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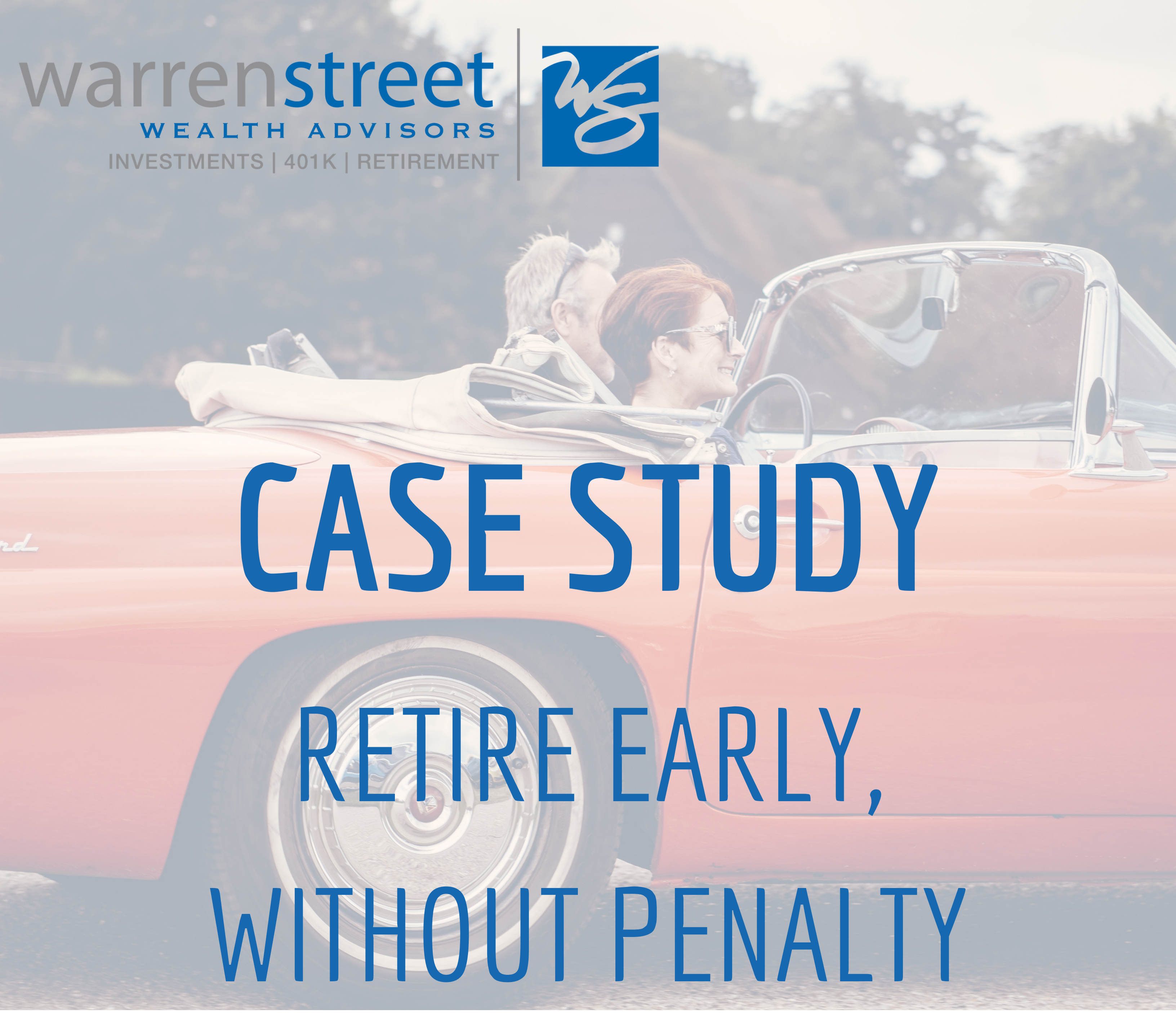
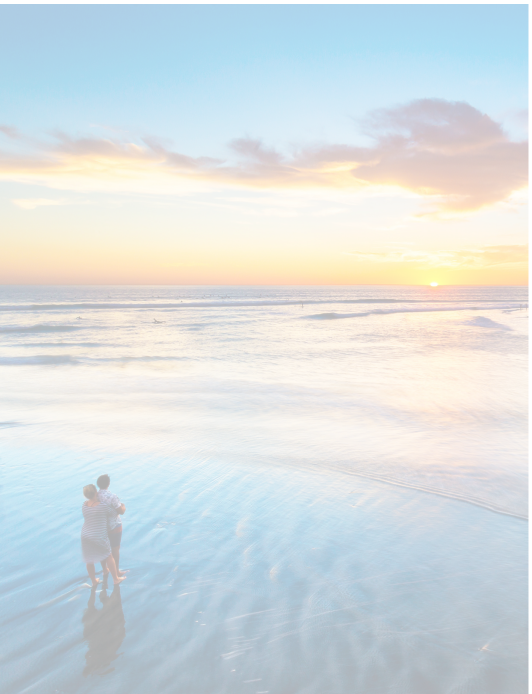


