



RETIREMENT PLANNING

Section 401(k)

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PLEASE NOTE

The Consolidated Appropriations Act, 2021 continues many temporary CARES Act provisions through 2021 to ease access to retirement funds, including:

- ◆ The exception to the 10% early withdrawal penalty for distributions prior to age 59½
- ◆ The elimination of the mandatory 20% withholding requirement on distributions
- ◆ The option to take out up to \$100,000 in a loan or withdrawal (if otherwise allowed under plan provisions)



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SUMMARY

WHAT IS A 401(K)?

A 401(k) plan is an employer-sponsored qualified retirement plan allowing employees to defer a portion of their compensation. Employee deferrals are often supplemented by employer contributions.

HOW ARE 401(K) CONTRIBUTIONS DETERMINED?

There are annual limits on how much an employee can defer. For employees under age 50, deferrals can't be more than \$19,500 in 2021. When the plan allows, additional "catch-up" contributions permit participants age 50 and over to defer up to \$26,000 (as indexed annually for inflation).

These limits apply to the sum of all of the employee's deferrals to similar employer-sponsored defined contribution arrangements. In other words, 401(k) deferrals may be reduced if the employee also participates in other arrangements such as another employer's 401(k) plan, 403(b) tax-deferred annuity or 457(b) plan.

Since many employers match all or a portion of each employee's contribution (or simply make additional contributions), the total amount actually deposited into the employee's account can exceed the individual limit. Overall "annual additions" to an employee's 401(k) plan accounts from all sources—employee deferrals, employer matching contributions, possible employer profit-sharing contributions, etc.—cannot exceed the IRS Section 415 limit for defined contribution plans, which is the lesser of 100% of compensation or \$58,000 in 2021.

WHAT IS THE TAX TREATMENT?

Elective deferrals are not included in an employee's gross income, which means that contributions are made with pre-tax dollars. Also, earnings inside a 401(k) plan accumulate on a tax-deferred basis.



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The employer also gets a tax deduction, within certain limits, for contributions to the plan.

Employee withdrawals at retirement that exceed any nondeductible contributions made during the accumulation period (Roth contributions, for example) are generally taxed to the employee as ordinary income.

WHAT ABOUT DISTRIBUTIONS?

As noted, withdrawals from a 401(k) account generally are taxed as ordinary income unless they represent a return of after-tax contributions. Also, if a participant takes a withdrawal prior to age 59½, the participant will pay a 10% penalty tax on the taxable amount unless certain exceptions apply.

Required minimum distributions (RMDs) generally must begin no later than April 1 of the year following the year when the participant reaches age 72. If the plan allows, participants who own 5% or less of the employing company may defer RMDs until actual retirement, if it occurs later than age 72.



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