



“On The Money Report”

By Steve Pomeranz, CFP

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Exceptions to the 10% Premature Withdrawal Penalty.**

401(k)

- Regular irrevocable payments– After separation from service, if the distributions take the form of an annuity paid out over your life expectancy.
- Distributions upon death or disability of the participant.
- Distributions after separation from service, if the separation occurred during or after the calendar year in which the participant reached age 55
- Distributions to a spouse as a result of a divorce; “qualified domestic relations order.”
- Distributions not exceeding deductible medical expenses (determined without regard to whether deductions are itemized)
- Certain distributions by ESOPs of dividends on employer securities.
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Loans from 401(k) and qualified plans

A loan will not be treated as a distribution if:

- Loan is repaid within 5 years, or
- Loan proceeds must be used to acquire a dwelling unit that is to be used as the principal residence of the participant. Refinancing of a home loan does not qualify.

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- Repayment of a loan from a third party that was used to acquire the principal residence may qualify under the exception!
 1. Example: On 7/1/03 Spiderman purchases a home that he will use as a principal residence. Spiderman obtains a \$50,000 home mortgage from Superhero’s Savings & Loan. One month later, Spiderman borrows \$50,000 from his 401(k) plan. Spiderman uses the money from his 401(k) plan to pay-off the \$50,000 home mortgage. Based on these facts, the plan loan would be treated as having been used to acquire Spiderman’s principal residence. As a result, Spiderman’s 401(k) plan loan would not be treated as a taxable distribution and would also avoid the 10% premature distribution penalty.

IRA – Traditional

- Annuities – After separation from service, if the distributions take the form of an annuity paid out over your life expectancy.
- Distributions upon death or disability of the participant.
- Distributions to a spouse as a result of a divorce; “qualified domestic relations order.”
- Medical Insurance Premiums – To the extent they do not exceed qualifying medical insurance premiums, distributions by an IRA (including a SEP or SIMPLE account) to certain unemployed individuals are not subject to the 10% penalty. Eligible unemployed individuals are those who have received federal or state unemployment compensation for 12 consecutive weeks. Qualified premiums are deductible premiums for the medical care of the unemployed individual, spouse, and dependents.
- Educational Expenses – The 10% penalty does not apply if the individual uses the IRA money to pay for “qualified higher education expenses” for the individual, spouse, child, or grandchild. Qualified expenses include tuition at a post-secondary educational institution, books, fees, supplies, and equipment.



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- First-Time Homebuyer Expenses – The 10% penalty does not apply if the individual uses the money for certain expenses associated with buying a principal residence. Only \$10,000 during the individual’s lifetime may be withdrawn without a penalty for this purpose. Qualified expenses include acquisition costs, settlement charges, and closing costs. The principal residence may be for the individual or the individual’s spouse, child, grandchild, or ancestor of the individual or the individual’s spouse. In order to be considered a first-time homebuyer, the individual and spouse must not have had an ownership interest in a principal residence during the two-year period ending on the date that the new home is acquired.

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“The Investor’s Advocate”
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