TAX YEAR
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Early Retirement Distributions — SEPP

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Early Retirement Distributions

You may choose, or be forced into choosing, early retirement. Retirement before age 59½ may create income challenges. You are not yet eligible to receive retirement benefits from Social Security. You may or may not have a monthly pension to generate income.

In many situations, you will need to generate income from your assets. Often, most of your assets are in a retirement plan through a 401(k) plan at your employer or in an individual retirement arrangement (IRA). Withdrawals of earnings and pre-tax contributions are subject to ordinary income tax. In addition, you may be subject to the 10% early withdrawal penalty tax on distributions taken before you reach age 59½.

Tax Summary

- Withdrawals of earnings and pre-tax contributions from an IRA are subject to ordinary income tax.
- Unless an exception applies, taxable withdrawals from an IRA prior to age 59½ are subject to a 10% early withdrawal penalty.
- If you take a series of substantially equal periodic payments from an IRA, you are not subject to the 10% additional tax.

Tax Planning Strategy

One strategy to generate income from retirement accounts if you are under age 59½ is to take periodic distributions from those accounts. If structured properly, the 10% additional tax will not be assessed on the distributions. You can take distributions from various retirement accounts such as 401(k) plans, 403(b) plans, and IRAs.

Substantially Equal Periodic Payments (SEPP)

The Internal Revenue Code allows you to take withdrawals from retirement accounts without incurring the 10% penalty. To do so, very specific rules need to be followed.

- The payments made to you from the IRA are based on one of three calculation methods.
- The payments must be made to you at least annually during the payment years. Payments can be made more frequently, such as monthly, but the total for each year during the SEPP period must meet the payment calculation result for the year or years during the SEPP.
- Payments must be made for a period of at least five years or until you reach age 59½, whichever is later.

Example: *Fred, age 52, establishes a SEPP from his IRA. He must continue to take withdrawals until he reaches age 59½. If he discontinues or changes his SEPP withdrawals at any time before he reaches age 59½, unless an exception applies, the current year withdrawal is subject to the additional 10% tax. In addition, the SEPP withdrawals for previous years are retroactively subject to the additional 10% tax.*

If, however, Fred begins SEPP withdrawals at age 58, he must continue the withdrawals to age 63 to comply with the 5-year withdrawal requirement.

Calculation Method

Payments are considered to be substantially equal periodic payments if they are made in accordance with one of the three calculation methods allowed.

1) **Required minimum distribution method.** Under this method, the account balance, the number from the life expectancy table, and the resulting annual payment amount is re-determined each year.
2) **Fixed amortization method.** The annual payment for each year is determined by amortizing in level amounts the account balance over a specified number of years