

Income Course

Hole 1

Par 5

582 Yards

Handicap 12

This arduous par 5 is known for its technical difficulties. Play this hole when a living client under 59½ needs an income stream from their qualified assets. If not using a purchased life annuity, other alternatives should be explored due to the strict rules of Section 72(t).



72(t)

Early Distribution

Hazards:

- ✗ 10% penalty
- ✗ Changing/skipping payment
- ✗ Rollovers to or from other Retirement Accounts
- ✗ Continued on next page...

Terms to Know

- Substantially Equal Periodic Payments
- Required Minimum Distribution Method
- Amortization Method
- Annuity Method
- Applicable Federal Midterm Rate

Under 72(t) rules, there are several situations in which the 10% penalty on distributions before age 59½ may be waived. Some examples include:

Death - Disability - Higher education costs - Substantially equal periodic payments

Substantially Equal Periodic Payments (SEPP):

- ⌄ Payments made at least annually
- ⌄ Continued for five years or until the account owner reaches age 59½, whichever is longer
- ⌄ Payment amount calculated according to one of three methods approved by the IRS

✓ Required Minimum Distribution Method

This is the simplest method for calculating your SEPP, but it also produces the lowest payment. It simply takes your current balance and divides it by your single life expectancy or joint life expectancy. Your payment is then recalculated each year with your account balance as of December 31st of the preceding year and your current life expectancy. This is the only method that allows for a payment that will change as your account value changes. Even though this may provide the lowest payment, it may be the best distribution method if you expect wide fluctuations in the value of your account.

✓ Amortization Method

With this method the amount to be distributed annually is determined by amortizing your account balance over your single life expectancy or your joint life expectancy, using the **applicable federal midterm rate** which changes monthly.

✓ Annuity Method

This method can be the simplest or the most complex calculation. It can be simple if the client buys a life annuity or a joint life annuity (with the beneficiary). If there is a period certain, it must be less than the owners life expectancy. If the client does not want to tie the money up for the rest of their life, an actuary should be involved with the calculation, thus making it the most complex.

72(t) distributions may have many benefits for those who need an income stream, including:

- ⌄ Allows withdrawals from retirement savings without the 10% early withdrawal penalty
- ⌄ Maintains the tax-deferred status of remaining retirement savings
- ⌄ Flexibility to respond to changing financial circumstances

Additional Information:

Revenue Ruling 2002-62 allows you to change your distribution method one time, without penalty, from the Fixed Annuitization or Fixed Amortization methods to the Required Minimum Distribution method.

There are three different life expectancy tables that the IRS allows you to use when calculating your SEPP with the "Fixed Amortization" or the "Required Minimum Distribution" methods. It is important to note that once you have chosen a distribution method and life expectancy table, you cannot change either throughout the course of your distributions (Except for a one-time change from the Fixed Annuitization or Fixed Amortization methods to the Required Minimum Distribution method).

For agent use only. Not for use with the public.

Keys to Success

Evaluating Alternatives ● Use Proper Tables ● Use Proper Interest Rate



Keys to Success:

📌 Evaluate all of the Client's Alternatives

Working, non-qualified investments, borrowing money (home mortgage or equity loan) or postponing plans may be better than chancing a substantial penalty if something goes wrong. Knowing which qualified accounts to use can be vital. Having at least one IRA that is not used in the calculations provides much flexibility to the planning.

📌 Use the Proper Tables

Usually the client will want the maximum payment possible under 72(t). Using the "RMD Single Life Table - Life Expectancy" will provide this. If the client wants to lower the payment after beginning, they can make a **one-time** switch to the "RMD Uniform Lifetime Table - Distribution Period" and use the RMD recalculation method after the switch. This table will give them the lowest payment amount.

📌 Use the proper Interest Rate

The RMD method doesn't use an interest rate. The "Life SPIA" method will use the company's interest rate. If you are going to calculate the payment using either the amortization or annuitization method you have to use an interest rate that **doesn't exceed 120% of the federal mid-term rate** (determined in accordance with Section 1274(d)) for either of the two months immediately preceding the month in which the distribution begins.

Hazards:

✗ 10% penalty

This penalty is applied to all money that has come out over the entire course of 72(t) withdrawals. This problem can be triggered by:

- ✗ Changing or skipping a payment
The total amount coming out in the tax year (usually calendar) must equal the calculated amount and be the same each year, (except if using the RMD method).
- ✗ Improperly done one-time change in withdrawals
- ✗ Rollovers to and from other retirement accounts
- ✗ Calculation Errors
- ✗ Failing to take payments for the entire time period
Payments *must* be taken until the client reaches 59½ or for a period of 5 years, *whichever is longer*.
- ✗ Taking payments that are too large
While the time frame that withdrawals must be taken for is as short as 5 years, the calculation used to determine these payments must use Substantially Equal Periodic Payments over the client's life expectancy as determined by one of the IRS approved life expectancy tables.

Give wise and suitable guidance to clients interested in 72(t):

- ✓ Unleash the power of our 72(t) software to help your client avoid the 10% penalty.
- ✓ Use our fact finder to further evaluate the client's situation and tolerances.
- ✓ Discuss the case with your consultant.

Additional Golf Holes available:

- ⇒ RMD (Required Minimum Distributions)
- ⇒ Rollovers & Direct Transfers
- ⇒ Age 55 Exception

If you have any questions or have a case you would like reviewed, call your sales consultant. They are experienced with the complexities of this topic.

For agent use only. Not for use with the public.