Thinking of Tapping Your Retirement Savings? Read This First

Article Highlights:

- Early-Withdrawal Penalties
- Reduction in Retirement Savings
- Exceptions from the Early-Withdrawal Penalty

If you are looking for cash for a specific purpose, your retirement savings may be a tempting source. However, if you are under age 59½ and plan to withdraw money from a traditional IRA or qualified retirement account, 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 59½ 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 an IRA or other retirement plan, including a 401(k) plan, a 403(b) tax-sheltered annuity plan, or a self-employed retirement plan, carefully consider the resulting decrease in retirement savings and increase in taxes and penalties.

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- **Withdrawals from any retirement plan to pay medical expenses—**Amounts withdrawn to pay unreimbursed medical expenses are exempt from penalty if they would be deductible on Schedule A during the year and if they exceed 10% of your adjusted gross income. This is true even if you do not itemize.

- **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.

- **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 weeks during the 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 59½.
- **Employer retirement plan withdrawals—**To qualify, you must be separated from service and be age 55 or older in that year (the lower limit is age 50 for qualified public-service employees such as police officers and firefighters) or 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 above may need to be met before qualifying for a particular exception. 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.