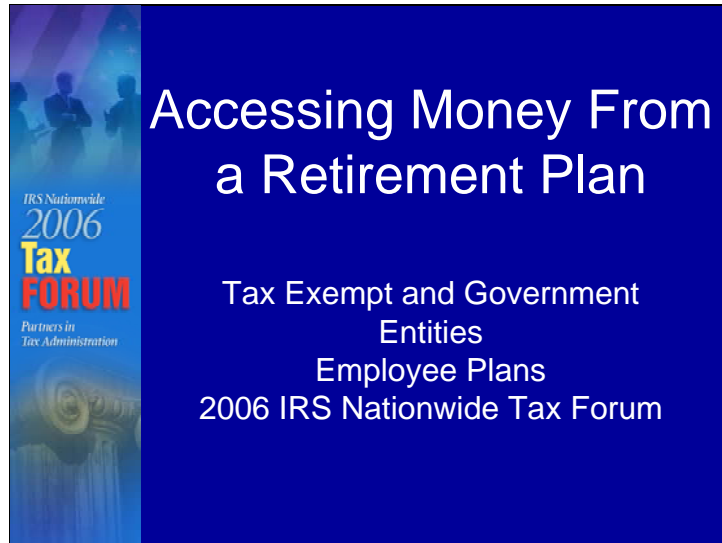


Slide 1



Howdy.

I'm "State Your Name" and I "State Your Qualifications for Speaking."

Money...how many of you here would like some? Think your clients might like some? How about their employees...or yours?

Now, if you or your clients have retirement plans, you may have another way to access some money. Granted, retirement plans are called "retirement" plans for a very good reason: they're used to save for and provide for retirement. But...sometimes there comes a reason or a circumstance to access retirement plan money *before* someone actually retires.

Then again, some people don't feel they *need* to access their retirement funds when they retire. Or they want to pass on the value of their retirement account to their family when they pass on. Once again, they're called "retirement" plans for a reason.


In today's show, I'll provide you with information on ways to access retirement money *before* retirement: loans and rollovers and pre-retirement distributions. I'll also talk about *required* distributions. We'll discuss the differences between distributions from "regular" plans vs. those from the new Roth 401(k) accounts. Finally, I'll talk to you about things that can go wrong w/ retirement fund assets and distributions, things known as "prohibited transactions."

And if there's time, I'll show you slides from my last family vacation. Highlights include the World's Largest Ball of Twine and the Barbed Wire Museum!

This presentation, along with the notes – but not the family vacation material – will be posted to our web site, www.irs.gov/ep in September after the final Tax Forum in New York. So if you miss anything during my discussion, please visit our web site to view the presentation.

But now it's time to Access Money from a Retirement Plan...and away we go!

Slide 2



IRS Nationwide
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Loans and Distributions and P/Ts, Oh My!

- Loans vs. Distributions
- The Law vs. the Plan
- What's a Prohibited Transaction?

There are lots of reasons for and ways to get money out of a retirement plan prior to actually retiring. And even though we'll be discussing those reasons and methods, we wholeheartedly recommend that people keep their retirement savings in their retirement savings vehicles until they retire.

Y'all know about Albert Einstein, his Relativity Theory and his pipe, right? Here's what he had to say about money and interest: "The most powerful force in the universe is compound interest." Accordingly, encourage your clients and their employees to be an Einstein and keep their money in the plan and take advantage of the most powerful force in the universe, Compound Interest, if at all possible.

But...we realize that there are times and circumstances when accessing retirement money is unavoidable, even necessary.

Now, folks need to know the consequences of using retirement plan money prior to retirement. For example:

Plan provisions – Does the plan allow for it?

Income tax – There are income tax questions.

Repayment possibilities – Take a loan or a distribution?

Additional taxes – Some early distributions are subject to an additional tax.

Impact on future retirement – i.e., loss of compounding.

Let's start w/ a look at "Loans vs. Distributions":

Loans get repaid and generally aren't included in income; distributions don't (get repaid) and are (includable in income).

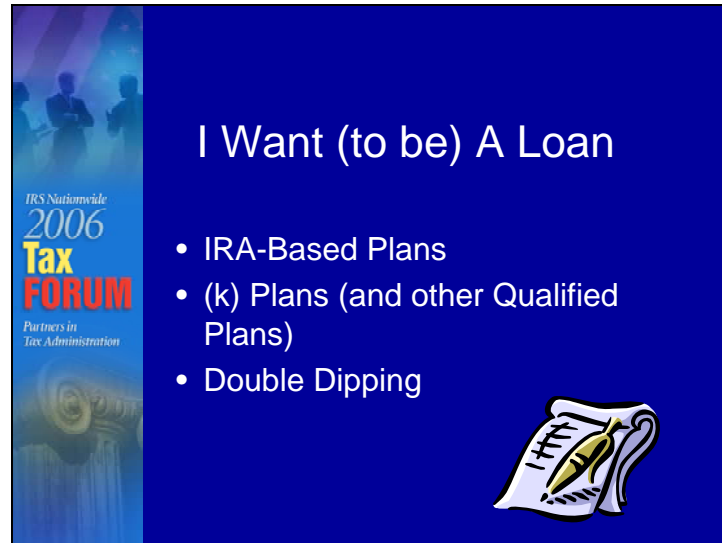
Many pre-retirement distributions are subject to a 10% additional tax *in addition to* being included in income. Loans, *if handled correctly*, are not subject to any tax.

