

Early IRA Withdrawals, Legal & Penalty Free[©]

You need money, now! It will be a long time before you can legally take income from your IRA (age 59-1/2). But you have urgent bills to pay, medical expenses, kids' college education, or you want to invest in your business, buy a new home or vehicle, etc. You have money in your IRA and would badly like to tap into that. Your understanding, though, is that if you take a withdrawal from the IRA before age 59-1/2 you have to pay both the taxes (possibly on the entire amount withdrawn unless the IRA is a Roth) plus a ten percent penalty. If that's the case the hit on a withdrawal could be as much as fifty percent considering both federal and state taxes, plus the penalty.

While these taxes and the penalty will be incurred if you simply take a withdrawal from the IRA, the federal tax code and the IRS have long provided a legal, tax advantaged and penalty free way to take a series of withdrawals. This is possible under Section 72(t) of the federal tax code and supported by numerous IRS rulings. This is so legal and such a mainstream practice that your professional tax advisor will have no problem verifying that this provision will work for you just as we describe it below.

This early withdrawal of IRA payments is called "72(t) SOSEP", which comes from the tax code reference to a "series of substantially equal payments" paid on a regular or periodic basis and operating under section 72(t) of the Internal Revenue Code. If you have either of the following situations you qualify for the 72(t):

- You have an existing IRA; either a Roth or traditional
- You have the ability to set up an IRA by a rollover from another type plan
- You have a non-IRA company retirement plan, such as a 401(k) etc., and have ended employment with that company, thus qualifying you for a rollover to an IRA from that plan.

How It Works. The rules state that the 72(t) must pay out a series of annual (or quarterly, monthly) payments until you reach age 59-1/2 or for five years, whichever ever comes later. If you were age 45 when starting the 72(t) you would have to continue the payments until age 59-1/2, no exception. If you were age 58 you would have to continue the payments until age 63 (five years comes later), no exception.

The rules provide several different methods to calculate the payments, but basically the calculations must be designed as follows:

1. The payment amount is such that if they continued for your actuarial life expectancy (from IRS tables), the IRA account would be exhausted precisely when you reached life expectancy. But you don't take the payments until that age. You take payments which are designed to last for that longer term, but in fact only take them until age 59-1/2 or for five years, whichever is later.
2. To do this you need to form an IRA which is solely dedicated to the 72(t). This will be a traditional or Roth IRA, depending on which of those you have now. You then divide out (roll over) any amount of your existing IRA money into this new IRA (or roll over some amount from an employer retirement plan if you no longer work for that employer). The payment amounts you receive will be based solely on the 72(t) IRA, while your other IRA money, accounts or plans, if any, will remain unaffected.
3. One of the reasons to segregate 72(t) IRA money into its own account is to provide for the precise payment size which you want, assuming that your entire IRA or other plan assets would create too large a payment. Another reason is to provide a single plan which is 100% operated for 72(t) purposes. Lastly, this dedicated plan needs to be placed with an IRA custodian with the expertise to follow all the IRS rules and correctly perform the 72(t) calculations and functions.

4. American Estate & Trust, LC (AE-Trust) can manage all aspects of the 72(t) plan, which includes calculating the exact and legally required payment details, making the actual payments according to your frequency choice (monthly, quarterly or annually), stopping the payments on the exact schedule, investing the IRA money safely for you, preventing you from making additional contributions or withdrawals to this IRA during the 72(t) period, accounting for the taxable vs. tax free payment difference between traditional and Roth IRA's, and calculating and reporting the appropriate tax information to you and the IRS.
5. When the 72(t) period ends the 72(t) IRA will convert to a normal IRA and will then operate under all standard IRA contribution and withdrawal rules. The money left over is yours to withdraw, roll over to other IRAs, convert to a Roth or self directed account, etc. And with the right investment plan (see "Investment and Growth" topic below) there should be substantial money left over when the 72(t) ends, possibly more than you started with. Remember that the 72(t) payments are designed to spread the money out for your IRS life expectancy, but you will actually receive payments for a shorter period of time.

Other Rules and Details.

- Your money may presently be in either a Roth, traditional IRA or other qualified plan (such as a 401(k) or other employer retirement plan).
- You can't change or stop any aspect of the plan once it is started, including the payment amounts or payment frequency, and payments must continue until your 72(t) time period ends whether you want the money or not.
- Payments must be based on the full value of the new 72(t) IRA.
- You cannot add to or move money out of the 72(t) IRA once the plan starts.
- All 72(t) payments from a Roth IRA are tax free to you. For traditional IRA's you and the IRS will receive a 1099R tax notice each year from AE-Trust, your 72(t) IRA custodian, and you will owe taxes on the "interest" portion of each year's total payments (obtain a 72(t) illustration, below, for details).

