

IRA withdrawal endangers retirement

If I would like to borrow some money from my traditional IRA account, there additional taxes besides the 10 percent federal and the 1 percent state taxes? Generally speaking, you can't borrow money from an IRA account. You can, in effect, get a 60-day loan by closing an account and then putting the money back to work in another IRA account within the 60-day window.

If you can't get a standard bank loan, consider whether you want to take a distribution from your traditional IRA account. Early distributions are subject to a 10 percent penalty tax plus state and federal income taxes. The amount of the income tax due depends on your overall income in that tax year. Taxes and penalties are different for early distributions from a Roth IRA because a Roth IRA is funded with after-tax contributions. Taking an early distribution out of a traditional IRA account should be a last resort. Not only are you subjecting yourself to the taxes and penalties, but you'll also suffer a big setback in retirement planning.

When it's OK to tap your IRA

You've been saving diligently for your retirement, but now you need some of that cash to cover today's expenses. Can you get to it without incurring Uncle Sam's tax wrath? In some instances, the answer is yes.

When it's OK to tap your IRA

- OK for school
- First-home exemption
- Military exceptions
- Allowable, but not preferable, distributions

When you take money out of an individual retirement account before you reach age 59½, the Internal Revenue Service considers these premature distributions. In addition to owing any tax that might be due on the money, you'll face a 10-percent penalty charge on the amount. But there are times when the IRS says it's OK to use your retirement savings early. Two popular, penalty-free withdrawal circumstances are when you use IRA money to pay higher-education expenses or to help purchase your first home.

OK for school

When it comes to school costs, the IRS says no penalty will be assessed as long as your IRA money goes toward qualified schooling costs for yourself, your spouse or your children or grandkids. You must make sure the eligible student attends an IRS-approved institution. This is any college, university, vocational school or other postsecondary facility that meets federal student aid program requirements. The school can be public, private or nonprofit as long as it is accredited.

Once enrolled, you can use retirement money to pay tuition and fees and buy books, supplies and other required equipment. Expenses for special-needs students also count. And if the student is enrolled at least half-time, room and board also meet IRS expense muster.

First-home exemption

Then, there's your home. Uncle Sam offers [various tax breaks for homeowners](#). He'll even bend the IRA rules a bit to help you get into your house in the first place. You can use up to \$10,000 in IRA funds toward the purchase of your first home. If you're married, and you and your spouse are both first-time buyers, you each can pull from retirement accounts, giving you \$20,000 in residential cash.

Even better is the IRS definition of first-time homebuyer. Technically, you don't have to be purchasing your very first abode. You qualify under the tax rules as long as you (or your spouse) didn't own a principal residence at any time during the previous two years. In fact, you can even share your IRA wealth. The IRS says the first-time homebuyer using your IRA funds for a down payment can be you, your spouse, one of your children, a grandchild or a parent. Be careful not to take out your money too soon. You must use the IRA funds within 120 days of withdrawal to pay qualified acquisition costs. This includes the costs of buying, building or rebuilding a home, along with any usual settlement, financing or closing costs.

Different treatment for Roths

These home buying IRA options apply to traditional retirement accounts. The rules are a bit different if your nest egg is in a Roth IRA. The \$10,000 you take out for your first home is a qualified distribution as long as you've had your Roth account for five years. This means you can take out your retirement money without penalty, and because Roth earnings are tax-free, you'll have no IRS bill either.

If, however, you opened your Roth IRA less than five years ago, the withdrawal is an early distribution. As with a traditional IRA early withdrawal, a Roth holder can use the first-home exception to avoid the 10-percent penalty but might owe tax on earnings that are withdrawn.

You can reduce the tax bite by first withdrawing the already taxed contributions you made to your Roth. In fact, the IRS has specific rules about the order in which you can take unqualified Roth distributions: contributions, conversions from traditional IRAs and earnings

Military exceptions

Members of the military reserves also can receive early IRA distributions without penalty. To qualify, the following conditions must be met.:

Conditions

- You were ordered or called to active duty after Sept. 11, 2001.
- You were ordered or called to active duty for a period of more than 179 days or for an indefinite period because you are a member of a reserve unit.
- The distribution is from an IRA or from an elective-deferral plan, such as a 401(k) or 403(b) plan or a similar arrangement.

In addition, the early distribution cannot be taken before you received your orders or call to active duty or after your active duty period ends. Personnel eligible for this early withdrawal exception include members of the Army or Air National Guard; the Army, Naval, Marine Corps, Air Force or Coast Guard Reserves; and the Reserve Corps of the Public Health Service.

Allowable, but not preferable, distributions

Early IRA withdrawals also are penalty-free in a few other instances. Unfortunately, most of these are hardship situations that no taxpayer wants to face:

Hardship circumstances for penalty-free withdrawals

- Payment of excessive unreimbursed medical expenses.
- Payment of medical insurance premiums while unemployed.
 - Total and permanent disability.
- Distribution of account assets to a beneficiary after you die.

You also can get IRS-approved early access to your nest egg if you take IRA money on a specific schedule. Known as substantially equal periodic payments, this method allows you to begin withdrawing from your IRA early as long as the amounts are determined by an IRS-calculated life-expectancy table.

Finally, keep in mind that the early withdrawal exceptions do not eliminate your tax bill if you take the money out of a traditional IRA. Unlike Roth accounts where you eventually can withdraw your money tax-free, taxes are merely deferred on traditional IRAs. So when you take the money out of such an account, regardless of your age or the purpose of the withdrawal, you'll owe your [regular tax rate](#) on the amount. But the early withdrawal exceptions do protect you from paying the IRS more in penalty charges.