72(t) Distributions

Sometimes you can take penalty-free early withdrawals from retirement accounts.

Provided by Benedict A. Mitchell Jr.

Do you need to access your retirement money early? Usually, anyone who takes money out of an IRA or a retirement plan prior to age 59½ faces a 10% early withdrawal penalty on the distribution. That isn't always the case, however. You may be able to avoid the requisite penalty by taking distributions compliant with Internal Revenue Code Section 72(t)(2).[1]

While any money you take out of the plan will amount to taxable income, you can position yourself to avoid that extra 10% tax hit by breaking that early IRA or retirement plan distribution down into a series of substantially equal periodic payments (SEPPs). These periodic withdrawals must occur at least once a year, and they must continue for at least 5 years or until you turn 59½ (whichever occurs later).[1,2]

How do you figure out the SEPPs? They must be calculated before you can take them. Some people assume they can just divide the balance of their IRA or 401(k) by five and withdraw that amount per year – that is a mistake, and that can get you into trouble with the IRS.[2]

The IRS allows you to calculate SEPPs by three methods, all with respect to your age and your retirement account balance. When the math is complete, you can schedule SEPPs in the way that makes the most sense for you.

The *Required Minimum Distribution (RMD)* method calculates the SEPP amount by dividing your IRA or retirement plan balance at the end of the previous year by the life expectancy factor from the IRS Single Life Expectancy Table, the Joint Life and Last Survivor Expectancy Table, or the Uniform Lifetime Table.[2]

The *Fixed Amortization* method sets an amortization schedule based on the current balance of your retirement account, in consideration of how old you are in the current year and your life expectancy according to one of the above three tables.[2]

A variation on this, the *Fixed Annuitization* method, calculates SEPPs using your current age and Appendix B of Rev. Ruling 2002-62. If you use the Fixed Amortization or Fixed Annuitization method, you must also specify an acceptable interest rate for the withdrawals which can't exceed more than 120% of the federal mid-term rate announced periodically by the IRS.[2]

A lot to absorb? It certainly is. The financial professional you know can help you figure all this out, and online calculators also come in handy (Bankrate.com has a very good one).

Problems occur when people don't follow the 72(t) rules. There are some common snafus that can wreck a 72(t) distribution, and you should be aware of them if you want to schedule SEPPs.

First of all, consider that this is a multi-year commitment. Once you start taking SEPPs, you are locked into them. You will take them at least annually, and you won't be able to contribute to that retirement account anymore as the IRS doesn't let you do that within the SEPP period.[2]

If you are taking SEPPs from a qualified workplace retirement plan instead of an IRA, you must separate from service (that is, quit working for that employer) before you take them. If you are 51 when you quit and start taking SEPPs from your retirement plan, and you change your mind at 53 and decide you want to keep working, you still have this retirement account that you are obligated to draw down through age 56 – not a good scenario.[1]

Some people forget to take their SEPPs according to schedule or withdraw more than they should, and that can subject them to Internal Revenue Code Section 72(t)(4), which tacks a 10% penalty plus interest on all SEPPs already made. The IRS *does* permit you to make a one-time change to your distribution method without penalty: if you start with the Fixed Amortization or Fixed Annuitization method, you can opt to switch to the RMD method.[3,4]

How can I boost or reduce the SEPP amount? The easiest way to do that is to increase or decrease the balance in the IRA or retirement plan account. You have to do that *before* arranging the payments, however.[2]

If you need to take a 72(t) distribution, ask for help. A financial professional can help you plan to do it right.

Florida Benefit Specialists
Primary Address: (North Florida Office) 2233 NW 41st Street, Suite 700-A, Gainesville, FL. 32606
(South Florida Office) 6451 North Federal Highway, Suite 1201, Fort Lauderdale, FL. 33308
Cellular Phone: 954-461-5502 Toll Free: 888-236-9894 Ext.1. Fax: 888-236-9894

Benedict A. Mitchell Jr. is registered with and securities offered through Kovack Securities, Inc. Member FINRA/SIPC. 6451 N. Federal Highway, Suite 1201, Ft. Lauderdale, FL 33308 (954) 782-4771. Advisory services offered through Kovack Advisors, Inc. Florida Benefit Specialists is not affiliated with Kovack Securities, Inc./ Kovack Advisors, Inc.

This material was prepared by MarketingPro, Inc., and does not necessarily represent the views of the presenting party, nor their affiliates. This information has been derived from sources believed to be accurate. Please note - investing involves risk, and past performance is no guarantee of future results. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional. This information should not be construed as investment, tax or legal advice and may not be relied on for the purpose of avoiding any Federal tax penalty. This is neither a solicitation nor recommendation to purchase or sell any investment or insurance product or service, and should not be relied upon as such. All indices are unmanaged and are not illustrative of any particular investment.

Citations.

1 - irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Substantially-Equal-Periodic-Payments#2 [11/21/13]
2 - forbes.com/sites/advisor/2012/02/13/the-72t-early-distribution-from-your-ira/ [2/13/14]
3 - financialducksinarow.com/531/penalties-for-changing-sosepp/ [3/27/09]
4 - bankrate.com/calculators/retirement/72-t-distribution-calculator.aspx [4/3/14]