SoSEPPs Allow Penalty-Free Access to Retirement Savings at Any Age

You're probably aware that a 10% penalty tax generally applies to distributions from qualified retirement plan accounts prior to age 59½, unless an exception applies; however, you may not be aware of the exception that allows retirement account holders to access their savings at any age, penalty-free.[1] Specifically, this exception allows distributions through a series of substantially equal periodic payments (SoSEPPs). Also known as the 72(t) strategy, SoSEPPs are subject to strict and complicated rules, so it may be best to proceed with caution.

SoSEPPs explained

Under the SoSEPP rule, you can take distributions from IRAs and most work-based plan accounts in a series of regular payments calculated using a specific method over a certain period of time. The payments must be taken at least annually and continue for a minimum of five years or until you reach age 59½, whichever is later. You may also be allowed to establish an installment arrangement — quarterly or monthly, for example — that totals the required payment each year. With respect to work-based plans, SoSEPPs can be used only after you separate from service from the employer maintaining the plan.

You may use one of three methods for calculating the payment — the required minimum distribution (RMD) method, the fixed amortization method, or the fixed annuitization method. Distribution amounts are based on your life expectancy or that of you and your beneficiary. To calculate the correct amount, you'll need to determine which method to use and then choose a life expectancy table (found in IRS Publication 590-B), interest rate (for the amortization or annuitization methods only), and account valuation date.

The IRS permits a one-time change from either the amortization or annuitization method to the RMD method. Otherwise, if you change from one distribution method to another or fail to take the required amount in any given year, the 10% penalty (plus interest) will generally apply to not only the current year's distribution(s) but to all prior SoSEPP distributions.[2]

Note that you cannot make additional contributions to the account nor take payments other than the SoSEPPs during the required period. Additionally, if the account balance reaches zero before the required time period is up, no penalty will apply.

Although it may be comforting to know you can access your retirement account penalty-free at any age, calculating and managing SoSEPPs is a complex process. Mistakes can be costly. For these reasons, you may want to seek the guidance of a qualified tax professional before making any decisions.

1) There is a 25% penalty for distributions from SIMPLE IRAs taken within the first two years of participation.

2) The 10% penalty, plus interest, does not apply if the change was due to death, disability, or another IRS-approved reason.

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