

## Taking Early Withdrawals From Retirement Plans

Are you thinking of withdrawing funds early from your qualified plan, such as a traditional or Roth IRA, profit-sharing plan, or pension plan? Generally, you should do so only as a last resort because, in most cases, you will be subject to income tax — plus a 10% penalty if you take distributions before age 59-1/2.

Of course, many reasons exist for dipping into retirement accounts. For example, you may have retired at a young age and most of your assets are in qualified plans, or a financial crisis has struck your family — such as a long layoff or illness, business failure, or divorce. But even in circumstances like these, you may want to borrow rather than withdraw assets. Let's look at the consequences of early qualified plan distributions as well as how you can avoid or reduce potential income taxes and penalties.

### Know the Rules

Keep in mind that distributions are subject to federal income tax — at ordinary income rates — except for qualified Roth IRA distributions, and qualified plan rollovers and nondeductible contributions.

Even if you die, your beneficiaries must still pay income tax on the distributions (except on distributions from Roth IRAs that have been open for at least five years). The step-up in basis that applies to other investments has no effect on inherited IRAs or qualified plan accounts. But make sure you check to see whether your state also taxes these distributions.

### Note the Exceptions

Although the income tax bite on early withdrawals may hit your wallet hard, the additional 10% penalty tax is onerous because you cannot offset it — even with other losses — and because it could be avoided simply by waiting until age 59-1/2. Fortunately, you can steer clear of the consequence if you meet these exceptions:

- Distributions are received after death or permanent disability,
- Distributions are used to pay medical or qualified higher education expenses for you, your spouse or your dependent children,
- You receive qualified domestic relations order (QDRO) divorce payments from an ex-spouse's plan, or
- You incur first-time homebuyer's expenses, up to \$10,000. (But you must have owned no home in the last two years.)

Another exception: If you receive substantially equal periodic payments, the IRS may not penalize you. The periodic payments exception is a catchall because you may qualify regardless of your distributions' purpose. It generally works well for individuals close to retirement age because you must carefully adhere to a schedule of payments made at least annually and for at least five years, and until you reach age 59-1/2. On the downside, it is typically ineffective for those with large one-time expenditures. Remember, if you break from the prescribed amounts before the period ends, you will be subject to penalty on all prior payments.

**Consider the Bottom Line**

The bottom line is, in some instances, you may have to take preretirement distributions from your qualified plans — it may be your only choice. But, if possible, borrow funds from them instead.

And either way, please call us; we'll help you determine whether you can avoid paying the penalty on early withdrawals and whether you should explore other options.