Avoiding the penalties

Accessing retirement accounts prior to age 59½

To help encourage people to save for retirement, assets held within IRAs and qualified plans are permitted to accumulate on a tax-deferred basis.

To promote the use of these assets for the intended purpose of retirement, there is usually a 10% additional federal tax on the portion of withdrawals included in gross income prior to age 59½.

For people who need to withdraw money from their retirement accounts prior to age 59½, there are exceptions when the penalty is not assessed. It's important to note there are different rules that apply to IRAs and to qualified plans.

Exceptions to the 10% additional federal tax[1]	IRA, SEP-IRA, SIMPLE IRA, SARSEP, and ROTH IRA	401(k) and other qualified retirement plans
Employee/account owner attains age 59½	✓	✓
Death of employee/account owner	✓	✓
Disability	✓	✓
Medical expenses	✓	✓
Qualified birth or adoption distribution	✓	✓
Domestic abuse (limited to lesser of $10,000 or 50% of the balance of the account)	✓	✓
Financial emergencies (limited to one per calendar year and a maximum amount of 1,000)	✓	✓
Federally declared disasters (limited to an aggregate of $22,000)	✓	✓
Terminal illness	✓	✓
Distributions to unemployed individuals for health insurance premiums	✓	
Higher education expenses	✓	
First-time home purchase (limited to a maximum withdrawal of $10,000)	✓	
Separation from service in the year employee reaches age 55, or later		✓
An alternate payee under a Qualified Domestic Relations Order (QDRO — generally issued due to divorce)		✓
Series of Substantially Equal Periodic Payments (SEPPs)[2]	✓	✓

[1] Internal Revenue Code Section 72(t). There may be other limitations on taking withdrawals from IRAs and qualified plans (e.g., SIMPLE IRA two-year rule). This list does not include all of the exceptions to the 10% additional tax.

[2] See other side for explanation on series of Substantially Equal Periodic Payments (SEPPs)

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Know your limitations

Substantially Equal Periodic Payments (SEPPs): this exception, which is available to anyone, allows a stream of payments to escape the 10% additional federal tax if all of the following criteria are met:[1]

- Payments must be taken at least annually;
- The amount of the payments is calculated according to one of three IRS-approved methods for determining SEPPs;
- Payments cannot be modified for the greater of five years or attainment of age 59½, whichever is longer; and
- Under SECURE 2.0 Act, Section 323, as long as the distribution amount does not change, an account under SEPP distributions can be rolled over, transferred, or partially rolled over or transferred without a material modification.

The penalty for failing to meet the requirements can be substantial. If you fail to adhere to the rules, the entire sum of your SEPPs received before age 59½ may be subject to a retroactive application of the IRS 10% additional federal tax and additional interest.[2]

When considering SEPP distributions, it is important to discuss the benefits, as well as the limitations, with your tax or financial professional.

What is meant by disability? The precise definition of disability is found in Internal Revenue Code section 72(m)(7). Consult with your financial professional to ensure you meet this exception.

Are there limitations on medical expenses? Generally, distributions are exempt to the extent they don't exceed the amount of unreimbursed medical expenses less 10% of your adjusted gross income for the withdrawal year.[3]

Higher education expenses: For example, payments for tuition, fees, books, and supplies for yourself, your spouse, or the children or grandchildren of you or your spouse are eligible for this exception.[4]

First-time home purchase: For example, this exception can be used for the cost of acquiring or building a residence for you, your spouse, child, or grandchild. Limited to a lifetime maximum of $10,000.[5]

Payment of health insurance premiums for the unemployed: This exception is only available if you have received unemployment compensation for 12 consecutive weeks. This also requires that the distributions be made in the year the individual is unemployed or in the next year. Also, the distributions cannot be made if the individual has been re-employed for at least 60 days.[6]

Payments to an alternate payee pursuant to a Qualified Domestic Relations Order (QDRO): In general, this includes a judgment, decree, or order that relates to child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of the participant.[7]

Qualified birth or adoption distribution: Generally, distributions made during the one-year period beginning on the date on which a child of the individual is born or adoption is finalized are exempt from the 10% additional penalty. Limited to $5,000 per child birth or adoption.[8]

Domestic abuse: Effective for distributions made after 2023 for victims of domestic abuse or the account holder's child or individual of their household.

Financial emergency: Beginning in 2024 anyone who experiences unforeseeable or immediate financial needs related to necessary personal or family emergency expenses.

Federally declared disasters: Retroactive to disasters occurring on or after January 26, 2021, if an individual's principal residence is within a federally declared disaster area and distributions were taken within 180 days of the disaster.

Terminal illness: Individuals who have been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 84 months or less.

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[1] Source: IRC Secs. 72(t)(2)(A)(iv); 72(t)(4); Rev. Rul. 2002-62.
[2] Source: IRC Sec. 72(t)(2)(A)(iii).
[3] Source: IRC Secs. 72(t)(2)(B); 213.
[4] Source: IRC Secs. 72(t)(2)(E); 72(t)(7).
[5] Source: IRC Secs. 72(t)(2)(F); 72(t)(8).
[6] Source: IRC Sec. 72(t)(2)(D).
[7] Source: IRC 72(t) (2)(C); 414(p)(1).
[8] Source: IRC 72(t)(2)(H)

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