

## How to Get Money Out of Your IRA

Many people have money locked into deductible (or “traditional”) IRAs – so close, and yet so far away, unless you are at age 59-1/2 or older. At least, so it seems. In this day of high unemployment, uncertainty in the world economy, and historically low tax rates, I’ve had plenty of questions concerning how to tap into IRAs. Contrary to popular belief, there is no exception to the 10% penalty for general financial or economic hardship, you *are* allowed penalty-free withdrawals for certain hardship circumstances. Let’s go over the do’s and don’ts, starting with the don’ts.

**Don’t look to your IRA *first* when you run low on cash.** The general rule of thumb I give clients is to plan on losing 1/3 of an early distribution to taxes. If you live in Kentucky, Illinois, and Missouri, IRA distributions are *generally* not subject to taxation, so the bite will be a little less, but check with your financial advisor to be sure. In working with clients, our goal is to find creative strategies for cutting costs and tapping into other sources of cash flow – we try to do almost anything in order to leave the IRA alone. You should almost always cash in *after tax* funds (Roth IRAs, non-taxable 401(k)s) first.

**Don’t borrow from your IRA.** While it is permissible to take tax-free loans from 401(k)s and other qualified plans, a loan from an IRA is considered a “prohibited transaction”. If you engage in a prohibited transaction in your IRA, your IRA will lose its tax-deferred status and the full balance will be deemed distributed as of the first day of the transaction year. You will owe income taxes and penalties on all pre-tax contributions to your IRA.

**Know what constitutes a prohibited transaction.** Other prohibited transactions which you must avoid include: using your IRA as security for a loan, selling property to it, and buying property for personal use with IRA funds. By engaging in any of these activities, you would be subject to the same tax and penalties as for borrowing from your IRA.

Now that we’ve gotten the no-no’s out of the way, let’s look at what you *can* do:

**First-time homebuyers** You can take up to \$10,000 penalty-free from your IRA (for each spouse) to purchase a home if you use the money to pay qualifying costs within 120 days. This is a lifetime limit and must be for your principal residence. By the way, this doesn’t have to be your “first” home, but you (or your spouse, if married) cannot have owned a principal residence within the last two years.

**Higher education** Your IRA withdrawal will be penalty-free if used for tuition, fees, books, supplies, and (for students enrolled at least half-time) for room and board. The student can be the IRA owner or his/her spouse, children, or grandchildren.

**Hardship circumstances** Be sure to check with your financial advisor before tapping your IRA due to hardship because each of these situations all have specific requirements that must be met to qualify. Removing assets from your IRA due to these events will not cause a penalty assessment:

- ♦ Payment of excess unreimbursed medical expenses
- ♦ Payment of medical insurance premiums while unemployed
- ♦ Total and permanent disability, and
- ♦ Distribution of the IRA assets to a beneficiary after you die

**60-day rollover rule** You can roll funds from one IRA to another one time per year. While you cannot borrow from your IRA, you have use of the funds short-term during this period. There are a few caveats to doing this:

- ♦ You must be able to replace the funds all at the end of the 60 days.

- ♦ When you take possession of the funds in a rollover, the plan provider will withhold income taxes, so you must be able to replace the taxes withheld.
- ♦ Any funds not rolled over within 60 days will be subject to taxes and (if under age 59-1/2) penalties.
- ♦ You should be very careful not to appear to be borrowing money from your IRA. In a recent case, the court found that withdrawing money from an IRA to use in a business, and then replacing it within 60 days, was equivalent to borrowing from the IRA

**72(t) payments** Also known as “Substantially Equal Period Payments” or SEPPs, you can take money out of your IRA at any age, penalty-free, as long as you follow these complicated set of rules and take payments for five years or age 59-1/2, whichever comes **later**. See your financial advisor for assistance with calculating 72(t) payments (so named because they are located in section 72(t) of the tax code. This method generally works best for IRA owners in their mid to late 50s who are confident that they can maintain the payment schedule for five years. You can learn more by going to [www.72t.net](http://www.72t.net).

Keep in mind that these exceptions are for the early-withdrawal penalty **only** – you still have to pay the income taxes. When planning with clients, we always keep an eye on the tax bracket. It’s not an “all or nothing” proposition when taking money from your IRA, so plan to try to keep your taxable income in the same bracket as it would be without the distribution. For example, the 2010 15% tax bracket ends at \$68,000 of taxable income for couples. If you will have \$35,000 of taxable income, taking another \$33,000 will cost you only 15%. Anything above that will be taxed at 28% - almost double!

Here’s one last tip that didn’t fit anywhere else: If you are age 55+ and have separated from service at a company where you have a 401(k), you may not want to roll it out to an IRA. That’s because you can take penalty-free distributions from your 401(k) under these circumstances while you would have to wait until age 59-1/2 if you rolled the money into an IRA.

Finally, to let the IRS know that you used the retirement money early for a tax-acceptable purpose, file Form 5329. When you report your withdrawal here, you'll also enter a code, found in the form's instructions, that lets the IRS know the distribution is penalty free.