Total Wealth Enhancement Group, LLC

A Specialized Practice in IRA & Qualified Plan Distributions & Strategic Estate Tax Planning*

Penalty Free Retirement Plan & IRA Distributions – Part I…

Now that we are a little more familiar with the many benefits of opening and funding various types of IRA's, it would be a good idea for anyone considering these accounts to have a general working knowledge of the various rules and restrictions that apply. IRA's as well as most other retirement accounts are entitled to certain income tax deferral privileges, provided the account owner abides by these various rules. Additionally, these accounts have very strict distribution rules that likewise must be adhered to. Ignoring or disregarding these rules for whatever reason can be a very costly and, many times, irreversible mistake that can cause the owner to loose 50-60 % of the accounts value to taxes; particularly problematic is when an account owner is under the age of, 59 ½. Unless the taxpayer qualifies for one of the exceptions to the early distribution rules, the IRS imposes an additional 10% penalty tax, on top of the ordinary taxes they may incur on the early distribution. Although many of us would like to think otherwise, in this particular case however, the IRS is not the "bad guy" just looking for another way to take money from your pocket. The early distribution penalty was actually designed by Congress to deter taxpayers from tapping into funds earlier than necessary. The fact that these accounts are generally established and designed for retirement purposes, Congress felt that without an early distribution penalty, taxpayers would have virtually unlimited, restriction free access to the funds in these accounts. Without restrictions, many account owners would likely use these funds throughout their working years for current living expenses, thereby reducing or even eliminating the funds necessary for one's retirement. This would have obviously defeated Congress' intended purpose.

There are, in fact, a number of strategies retirement account owners can use that can help to minimize any taxes they will ultimately pay on plan distributions. These various strategies will be discussed in future publications. As well, there are a number of early distribution exceptions that are penalty free under IRS code section 72 (t), for those under the age of 59 ½. Although these accounts are designed for retirement, frequently, plan participants find themselves in financial situations that require them to tap into these funds earlier than they would have otherwise thought. ***Currently there are 13 exceptions to the under age 59 ½ penalty*** which allow account owners to access funds without incurring the additional 10% tax. ***These exceptions are not the same for all types of retirement plans.*** Some that are available for qualified plans and 403-B arrangements are not available for IRA distributions. Other exceptions apply only to IRA's. Some exceptions apply differently depending on the plan involved. Most of the exceptions have limited usefulness for planning purposes because they are triggered only in particular hardship situations like a disability. Finally, some exceptions are contingent on a particular use of the funds, like the "first time" Home Purchase. Regardless of your particular circumstances, ***it is very important to note the following:*** If an account owner, under-age 59 ½, takes money from a retirement plan and does not qualify for any of the specific and limited exceptions, the penalty will be imposed regardless of the taxpayer's ignorance of the rules, good intentions or any other excuse. The IRS and the Courts will not waive the penalty unless the requirements for the exception are met.

Let us review the first four exceptions and the particular conditions in which they can apply. We will first look at the exceptions that currently apply to "all" retirement plans. Perhaps the most significant exception of all is ***# 1) Series of Substantially Equal Periodic Payments or (SOSEPP):*** The IRS will waive the early distribution penalty for any distribution that is part of SOSEPP. That is, you are committing to receive regular (not less than annual) distributions for life. At first glance, this exception seems to be very rigid. In fact, however, it is actually quite flexible. I believe this to be the most significant exception primarily for its planning possibilities. In fact, the many planning opportunities this exception provides along with the various details that accompany the use of this provision are beyond the scope of this article. However, two clearly noteworthy conditions of this exception are as follows; **a)** The payments do not in fact have to continue for the entire life of the recipient. They must, however, continue until the participant reaches the age of 59 ½ or until 5 years have elapsed, *whichever occurs later.* **b)** The participant must choose one of only three IRS approved methods for determining the SOSEP Payments. There is no minimum age requirement to exercise this provision, however, once started it must be continued. **Note:** *If the recipient modifies or prematurely discontinues the SOSEPP before the required period of time has elapsed, they will be severely punished. The qualification for the SOSEPP exception is retroactively revoked, and he or she will owe the penalty and interest on all the taxable series payments taken prior to age 59 ½.* ***2) Death Benefits:*** A distribution from any plan made to a beneficiary or to the Estate of the account owner on or after the participants death is exempt from the early distribution penalty. Although this provision, at first glance, seems straight forward, there are different rules and methods of distribution available to the beneficiaries that are contingent upon the relationship of the beneficiary to the participant and the method in which the beneficiary inherits; specifically, receiving proceeds through the Estate of a participant or directly through the plans beneficiary form. ***Improperly prepared beneficiary forms or the omission of beneficiaries can have a significant effect on and potentially disastrous, albeit unintentional results for beneficiaries.*** In affect, an incorrect or incomplete beneficiary form can ultimately cause the IRS to become your largest and probably unintended beneficiary. ***3) Disability:*** a distribution from any type of plan that is "attributable to the participant being disabled" is not subject to the penalty. ***First,*** disabled is defined in IRS code Sec 72(m) as unable to engage in any substantial, gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. In fact, the definition requires ***"Total Disability". 4) Distributions To Pay Deductible Medical Expenses:*** Distributions after 1996 ***from any type of plan*** are penalty free to the extent such distributions do not exceed the amount allowable under IRS Code Sec 213(a) to the taxpayer for amounts paid during the taxable year for medical care. This provision is actually more complicated than it initially appears. Under Sec 213, medical expenses are deductible only to the extent that they exceed 7.5 % of Adjusted Gross Income or (AGI). Retirement Plan distributions are includable in gross income and as such will decrease the amount allowable as a deduction. This can become a vicious circle when trying to keep your distribution from exceeding your total medical expenses, minus 7.5% of your distribution and other income. Although I personally have not had any of my clients exercise this option in the past, it is available and has undoubtedly come in handy for many, especially during these tough economic times. The above exceptions apply to all retirement plans including IRA's. In my next publication, we will discuss several more exceptions that apply only to certain plans. The above does not provide all the necessary details required to effectively understand and utilize these exceptions. Before attempting to withdraw money from any retirement plan, you should consult with a qualified professional well versed in the subject matter. **Meanwhile, if you have any questions about this article, Roth Accounts or any other IRA/Qualified plan concerns, please send your questions to mtksiras@twegllc.com.**

COMPANY:
Total Wealth Enhancement Group, LLC

Michael T. Kuczinski, CLU, ChFC, CFP®

CONTACT INFORMATION:
600 State Route 33 West
Suite A
Millstone Twp., NJ 08535
Phone: 732-786-8415
Fax: 732-786-8416
Email: mtksiras@twegllc.com
Web: www.twegllc.com

OCCUPATION:
Financial Advisor

MOTTO:
Strategies to Grow and Preserve Your Wealth To Last A Lifetime...And Generations To Come...

Michael T. Kuczinski, CLU,ChFC,CFP®, Total Wealth Enhancement Group, LLC.