

# 10 Things You Should Know About the 10% Early Distribution Penalty and IRAs

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IRAs are designed to be used for retirement savings. Ideally, to maximize the benefits of these accounts, you should not touch these funds before reaching retirement age. However, in the real world, you may need money and consider tapping your IRA earlier. If you do, you should be aware of the 10% early distribution penalty. This penalty is assessed on early distributions from IRAs, in addition to any taxes you may owe. Here are ten things you should know about the 10% early distribution penalty and IRAs.

1. The 10% penalty applies to IRA distributions taken prior to age 59 ½. If you will be age 59 ½ later in 2015 but you take an IRA distribution today, prior to six months past your 59th birthday, your distribution will be subject to the penalty. This is true even though you will attain age 59 ½ later in the year.
2. The 10% penalty applies only to the taxable portion of your traditional distribution. Any distribution of after-tax dollars (basis) from a traditional IRA would not be subject to the penalty.
3. The 10% penalty usually applies only to the taxable portion of your Roth IRA distribution. However, it also applies to a distribution of converted funds taken within five years from the year of a conversion, unless the funds converted were basis. This is true even though your distribution from the Roth IRA would not be taxable because the taxes would have already been paid on those funds in the year of your Roth IRA conversion.
4. The 10% penalty applies in addition to any income tax you owe on the IRA distribution.
5. Distributions you take from an inherited IRA are never subject to the 10% penalty. This is the case even if both the IRA owner and beneficiary are under age 59 ½.
6. There is an exception to the 10% penalty if you take distributions from your IRA or company plan as part of a series of substantially equal periodic payments over your life expectancy or the joint life expectancy of you and your beneficiary.



These are sometime referred to as 72(t) payments.

7. Your distribution from your IRA or company plan may not be subject to the 10% penalty if it is taken due to disability, medical expenses, an IRS levy, or taken while you are an active military reservist. Due to the complexity of these rules, always check with your tax advisor before taking a distribution from your IRA.

8. Your distribution from your IRA, but not your company plan, may not be subject to the 10% penalty if is taken to pay for a first home (lifetime cap of \$10,000), qualified higher education expenses, or health insurance if you are unemployed. Again, these rules are complicated. Check with your tax advisor before taking a distribution.

9. There is no exception to the 10% penalty if you take a distribution from your IRA due to economic hardship. There are many court cases where taxpayers have tried making this argument but none have been successful.

10. You will use IRS Form 5329 to calculate and pay the 10% penalty when filing your federal income taxes.