Plans may/may not allow for loans even though the law permits them.

And this brings up an important point: *Even if the law permits it, the plan has to provide for it.* That is, the plan document must explicitly state that such loan/distribution is allowed. Plans can always be amended to add these provisions, law permitting. But many plan administrators don't like these provisions because they can be burdensome/troublesome to administer, esp. loans and their repayment.

And the final part of our introduction: P/Ts, or Prohibited Transactions. Basically, a P/T is any "improper" use of retirement plan assets by the account holder, beneficiary or "disqualified person." We'll discuss P/Ts further later on in the show.


Slide 3



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I Want (to be) A Loan

- IRA-Based Plans
- (k) Plans (and other Qualified Plans)
- Double Dipping



The first early way – and let me state that by “early” what I mean is pre-retirement – to access retirement plan money that we’ll discuss is taking a loan.

Loans in general:

First, *loans are not allowed in IRA-based plans* like SEPs, SARSEPs, SIMPLE IRA Plans and plain, old-fashioned “personal” (or “traditional”) IRAs. A loan from an IRA is a P/T and causes the IRA to cease being an IRA. So if you take a loan from an IRA, the whole IRA is included in your income.

In addition, if part of an IRA is used for collateral, that part becomes income. You may have to pay an additional 10% tax on this amount, which is now an “early distribution.”

Now let’s take a look at 401(k) and other qualified plans (**BTW**: A “qualified plan” is one that satisfies the requirements of IRC section 401(a). Examples include profit-sharing and defined benefit plans and ESOPs. But since most of y’all are familiar w/ 401(k) plans, that’s the term – k plan – that I’ll use most often here.)

It’s important here to re-state that even though **the law** allows for loans from a 401(k) plan, **the plan** itself must contain language allowing for them.

So...how much can a participant take as a loan?

Answer: Up to 50% of their vested account balance but no more than \$50,000.

Loans decrease the amount in the account that could otherwise be getting earnings and thereby losing the force of compound interest.

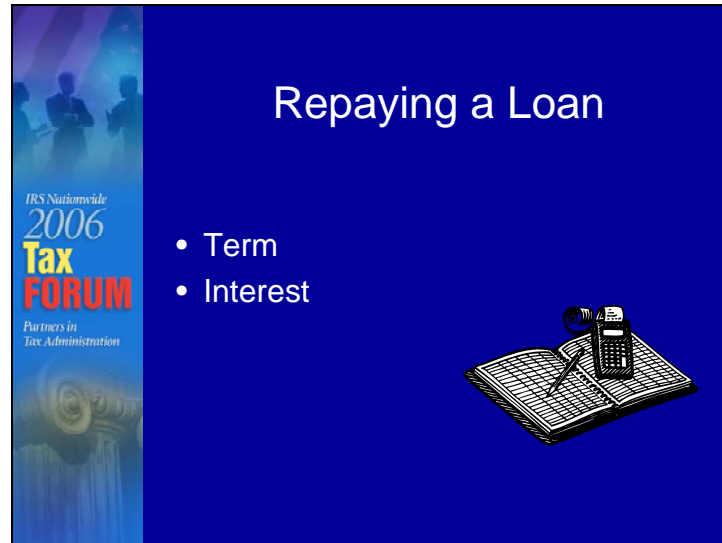
Plans can have a loan limit less than the \$50,000 figure but not a higher one.

Before we go any further, if the participant is married, their spouse may have to consent to the loan.

And some of you may be wondering if someone can "Double Dip," or have more than one loan at a time?

The answer is "yes." If there's a loan w/in one year prior to the new loan, the \$50,000 figure discussed before is reduced by the highest outstanding balance during that year. This includes renegotiated loans unless certain conditions are met.


Slide 4



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Repaying a Loan

- Term
- Interest



How long does the participant have to repay the loan?

Generally, repayment must be completed w/in 5 years. The repayment period can be longer than 5 years the loan is for the purchase of a main home.

Use substantially equal payments that include principal and interest – at least quarterly in frequency.


