

## Playing by the IRA Rules

Even the most rebellious at heart may want to play by the rules governing traditional Individual Retirement Accounts (IRAs), in order to avoid any penalties. Traditional IRAs offer favorable tax-deferral benefits to people saving for retirement, and with those benefits come certain rules about when distributions may be taken. Contributions to a traditional IRA, depending on your income and participation in employer-sponsored plans, may entitle you to certain income tax deductions. Furthermore, because your funds are not taxed until distributions begin, your savings have the potential for tax-deferred growth. For most, traditional IRAs work best as long-term savings vehicles; but if the need arises, you may be able to withdraw funds early and without penalty provided your situation qualifies as an exception.

### The Age 59½ Rule

The Age 59½ Rule stipulates that, if you take distributions from your traditional IRA before you reach the age of 59½, you may be subject to a 10% federal income tax penalty in addition to paying regular income tax. However, you may not have to pay the 10% federal income tax if your early distribution meets certain requirements.

### Exceptions

You may be eligible for qualified distributions, penalty free, if one of the following exceptions applies:

- You are taking qualified distributions as the **beneficiary** of a deceased IRA owner. If you inherit a traditional IRA, there are stipulations outlining when you must begin taking distributions based on your relationship to the decedent. For nonspousal beneficiaries, when the IRA owner died, not the age of the beneficiary, determines when distributions must be taken; therefore, there is no penalty if the beneficiary has not yet reached age 59½. The age of the beneficiary will determine only the amount of the **required minimum distribution (RMD)**. The same is true for spousal beneficiaries who do not opt to treat an inherited IRA as their own. The exception does not apply to spousal beneficiaries who opt to treat the account as their own.
- You are paying for certain **first-time homebuyer** expenses, generally referred to as qualified acquisition costs, such as buying, building, or renovating a first home. Distributions, which may not exceed \$10,000, may be used to cover qualified costs for you, your spouse, your children, or your grandchildren.
- You, your spouse, or dependents have unreimbursed medical expenses that total more than 7.5% of your **adjusted gross income (AGI)**. If a medical expense for you, your spouse, or a dependent qualifies to be itemized on your income tax return, it generally will be considered eligible for exception.
- The distributions are part of a series of substantially equal payments that meet certain **annuity** criteria. The Internal Revenue Service (IRS) currently endorses three methods for determining an early distribution schedule: the **life expectancy** method, the **amortization** method, and the **annuitization** method. Once an early distribution schedule is established, it must be maintained for five years, or it must last until you reach age 59½, whichever length of time is longer. Furthermore, at least one distribution must be taken annually.
- You qualify as being **disabled**. Certain physical and mental conditions, generally determined by a physician to limit activity, may excuse an individual from the penalty tax.
- You are paying **medical insurance** premiums due to unemployment. If you lose your job and receive unemployment compensation for 12 consecutive weeks, you may take distributions from your IRA, penalty free, during the year in which you received unemployment compensation, or in the following year, but no later than 60 days after you have been re-employed. Distributions may not exceed the amount paid in medical premiums for you, your spouse, and your dependents.
- You are paying for **higher education expenses**, such as tuition, fees, and books at an eligible educational institution (generally all accredited postsecondary institutions). The distributions may not exceed your qualified education expenses, or those of your spouse, your children, or your grandchildren.
- The distribution is attributable to an **IRS levy** of the qualified plan.

Because traditional IRAs are so strictly regulated, they generally work best as long-term savings vehicles. But, in the event you do need income from your traditional IRA before you reach age 59½, it is important to know if your situation excuses you from the penalty tax levied on early distributions. Playing by the rules may save you money.