CASE STUDY

RETIRE EARLY, WITHOUT PENALTY



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RETIRE EARLY, WITHOUT PENALTY

Client Description

- Married couples ages: 58 & 55
- $23,000 Unused sick time benefit
- $35,000 Roth IRA
- $1,200,000 Company 401(k) & pension assets
- Outstanding 401(k) loan & debt prior to retirement

Client Goal

Retire pre-59½ without paying penalties, receive $60,000 per year in income to cover living expenses, and move out of state to purchase property to live on and house their RV.

How we solved the problem

The biggest hurdle facing this case was trying to avoid penalties on withdrawals taken before 59 ½ years old. In order to navigate around penalties, we needed to take full advantage of IRS and 401(k) plan specific rules.

When we refer to penalties, we are speaking about the 10% federal and 2.5% California withdrawal penalties from an IRA or 401(k) prior to reaching the retirement age of 59 ½ years old. The 12.5% total is tacked on to the income tax that becomes due upon distribution from the account. For example, if your combined federal and state tax rate is 32%, add an additional 12.5% on top of that for a nominal rate of 44.5% if you take the distribution before 59 ½.

These regulations were put in place to encourage people to save for retirement and not tap into the funds too early. However, this can become an issue for those who have done a good job saving and want to retire prior to age 59 ½.

At the clients' retirement, utilizing the rules and guidelines of the company's 401(k) plan, we took a one-time, penalty-free distribution where a portion would be used to eliminate an outstanding 401(k) loan and minor debt. The Roth IRA was mainly comprised of contributions and can come out of the Roth at any time penalty free, so they were used to help eliminate some debt as well. The remainder of the one-time 401(k) distribution would be used for a 72(t) distribution to generate income until they reached 59 ½.

A 72(t) distribution allows you to take withdrawals from an IRA without penalty as long as IRS guidelines are followed. The account holder must take at least five substantially equal periodic payments (SEPP) across 5 years or until the account owner reaches 59 ½ years old, whichever period is longer. Payment amounts are calculated based on the account holder's life expectancy, and payments are taxed as ordinary income in the year they are received.

If the SEPP rule is not followed, early withdrawal penalties plus interest will be added to all payments retroactively. We automated the distribution process for the client to ensure that the correct amount came out each year, and they did not need to worry about suffering penalties.

Despite the 72(t) distributions, sick time benefit, and Roth IRA contributions, getting the clients to the 59 ½ mark was going to be tight, but the clients had two factors working in their favor: the clients expressed interest in working part-time in retirement, and they were moving to a state with no state income tax and lower cost of living compared to Southern California. These two factors contributed to our clients being able to retire early, get the income that they needed, and help build their short-term cash reserves.

Once the first client reached age 59 ½, they had built up a nice cash reserve and were then able to draw from their qualified assets without penalty.

When it came to purchasing property, the clients were eager to buy something immediately for them to park and store their RV and have additional space for their children to visit and have their own property as well.

Prior to purchasing the land, there were things we wanted them to think about before pulling the trigger. Things such as: if they would like their new location? How would they make the purchase or qualify for a loan without full-time income? How would a down payment out of their retirement assets impact their retirement plans? Do their children also want to make the move with them?

After we provided them with this counsel, they appreciated where we were coming from and held off on the purchase to continue exploring the area and find a property that would fit their needs. Thus far, they are continuing to rent space for their RV, so they can continue to travel. Again, having part-time income to supplement their distributions from retirement accounts gives them flexibility to possibly purchase property in the future and keeps more cash inside their retirement savings.

Finally, they wanted to make sure we could still work with them even if they moved out-of-state, a question we get all the time from clients. We are still able to maintain financial plans, update investments, and continue assisting them through their retirement as if they never left.

There were a lot of moving pieces to help these clients retire successfully. Generating income for a pre-59 ½ retirement, utilizing IRS and 401(k) plan guidelines to avoid penalties, and purchasing property in another state sounds complicated on the surface, but in the end, it was all about formulating a plan and sticking to the process.

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2. CALL - 714-876-6200

Simply ask for your free consultation and we will connect you with one of our advisors.

3. EMAIL - INFO@WARRENSTREETWEALTH.COM

Send us an email requesting your free consultation and we will have an advisor respond to you via email.

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