The repayment terms – length, frequency of payment and interest rate – have to be written in the plan. The plan **has to** use a “reasonable” rate of interest when determining loan repayments. Repayment terms must be set forth in an enforceable agreement. Not using a reasonable interest rate is a common P/T that we in the IRS (*and probably in DOL as well*) see when we examine plans. As for what constitutes a “reasonable” rate, I’d say a rate similar to what’s used in the market. But that determination is made on a facts & circumstances basis.

It’s possible at this point in the program that you’re asking yourself, “Can the plan charge a fee for a loan?” If that’s the case, good: that means you’re awake and paying attention. Oh and the answer to your question is “Yes” – for example, the federal gov’t version of a 401(k) plan, the Thrift Savings Plan (TSP), charges participants a \$50 loan fee.

Also, in the case of military personnel, the loan can be – but doesn't have to be – suspended while the participant is in military service. Interest continues to accrue during any repayment suspension.

Payment of certain large medical expenses.

There are other, esoteric distributions that are exempt from the additional tax as well.



The slide features a blue background. On the left, there is a vertical banner with the text "IRS Nationwide 2006 Tax FORUM Partners in Tax Administration". The main title "Hardship Distributions" is centered in white. Below the title is a bulleted list: "Requirements" and "Disaster – Katrina, Rita, Wilma". At the bottom center is a circular illustration of a house on fire.

First, the law and IRS guidance spell out the criteria used in order to determine whether there's a hardship. However, *if the plan provides for such distributions*, then it must provide the *specific* criteria used to make the determination of hardship.

General legal requirements in a 401(k) plan:

There must be "immediate and heavy financial need"

Deemed "immediate and heavy" for:

Medical expenses;

Purchase of principal residence;

Tuition and related education expenses;

To prevent eviction;

Funeral expenses; and

Repairing casualty damage to your house.

Remember, the plan has to provide for these kinds of distributions. For example, the plan may provide hardship distributions in the case of medical and home-related expenses but it might not provide for distributions to pay for tuition or funeral expenses. BTW: Approvals for these applications cannot discriminate between low-paid and high-paid employees.

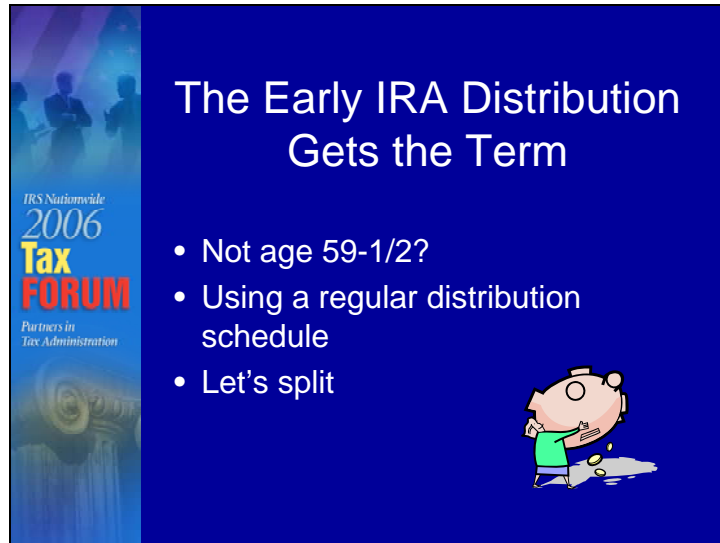
2005 Hurricane Relief:

Time-frame: Distributions between August 25, 2005 and December 31, 2006;

Amount: Up to \$100,000;

No 10% additional tax;
Included in income but spread over 3 years.

Slide 8



The slide features a blue background with white text. On the left side, there is a vertical banner for the "IRS Nationwide 2006 Tax FORUM" with the tagline "Partners in Tax Administration". The main title is "The Early IRA Distribution Gets the Term". Below the title is a bulleted list of three points. To the right of the list is a cartoon illustration of a piggy bank with a face, wearing a green shirt and holding a coin.

The Early IRA Distribution Gets the Term

- Not age 59-1/2?
- Using a regular distribution schedule
- Let's split

These are retirement plans we're talking about, not regular savings accounts. As such, retirement plan assets receive tax-favored status. If these assets are used prior to retirement age, the purpose of the tax-favored status is lost.

These Early Distributions – unlike loans – are included in income.

But – depending on their purpose – they may/may not be subject to a 10% additional tax.

For IRAs, there are exceptions to the 10% tax:

Unemployed for at least 12 weeks and use the money to purchase health insurance.

Use the money to pay for unreimbursed medical expenses that exceed 7.5% of AGI (this exception is also available to k plans).

College tuition for you or a family member.

First-time home buyers can use up to \$10,000 to pay for house-related expenses.

If you're not yet age 59-1/2 and take a distribution, you can also avoid the 10% tax by using a regular schedule of periodic payments –

Must be based on the life/lives of the account holder(s).

Various ways to determine the amount – e.g., use original account balance/life table to determine all payments or re-determine the balance/life expectancy each year.

