

# WJM FINANCIAL, LLC

## Newsletter

### PENALTY-FREE IRA DISTRIBUTIONS

Individual Retirement Accounts (IRAs) are a foundation of retirement planning for millions of people. Contributions to traditional IRAs are typically tax deductible, and money in an IRA grows tax-deferred until it is withdrawn. The combination of tax deductions and tax-deferred growth is tough to find fault with.

In addition to these benefits, IRAs are also used as conduit accounts for individuals who leave an employer with money in their 401k. Rather than cashing out their 401k and paying taxes and penalties, or leaving their money in employer sponsored plans that may have limited investment options, many individuals have transferred their 401k assets into an IRA where they have greater control and retain the same tax advantages.

Unfortunately, there is a catch. Since IRA contributions are intended for retirement, certain restrictions apply to withdrawing your money. Until you are age 59½, most IRA withdrawals are subject to a 10% penalty in addition to applicable income taxes. However, many investors are unaware that there are exceptions to the 10% penalty, and that their IRA assets are not necessarily out of reach.

#### First time home purchases

- Account owners purchasing their first home may withdraw up to \$10,000 penalty-free if the money is applied to their home purchase.
- These distributions can be made for a home purchase by the account owner, his/her spouse, children, grandchildren, or parents/grandparents.

#### Qualified education expenses

- Account owners may withdraw assets penalty-free to pay qualifying higher education expenses for themselves, their children, grandchildren, or parents/grandparents.
- Qualifying expenses include tuition, fees, and books for undergraduate and graduate study.
- The maximum allowable amount is limited to the amount of qualified higher education expenses, reduced by any scholarships or other aid that is excludable from gross income.

#### Certain hardships

- Disability. Account owners who are disabled and can prove that they are incapable of working are allowed to withdraw funds from their IRAs without incurring penalties.

- Medical expenses. Early withdrawal penalties are waived if funds are used to pay for medical expenses that exceed 7.5% of the taxpayer's Adjusted Gross Income.

- Medical insurance. Early withdrawal penalties are waived if funds are applied to health insurance premiums while you are unemployed *provided you have collected at least 12 consecutive weeks of unemployment benefits*.

#### 60-day loans

- Account owners may withdraw funds from their IRA on a tax and penalty-free basis as long as the funds are returned to the IRA within 60 days.
- Loans are allowed only once each year, and any money that is not repaid within 60 days is subject to taxes and the 10% early withdrawal penalty.

#### Substantially equal distributions – 72(t) election

- Account owners may withdraw assets penalty-free by “annuitizing” their accounts (or a portion of their accounts) over the greater of 5 years, or until they turn age 59½. The required withdrawals may be calculated in one of three ways:
  1. Minimum distribution calculation based on either the life expectancy of the IRA owner or the joint life expectancy of the IRA owner and the owner's designated beneficiary.
  2. Amortization of the account balance over a number of years equal to the life expectancy of the account owner or joint life expectancy of the account owner and beneficiary at an interest rate that does not exceed a reasonable interest rate on the date payments commence.
  3. By dividing the account balance by an annuity factor derived using a reasonable mortality table and an interest rate on the date payments commence.
- Consult with your financial planner or accountant or before making this election. Different strategies may maximize the effect of this planning.

#### Conclusion

Although early distributions from an IRA are typically subject to a 10% penalty, there are certain instances in which the penalty can be avoided. Understanding early withdrawal strategies and the rules may help you avoid penalties when withdrawing money from your IRA.