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## Early Withdrawals from Individual Retirement Accounts

During the current economic slowdown, many individuals are considering withdrawing funds from an Individual Retirement Account (IRA) to help cover daily expenses. You may withdraw money from an IRA at any time. However, there are important tax consequences. The withdrawal will trigger income tax liability of the amount withdrawn (except for some Roth IRAs) and a penalty unless you qualify for an exception to the penalty. Funds in an IRA usually should be the last nest egg you touch.

Generally, the amounts you withdraw from an IRA before reaching age 59 1/2 are called "early" or "premature" distributions. You must pay an additional 10 percent early withdrawal penalty and report the amount to the IRS for any early distributions, unless an exception applies.

Withdrawals from traditional IRAs and Roth IRAs are taxed differently since the 10 percent penalty only applies to the portion of the distribution subject to income tax (except for amounts attributable to Roth conversions within five years):

- \* For a traditional IRA, distributions are treated as coming ratably from contributions and earnings. Only the portion of a distribution attributable to nondeductible contributions is not taxed, while the portion of the distribution attributable to deductible contributions is treated the same as earnings.
- \* For a Roth IRA, distributions are first deemed to be paid out of contributions, which are nondeductible (or already taxed in the case of a rollover situation). Therefore, substantial withdrawals may be made for any reason from Roth IRAs without tax or penalty. There is a five-year wait period from the time the Roth IRA is first opened, however.

Several exceptions to the 10 percent penalty have been created in recent years. Most of these exceptions apply to both traditional IRAs and to Roth IRAs. The 10 percent penalty will not be assessed on an IRA distribution to the extent that any of the following exceptions apply:

- \* Qualified first-time home buyers can take up to up to \$10,000 from an IRA tax-free for acquisition costs and settlement costs as well as other eligible expenses (traditional or Roth IRA).
- \* The 10 percent penalty does not apply if you use the IRA distribution to pay for qualified higher education expenses (traditional or Roth IRA).
- \* Some unreimbursed medical expenses also are eligible for tax-free distributions (traditional or Roth IRA).
- \* Some unemployed individuals can withdraw funds from an IRA to pay medical insurance premiums (traditional or Roth IRA).
- \* Military reservists who are called to active duty may be eligible for penalty-free withdrawals.
- \* Distributions made on the death or disability of the IRA owner.
- \* "Periodic distributions" made evenly each year based on the remaining life expectancy of the account holder.

"Hardship distributions" are not among those exceptions sanctioned to avoid the 10 percent early withdrawal penalty. Some taxpayers confuse the ability of participants to withdraw funds from their employer-sponsored 401(k) plans "for hardships: with penalty free withdrawals in general. If a 401(k) plan includes a provision that allows for hardship distributions, that provision simply allows the withdrawal. It does not exempt it from either income tax or the 10 percent early withdrawal penalty.

The general rule of thumb on IRA withdrawals under normal circumstances is that a taxpayer should contribute in the first place only those funds that he or she will not touch under any circumstances. However, if emergencies arise, at least it will be up to you, rather than Uncle Sam, to make the decision on the trade off between keeping funds for retirement and using them for certain other important lifetime events.

If you have any further questions on IRA withdrawals, please do not hesitate to call our office. 1-866-657-0246 or [jwaage@strategicclawgroup.com](mailto:jwaage@strategicclawgroup.com)