Total Wealth Enhancement Group, LLC

Penalty Free Retirement Plan & IRA Distributions – Part II…

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We last left off detailing the first 4 of 13 exceptions to the IRS Early Distribution Penalty rules. These exceptions, the Series of Substantially Equal Periodic Payments or SOSEPP, Death of the Participant, Total Disability of The Participant and Medical expenses that exceed 7.5% of the Taxpayers AGI, stand out from the rest in that they ***are available for distributions from any type of retirement plan***. The next 4 exceptions we will discuss are only available in specific types of plans or circumstances. It is very important to know and understand how and where these exceptions apply because as I expressed in my previous article, the IRS is not very forgiving when it comes to enforcing these rules.

The next penalty free distribution exception is known as,

5) ***Early Retirement or age 55 exception*** and is available for participants who receive distributions after attaining the age of 55 and have separated from service. This exception is available for participants in Qualified Retirement Plans or QRP's, 403-(b) & Government Plans. In fact, under Sec 828 of the Pension Protection Act of 2006 (PPA-06), the exception was further expanded to exclusively benefit Firemen, Policemen & Emergency Medical Personnel who separate from Service and receive post PPA 06 distributions from Government Plans at the attained age of 50, rather than 55 (sec 72(t)(10). **This option *is not available for distributions from IRA's.***

6) Qualified Domestic Relations Order or QDRO:
Distributions from a qualified retirement plan or 403-(b) arrangement made to an "Alternate Payee" under a QDRO are exempt from the distribution penalty, 72(t)(2)(C). This allows a divorcing spouse who is under the age of 59 ½ to receive penalty free distributions from the share of his/her ex-spouse's QRP or 403(b) that was awarded to them in the divorce proceedings. Of course, the QDRO procedures must be properly followed to qualify. Although ***this particular exception is not available to IRA plan participants***, congress did provide for the Tax-free separation of IRA accounts between divorcing spouses. However, ***they did not extend the penalty exception to IRA's.*** Therefore, a divorced spouse who receives part of his or her ex-spouses IRA under Sec 408(d)(6) cannot withdraw from that account prior to age 59 ½ without paying the penalty or if they qualify for some other exception.

7) Dividends on Employer Stock:
This provision is only available for participants who belong to an ***Employee Stock Ownership Plan or ESOP:*** Under Sec 404(k) a company can take a tax deduction for dividends paid on stock held by the ESOP and the ESOP can pass these dividends out to plan participants if specific requirements are met. **These dividend payments are not subject to the 10% penalty.**

8) Qualified Rollovers:
Another provision under the tax code that ***escapes the 10% penalty for all qualified plans as well as for IRA's is the 60-day rollover provision.*** Technically available for all plans, it was not mentioned in my previous article because it applies differently to the different types of plans and it is not really designed for true, real life need, early distribution situations. This provision is more designed for the movement of your IRA or qualified plan funds from one plan custodian to another. You may want to do this to better provide for your particular investment objectives and/or desire to select investments that may not be available under the plan options you currently have. In essence, if you take money from your regular or Roth IRA, the IRS gives you 60 days from the date of your withdrawal to put the money back into the same or another IRA/Qualified plan account. If you do this within the allotted time frame, the IRS does not tax or impose any penalty on this movement of funds. ***The same can be done with your qualified plan (401-k 403-B, etc); however, with the following catch. The law requires that a mandatory withholding of 20% of the withdrawal be withheld for any potential federal income taxes***. Of course if you do roll the funds over or your total income for the year puts you in a lower overall federal tax bracket, you can apply for a refund for any tax that was withheld on those funds but was in fact rolled-over. Unfortunately however, unless you are able to make up that difference with other funds, your rollover will be short by 20% and that portion will be deemed an early distribution subject to taxes as well as penalties if you are under age 59 1/2. This provision only applies to the distributions you take actual possession of and does not apply to direct transfers from one custodian to another. For this reason alone, I seldom if ever recommend anyone doing a rollover from a qualified plan that is not a direct trustee to trustee transfer. One last point on IRA rollovers! The law only allows one 60 day rollover per IRA every 12 months. This provision clearly has limitations that must be strictly adhered too or you can potentially suffer a very costly and in most cases irreversible mistake.

8a) The Active Reservist Exception:
There is another exception that is closely related to the rollover exception but has specific parameters, is only provided to a specific class of citizens, and only applies to the employee contributions of specific plans. This exception was designed to help active military personnel who needed to take a withdrawal from their IRA, 401-K or 403-B in order to help them along during a period of diminished income, as a result of active service in the Military. Not only is the 10% penalty waived with this provision, the active reservist is also given 2- years from the day after active duty ends to put the money back into an IRA. The repayment will not affect regular IRA contribution limits.

Well, that's enough to scramble your brain for now; please join us next month as we discuss the remaining exceptions to the IRS, 10%, early withdrawal penalty and how they can help with your planning needs.

*The above does not provide all the necessary details required to effectively understand and utilize these or any other 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.**

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