

# You can make penalty-free withdrawals from your IRA before you reach age 59

**Y**ou may not be aware that there is a way for you to tap into your IRA before age 59 without being subject to the usual 10 percent premature distribution penalty tax. You don't need a special reason to take advantage of this technique, although it is not a decision that should be made lightly. After all, by withdrawing money from your IRA now, you will be reducing your future retirement savings nest egg. However, if you need cash now, this is an option you may wish to discuss with your tax and/or legal advisor.

This IRA distribution method, referred to as "substantially equal periodic payments," or 72(t) distributions, presents IRA owners with an opportunity to tap into a portion of their IRA funds penalty-free (see legal note #1), while still maintaining part of their IRA funds for their retirement years. These distributions are, however, still subject to federal income tax, and may also be subject to state income tax.

## KEY REQUIREMENTS OF THE 72(T) DISTRIBUTIONS EXCEPTION

There are two main requirements that must be met in order to avoid triggering the 10 percent penalty tax on pre-59 distributions:

1. Not a one-shot deal — You must take distributions for at least five years or until you reach age 59, whichever is the longer period. For example, if you are age 45, you have to continue taking distributions for at least 14 years - until you reach age 59. If you are age 57, however, you have to continue taking distributions at least until you reach age 62 (five-year minimum).

2. Calculating the distribution amount — There are three IRS-approved methods that you can use to calculate payment amounts:

a. Life Expectancy Method — The payments under this method are based on your life



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expectancy or the joint life expectancy of you and your IRA beneficiary (see legal note #2). The amount of the payment will change from year to year, along with your account balance and your life expectancy. Of the three methods, the Life Expectancy Method generally provides you with the smallest payment amount. Furthermore, using the joint life expectancy of you and your beneficiary will generally result in a smaller payment amount than the use of single life expectancy.

b. Amortization Method — The payments under the amortization method are also based on your life expectancy or the joint life expectancy of you and your IRA beneficiary. However, you must also factor in a projected reasonable interest rate on your IRA balance as well as distributions that are made from your IRA. You must receive a fixed amount each year under the amortization method, and the payments generally are larger than under the life expectancy method.

c. Annuitization Method — The payments under this method are determined by dividing your IRA account balance by an "annuity" factor. The annuity factor is obtained by referring to an IRS-approved mortality table and applying a reasonable interest rate. The annuitization method results in a fixed payment amount that generally is the highest of the three methods.

## A BINDING DECISION

Once you select one of the three calculation methods and begin receiving payments, you are bound by your choice. You can not vary the amount you withdraw each year from the amount required under the method you select, unless the change is a result of your disability or death. If you do vary the amount, all of the amounts withdrawn prior to age 59 during the period you were supposed to be using the 72(t) distributions method will be subject to the 10 percent penalty tax, plus interest.

## AN INNOVATIVE 72(T) DISTRIBUTIONS STRATEGY

Say you are considering taking 72(t) distributions from your IRA, but find that the annual payment you would receive under the Life Expectancy Method — which generally results in the smallest payments — exceeds your cash flow needs. You may be able to split your IRA into two separate IRAs, and base your 72(t) payments on the balance of one of the IRAs. Utilizing this strategy, you may be able to withdraw the minimum amount needed to meet your cash flow needs.

## IS THE 72(T) STRATEGY FOR YOU?

Any person who owns an IRA is eligible to take 72(t) distributions at any time for any reason. This doesn't mean, however, that this strategy is appropriate for all IRA owners. Annual payments are based, in large part, on your IRA balance and life expectancy. As a result, individuals with relatively small account balances generally can expect to receive small annual payments. Younger individuals, with relatively long life expectancies, can expect similar results.

Individuals who elect to take 72(t) payments typically tend to be IRA owners in their early to mid-50s. In many cases, they have taken early retirement or have recently become separated from service. They tend to have larger IRA balances (e.g., as a

result of rolling over funds from their former employer's retirement plan), and only have a few years until they reach age 59. The 72(t) distributions allow them to access IRA money without penalty if they need the cash, without locking them into taking withdrawals for a long period of time.

The 72(t) distributions strategy may also be appropriate for IRA owners with special cash flow needs. For example, it may be a means to help meet home mortgage expenses.

Although 72(t) distributions may be appropriate for some individuals, the decision to take 72(t) distributions is not one that should be made lightly.

For more information on 72(t) distributions, contact your financial adviser.

Also, consult with your tax and/or legal advisor before you elect to start receiving 72(t) payments.

*This article is intended to serve only as general information. It is not intended to offer and should not be taken as legal or tax advice. You should seek the services of your attorney and/or professional tax adviser before taking any action that could affect your tax liability.*

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