

Help your IRA clients avoid penalties on early withdrawals

Although individual retirement accounts (IRAs) are intended to provide income during retirement, some investors may require distributions earlier. Sounds good, but there's a hitch.

Remind your IRA clients about their beneficiary designations

Some IRA investors forget to name a beneficiary or, during times of personal change, fail to update an obsolete designation. Make sure your IRA clients understand that if they neglect to name a beneficiary, the IRA agreement will determine how their account will be distributed in the event of their death.

Withdrawals from an IRA before age 59½ are subject to ordinary income taxes and may be subject to an additional 10% tax (that's the hitch). However, under Section 72(t) of the Internal Revenue Code, the additional 10% tax doesn't apply if an exception is met, including, but not limited to, withdrawals resulting from or attributable to:

- Death
- Disability
- Certain medical expenses
- Health insurance premiums (when unemployed)
- First-time home purchases, builds or rebuilds (up to \$10,000 lifetime maximum)
- Qualified higher education expenses
- Substantially equal periodic payments
- Payments made to you within one year after the birth or adoption of a child (up to \$5,000 per birth or adoption)

A deeper dive on substantially equal periodic payments

Taking substantially equal periodic payments is a common strategy used to avoid the 10% penalty. Here's how it works under Section 72(t):

Calculation

The Internal Revenue Service has approved three calculation methods for substantially equal periodic payments:

1. The **required minimum distribution (RMD)** or life expectancy method uses the same tables for calculating RMDs. Since payments are based on life expectancy, they will vary from year to year. Generally, payments under this method start lower than with other methods but increase annually over time.
2. The **fixed amortization** method distributes the IRA balance incrementally over the life expectancy of the IRA owner or over the joint life expectancy of the owner and beneficiary. Since payments are not recalculated annually, they remain constant over time.
3. The **fixed annuitization** method calculates the payments by dividing the IRA balance by an annuity factor but doesn't require formal annuitization. Because payments are not recalculated annually, they remain constant over time.

72(t) rule tip

One way to plan for unexpected financial needs that could disrupt the arrangement is to split the IRA account into two separate accounts before the client begins taking distributions.

Here's how:

1. Help your client establish a second, unfunded IRA.
2. Request a direct transfer from the first IRA to the second.
3. Calculate substantially equal periodic payment distributions using the balance of only one of the IRAs.

The second IRA can then be tapped to meet other client needs in the future.

Duration

To qualify for the 72(t) exemption, investors must generally receive payments (at least annually) for at least five years or until they reach age 59½, whichever is later.

Modifications

A 10% additional tax for early withdrawals will apply retroactively to all distributions if the IRA owner modifies the payment amount once substantially equal periodic payments have begun, but before the end of the required payment period. Adding to the IRA through contributions, asset transfers or rollovers while taking payments is also considered a modification that triggers the additional tax. If the IRA assets are completely depleted, the resulting cessation of payments will not be treated as a modification. The rules do permit the IRA owner to make a one-time modification from the amortization or annuitization method to the RMD method.

Choice of calculation method depends on investor objectives

Early withdrawals based on substantially equal periodic payments can differ considerably by the calculation method. The right calculation method for a particular client depends on his or her priorities. For example, if the key objective is:

- Current income (over the first 10 years) – consider the fixed annuitization method.
- Long-term income – consider the RMD method.
- Preservation of the IRA account – consider the fixed amortization method.

Three easy steps to taking substantially equal periodic payments

1. **CONFIRM** the need and amount

2. **DETERMINE** distribution amounts

3. **SUBMIT** distribution request form

For guidance, call Capital Group at (800) 421-9900.

Tax issues involving IRAs can be complex. Please consult your tax or legal advisor before making any decisions. This material is not intended to be used, and it cannot be used, by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax laws.

All Capital Group trademarks mentioned are owned by The Capital Group Companies, Inc., an affiliated company or fund. All other company and product names mentioned are the property of their respective companies.

Capital Client Group, Inc.

Lit. No. IRGEFL-017-0525P Printed in USA CGD/TM/9966-S94024 © 2025 Capital Group. All rights reserved.