Let's Split –

Let's say you're not yet 59-1/2 and you'd like to take some distributions from your IRA but you don't want to have all of the IRA distributed. To avoid the tax, you can split your IRA. Figure out how much you think you'll need, and put that in one IRA – this will be the basis of your payment plan. Keep the rest in the original IRA, where it can continue to grow-tax-deferred.

Question: Anyone here familiar with the Tax Court (www.ustaxcourt.gov) case *Keith Lamar Jones v. Commissioner of Internal Revenue*? Considering our topic here is Distributions from a retirement plan, I think it's important to talk about it for a bit.

In this case, Mr. Jones quit his job and later returned to school to earn his PhD. He took out some \$30,000 from his 401(k) account at his former employer to pay for school expenses and to buy his first home. Mr. Jones declared the money as income and paid the normal tax on it. Mr. Jones was audited and the IRS determined that – since Mr. Jones was not yet 59-1/2 – he also owed the 10% early distribution tax. While the Tax Court sympathized w/ Mr. Jones, it concluded that penalty-free withdrawals for higher-education and first-time home-buying expenses are only available to IRAs, not 401(k) plans.

So...to do it right – i.e., w/o the 10% additional tax – Mr. Jones should have made a direct rollover from the 401(k) account to an IRA. Once in the IRA, the funds for his purposes could've been withdrawn w/o the additional tax. Be careful.

Business Owners –

If you own (more than 5% of the business) you must start RMDs by age 70-1/2 regardless of whether you're still working or whether the money is in an IRA or k plan.

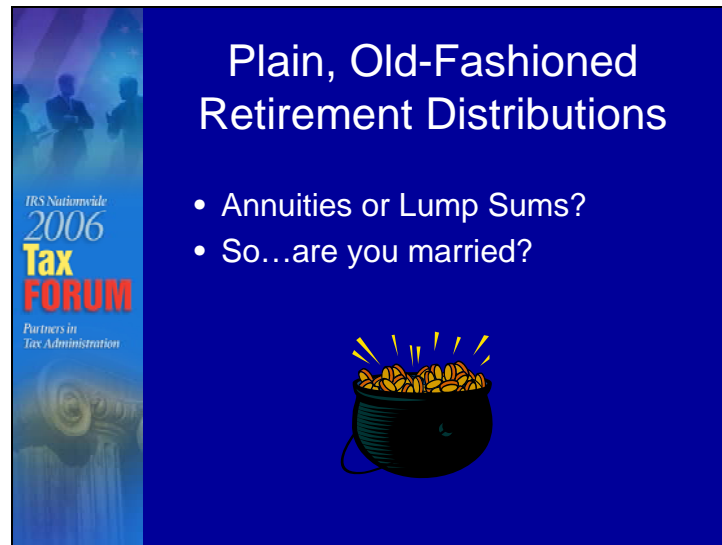
Regular Schedule –

Is the account just in your name or do you have a co-holder? The RMD is based on the life expectancy/ies of the account holder(s).

Use the tables in the regulations under Code § 401(a)(9).

Penalties –

If you snooze, you lose. Penalty = $\frac{1}{2}$ of the difference between RMD and what was actually taken. Don't let the gov't take money from your retirement plan via this penalty, which happens each year you don't take the RMD.



The slide features a dark blue background. On the left side, there is a vertical banner with the text "IRS Nationwide 2006 Tax FORUM Partners in Tax Administration". The word "Tax" is in yellow, and "FORUM" is in red. To the right of the banner, the title "Plain, Old-Fashioned Retirement Distributions" is written in white. Below the title, there are two bullet points: "• Annuities or Lump Sums?" and "• So...are you married?". At the bottom right, there is a cartoon illustration of a black pot overflowing with gold coins, with yellow rays of light emanating from the top.

According to a 2005 Congressional Research Service report, 84% of lump sum recipients rolled over all or some part of the distribution into personal savings.

44% rolled over all of it.

40% saved a portion using IRAs, stocks, mutual funds, property, etc.

According to the same study, a 25-year-old today can expect to have seven different employers by the time they reach age 65. This will lead to plenty of opportunities to receive distributions and roll them over...or to spend them right away and lose the All-Encompassing Power of Compound Interest.

Annuities or Lump Sums –

Annuities come in plenty of flavors:

There are ones w/ a guaranteed minimum number of payments where if death happens before the minimum is reached, the value of the remainder goes to the estate.

Survivor annuities: for example, where the spouse receives a survivor annuity of some % (common %s include 50, 75 and 100) of the original annuity.

Lump Sums: Avoid current taxation by rolling some or all of it into an IRA.

So...are you married?

Married participants –

The law requires some plans to obtain spousal consent before distributing lump sums.

This – lack of spousal consent for lump sums – is a common problem that we see in our correction programs.

