

RETIREMENT PLAN DISTRIBUTIONS: A BASIC REVIEW

By Samuel A. Dodson, M.S. (Tax)

Recent corporate restructuring as well as other needs for cash has many individuals considering taking funds from their retirement plans. The following paragraphs provide an abbreviated discussion of the distribution options available. The discussion in this article will focus on IRAs and SEP/IRAs. Subsequent articles will discuss employer-sponsored pension and profit-sharing plans.

Types of IRA Distributions

There are generally three types of distributions. They can be described as follows:

- Early- any distribution made prior to age 59 ½
- Normal- distributions made between ages 59 ½ and 70 ½
- Required-distributions made after age 70 ½

General Federal Income Taxation of Distributions

While there are many exceptions and nuances to the tax rules, they can be generally applied as follows depending on the type of distribution:

- ✓ Early-distribution are taxed as ordinary income and subject to a 10% penalty unless one of the special exceptions applies
- ✓ Normal-distributions are taxed as ordinary income
- ✓ Required-distributions are taxed as ordinary income, but if the distribution is not large enough and don't begin soon enough according to IRS rules, a 50% penalty could apply

Early Distributions

Many people who are under age 59 ½ and looking for extra cash are now planning to take funds from their IRA or SEP/IRA account(s). As previously stated, these distributions will be subject to ordinary income tax and a 10% penalty unless one of the following exceptions (applicable to IRAs and SEP/IRAs) applies:

- ❖ Death
- ❖ Disability
- ❖ Payments are for certain qualifying medical expenses
- ❖ Payments are for health insurance premiums while unemployed
- ❖ Higher education expenses

- ❖ First time home purchase
- ❖ Correcting an excess contribution to the IRA or IRA/SEP
- ❖ Payments are part of a series of substantially equal periodic payments

Each exception has its own special set of additional rules and exceptions that can be quite complex, so care is required in using these breaks.

Substantially Equal Periodic Payments over Time

This particular exception to the early distribution rules is probably the most commonly used and is known to many by its tax code section number, 72(t). A companion section, known as 72(q), applies to tax-deferred annuities that were not purchased as part of a retirement plan (known as non-qualified annuities).

This exception offers three methods of calculating the payments that you might receive. Each has its pluses and minuses, so it's important to consult with a qualified financial advisor and your tax accountant, so that you can design a program that is most useful for your particular needs. It is possible that it may be best just to take early payments and pay the tax and the related penalty. There is no one size fits all calculation.

No matter which of the payment methods you ultimately choose, you must take payments until the later of 5 years or age 59 ½. If the stream of payments is changed at any time during this period, the IRS will impose the 10% penalty retroactively back to the first dollar taken.

The information contained in this article is not intended to constitute legal, accounting, tax, investment, consulting or other professional advice or services. For specific information that applies to your circumstances you should consult a qualified tax advisor. In accordance with IRS Circular 230 Disclosure, and to ensure compliance with requirements imposed by the U.S. Internal Revenue Service, we inform you that any tax advice contained in this article was not intended or written to be used, and cannot be used, by any taxpayer for the purpose of (1) avoiding tax-related penalties under the U.S. Internal Revenue Code or (2) promoting, marketing or recommending to another party any tax-related matters addressed herein.