What Happens If I Withdraw Money from My Tax-Deferred Investments Before Age 59½?

Withdrawing funds from a tax-deferred retirement account before age 59½ generally triggers a 10% federal income tax penalty; all distributions are subject to ordinary income tax. However, there are certain situations in which you are allowed to make early withdrawals from a retirement account and avoid the tax penalty.

IRAs and employer-sponsored retirement plans have different exceptions, although the regulations are similar.

IRA Exceptions

The death of the IRA owner. Upon your death, your designated beneficiaries may begin taking distributions from your account. Beneficiaries are subject to annual required minimum distributions.

Disability. Under certain conditions, you may begin to withdraw funds if you are disabled.

Unreimbursed medical expenses. You can withdraw the amount you paid for unreimbursed medical expenses that exceed 10% of your adjusted gross income in a calendar year. Individuals older than 65 can claim expenses that surpass 7.5% of adjusted gross income through 2016.

Medical insurance. If you lost your job or are receiving unemployment benefits, you may withdraw money to pay for health insurance.

Part of a substantially equal periodic payment (SEPP) plan. If you receive a series of substantially equal payments over your life expectancy, or the combined life expectancies of you and your beneficiary, you may take payments over a period of five years or until you reach age 59½, whichever is longer, using one of three payment methods set by the government. Any change in the payment schedule after you begin distributions may subject you to paying the 10% tax penalty.

Qualified higher-education expenses for you and/or your dependents.

First home purchase, up to $10,000 (lifetime limit).

Employer-Sponsored Plan Exceptions

The death of the plan owner. Upon your death, your designated beneficiaries may begin taking distributions from your account. Beneficiaries are subject to annual required minimum distributions.

Disability. Under certain conditions, you may begin to withdraw funds if you are disabled.

Part of a SEPP program (see above). If you receive a series of substantially equal payments over your life expectancy, or the combined life expectancies of you and your beneficiary, you may take payments over a period of five years or until you reach age 59½, whichever is longer.

Separation of service from your employer. Payments must be made annually over your life expectancy or the joint life expectancies of you and your beneficiary.

Attainment of age 55. The payment is made to you upon separation of service from your employer and the separation occurred during or after the calendar year in which you reached the age of 55.

Qualified Domestic Relations Order (QDRO). The payment is made to an alternate payee under a QDRO.

Medical care. You can withdraw the amount allowable as a medical expense deduction.

To reduce excess contributions. Withdrawals can be made if you or your employer made contributions over the allowable amount.

To reduce excess elective deferrals. Withdrawals can be made if you elected to defer an amount over the allowable limit.

If you plan to withdraw funds from a tax-deferred account, make sure to carefully examine the rules on exemptions for early withdrawals. For more information on situations that are exempt from the early-withdrawal income tax penalty, visit the IRS website at www.irs.gov.