Investment and Growth In 72(t) IRA. You may choose either of two AE-Trust investment funds for your 72(t), the "Quick Access Fund" or the "Hi-Yield Stable Value Fund". Both of these are fixed interest payment funds where you will know in advance exactly what your IRA is earning. For more information on these two funds, go to: www.IRACentral.com, click on "IRA Investment Options" at the top of the page, then click on "Portfolio Option 1" and then "Portfolio Option 4".

The 72(t) payments are limited by law to a fixed interest rate of return which the IRS issues (called the AFMR rate). The rate which is in effect on the date you establish the 72(t) will be fixed for the whole 72(t) period. This rate could be less than that which is earned by your IRA, depending on your investment choice (above) and the AFMR rate which is applicable to your 72(t). When that happens your IRA actually gains money, even after making the 72(t) payments. Many 72(t) IRAs will have that result, more money left at the end than the account started with. And, whatever the amount left over, it is your money to use under all the regular IRA contribution and withdrawal rules.

Keeping it Legal. To be legal you need a plan or system which automatically makes the payments annually, quarterly or monthly, in the exact amount and which is based on a specific return of principal and interest in each payment, which will start and end on a precise schedule, and which properly documents and reports this to you and the IRS. You are not allowed to contribute any additional amounts to the 72(t) during the 72(t) period, nor are you allowed to make any withdrawals other than the 72(t) payments. (After the 72(t) ends, then the IRA converts to a regular IRA, subject to all the normal contribution and withdrawal rules.) You need an IRA custodian which is 72(t) savvy. If the custodian fails to understand or follow all the rules or fails to take care of the details and subtleties, they could cause your plan to be illegal. There can be drastic consequences for failure to do all this correctly.

Hint: The 72(t) is a **specialty** of American Estate & Trust. We expertly set all this up and run it for you.

Leveraging a Larger Amount. One concern that some have about the 72(t) payment stream is that the amount may be too small for their needs, due to having an IRA which is too small. They want to take a much larger withdrawal and would like to take it all at once. Though there is a way to enhance or leverage the 72(t) payment amounts (next paragraph), unfortunately there is nothing outside the 72(t) which allows penalty free withdrawals before age 59-1/2. So leveraging the payments is the next best thing.

How is leveraging done? By using the 72(t) payment stream to finance or help finance a loan. One good example of this is: Refinance or take out a second mortgage on your personal residence, or take out a simple signature loan, and plan to use the 72(t) payments to cover some or all the loan payments. The resulting loan gives you the immediate money you need while the 72(t) provides a more painless way to repay it. And if the loan is on your personal residence, the interest portion of the loan payments are tax deductible. This will help to offset the taxes owed on the interest portion of the 72(t) payments you receive. The interest component of many other types of loans also qualify for tax deductibility.

Another leveraging idea is this: Suppose you are age 49-1/2 so that your 72(t) period will last exactly ten years until age 59-1/2. Over that period you will need \$125,000, \$25,000 of it immediately plus \$10,000 per year for the next ten years. Your IRA account has sufficient money to cover both of these needs. You could go ahead and structure the \$10,000 annual 72(t) plan, and then withdraw enough more dollars to provide the immediate \$25,000. The \$25,000 withdrawal will be subject to the IRS ten percent early withdrawal penalty, and you will have to pay taxes on an amount which can be as much as the whole \$25,000. So you may have to withdraw \$35,000 or 40,000 in order to pay both the penalty and taxes on the \$25,000 withdrawal. But you may feel that you have no choice. There are cases where the penalty would be worth it to you, especially if you can minimize overall damage by getting the rest of the money you need via the 72(t). The 72(t) payments aren't subject to the penalty, and the taxes are incurred on a more tax favorable basis than on the immediate withdrawal.

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To see how much your 72(t) payments would be, go to IRACentral.com and click on “IRA & Retirement Calculators” (left side of the page), then click on “72(t) Calculator”.

For direct help at AE-Trust with a 72(t), write info@TrusteeAmerica.com or phone (801) 716-5625

To Set Up a 72(t) Early Withdrawal IRA, go to www.IRACentral.com, click on the “Access Your IRA For Quick Cash” link (left side of the page). Then look for the IRA enrollment application links at the bottom of that page.

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www.IRACentral.com