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Read This First Before Tapping Your Retirement Savings

Article Highlights:

- Tapping Your Retirement Savings
- Traditional IRAs and Qualified Retirement Plans
- Simple IRAs
- Early-Withdrawal Penalties
- Reduction in Retirement Savings
- Exceptions from the Early-Withdrawal Penalty
- Roth IRAs

Your 401(k), IRA or other retirement accounts may be a tempting source for cash if you find yourself short of funds or have a major purchase you are considering. But withdrawing money from a traditional IRA or qualified retirement account before you reach age 59 1/2 may not be the best idea, as you will likely pay both income tax and a 10% early-distribution tax (also referred to as a penalty) on any previously untaxed money that you take out.

Withdrawals you make from a SIMPLE IRA before age 59 1/2, and those you make during the 2-year rollover restriction period after establishing the SIMPLE IRA, may be subject to a 25% additional early-distribution tax instead of the normal 10%. The 2-year period is measured from the first day that contributions are deposited.

These penalties are just what you'd pay on your federal return; your state may also charge an early-withdrawal penalty in addition to the regular state income tax.

Thus, before making any withdrawals from a traditional IRA or other retirement plans, including a 401(k) plan, a 403(b) tax-sheltered annuity plan, or a self-employed retirement plan, there are two things you should carefully consider: (1) you are taking funds, and their future appreciation, from your retirement savings which can impact your future retirement lifestyle. (2) You will be creating unnecessary taxes and penalties which will increase the amount you will need to withdraw to obtain your needed funds.

If you have decided to make a retirement account withdrawal, there are a number of exceptions to the 10% early-distribution tax; these depend on whether the money you withdraw is from an IRA or a retirement plan. However, even if you are not subject to the 10% penalty, you will still have to pay taxes on the distribution. The following exceptions may help you avoid the penalty:

- **Withdrawals from any retirement plan to pay medical expenses -** Amounts withdrawn to pay unreimbursed medical expenses are exempt from penalty if they would be deductible on Schedule A during the year and if they exceed 7.5% of your adjusted gross income. This is true even if you claim the standard deduction and do not itemize deductions.

- **Withdrawals from any retirement plan as a result of a disability -** You are considered disabled if you can furnish proof that you cannot perform any substantial gainful activities because of a physical or mental condition. A physician must certify your condition.

- **Withdrawals up to $5,000 from any retirement plan related to birth or adoption - **Distributions that are penalty-free are those you made during the one-year period beginning on the date on which your child is born or on which the legal adoption of an eligible adoptee (an individual under age 18 or who is physically or mentally incapable of self-support) is finalized. For married couples, the $5,000 limit applies to each spouse who takes a distribution from their retirement plan.

- **IRA withdrawals by unemployed individuals to pay medical insurance premiums -** The amount that is exempt from penalty cannot be more than the amount you paid during the year for medical insurance for yourself, your spouse, and your dependents. You also must have received unemployment compensation for at least 12 consecutive weeks during the year you made the withdrawal or the following year.

- **IRA withdrawals to pay higher education expenses -**Withdrawals made during the year for qualified higher education expenses for yourself, your spouse, or your children or grandchildren are exempt from the early-withdrawal penalty.

- **IRA withdrawals to buy, build, or rebuild a first home -** Generally, you are considered a first-time homebuyer for this exception if you had no present interest in a main home during the 2-year period leading up to the date the home was acquired, and the distribution must be used to buy, build, or rebuild that home. If you are married, your spouse must also meet this no-ownership requirement. This exception applies only to the first $10,000 of withdrawals used for this purpose. If married, you and your spouse can each withdraw up to $10,000 penalty-free from your respective IRA accounts.

- **IRA withdrawals annuitized over your lifetime -** To qualify, the withdrawals must continue unchanged for a minimum of 5 years, including after you reach age 59 1/2.

- **Employer retirement plan withdrawals -** To qualify, you must be separated from service and be age 55 or older in that year (there's a lower limit of age 50 for qualified public-service employees such as police officers and firefighters) or, regardless of age, elect to receive the money in substantially equal periodic payments after your separation from service.

You should be aware that the information provided above is an overview of the penalty exceptions and that conditions other than those listed may need to be met before qualifying for a particular exception, and there are other exceptions not covered in this article.

You should also consider that you may be able to withdraw funds from a Roth IRA without tax or penalties depending upon certain circumstances which include whether the contributions to the Roth were regular, rollover, or conversion contributions; your age; and how long the funds have been in the Roth IRA. Generally, there is no tax when regular contributions to a Roth IRA are withdrawn.

You are encouraged to contact this office before tapping your retirement funds for uses other than retirement. Distributions are most often subject to both normal taxes and other penalties, which can take a significant bite out of the distribution. However, with carefully planned distributions, both the taxes and the penalties can be minimized. Please call for assistance.

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