**DEPARTMENT OF THE TREASURY**
**INTERNAL REVENUE SERVICE**
**WASHINGTON, D.C. 20224**

**OFFICE OF**
**CHIEF COUNSEL**

April 23, 2004

Number: **INFO 2005-0009**
Release Date: 3/31/2005
CC:TEGE/CONEX-116113-04
UIL: 9999.98-00

The Honorable Peter J. Visclosky
U. S. House of Representatives
Washington, DC 20515-1401

Dear Congressman Visclosky:

I apologize for the delay in responding to your letter, dated January 15, 2004, to the Pension Benefit Guarantee Corporation on behalf of your constituent, . wrote about the use of 401(k) savings to help supplement health care costs. She opposes the 10 percent penalty incurred when using 401(k) funds for this purpose.

To discourage the use of retirement plan funds (these include a 401(k) plan) for purposes other than retirement, the law imposes an additional tax on early distributions of those funds (early distribution tax). Distributions (both periodic and nonperiodic) from qualified retirement plans made before age 59 ½ are specifically subject to an additional tax of 10 percent, unless a statutory exception applies. This tax applies to the part of the distribution that she must include in gross income. It does not apply to any part of a distribution that is tax free, such as amounts that represent a return of her cost, or that she rolled over to another retirement plan.

The law provides exceptions to the additional tax for certain early distributions such as certain payments for medical care. If the payer of the distribution knows that an exception applies to an individual's early distribution, the payer would put distribution code "2", "3", or "4" in box 7 of the individual's 1099-R, and the individual would not have to report the distribution.

Based on the limited information supplied, she may qualify for the medical expense exception and may not have to pay the 10 percent additional tax on distributions that are not more than:

1) The amount she paid for unreimbursed medical expenses during the year of the distribution, minus

2) 7.5 percent of her “adjusted gross income” (Adjusted gross income is the amount on Form 1040, line 35 or Form 1040A, line 22) for the year of the distribution.

She can only take into account unreimbursed medical expenses that she would be able to include in figuring a deduction for medical expenses on Schedule A, Form 1040. She does not have to itemize her deductions to take advantage of this exception to the 10 percent additional tax.

I have enclosed a copy of Publication 575, “Pension and Annuity Income” that discusses the tax treatment of distributions individuals receive from pension and annuity plans and how to report the income on their federal income tax returns. The tax on early distributions and the exceptions are on page 28 of Publication 575. I also enclosed a copy of Publication 502, “Medical and Dental Expenses”, that explains the itemized deduction for medical and dental expenses, and what expenses she can and cannot include in figuring the deduction.

I hope this information is helpful. If you need additional information, please contact me at or of my staff at .

Sincerely,

Sarah Hall Ingram
Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures (2)