

Things to Consider if You Plan to Retire Before 60

Financially speaking, what moves might you want to make?

Provided by Ivana Lotoshynski, CFP®

By choice or by chance, some people wrap up their careers before turning 60. If you sense this will prove true for you, what could you do to potentially make your retirement transition easier? As a start, you may need to withdraw your retirement funds strategically.

The I.R.S. wants you to leave your retirement accounts alone until your sixties. To encourage this, it assesses a 10% early withdrawal penalty for most savers who take money out of traditional retirement accounts prior to certain ages. For a traditional IRA, the penalty applies if you withdraw funds prior to age 59½; for a workplace retirement plan, the penalty may apply as early as age 55.¹

You may be able to avoid that 10% penalty by planning 72(t) distributions. Under a provision in the Internal Revenue Code, you can withdraw funds from a traditional IRA prior to age 59½ in the form of substantially equal periodic payments (SEPPs) over the course of your lifetime. The schedule of payments must last for at least five years or until you reach age 59½, whichever period is longer. Once the schedule of periodic payments is established, it cannot be revised – if the payments are not taken according to schedule, you will be hit with the 10% early withdrawal penalty. All 72(t) distributions represent taxable income.^{1,2}

You can also take 72(t) distributions, in the form of SEPPs, from many employee retirement plans. To do this, you must “separate from service” with your employer, i.e., leave or lose your job. Should that happen in the year you turn 55 (or in subsequent years), you can take a lump sum out of the plan without any early withdrawal penalty. If you quit or leave before age 55, you may arrange SEPPs over your lifetime or prior to age 59½, as per the above paragraph.³

If you have a Roth IRA or Roth employer-sponsored retirement account, things get easier. You can withdraw your contributions to these accounts at any time without incurring taxes or tax penalties. At age 59½ or older, both account contributions and account earnings can be distributed tax free and penalty free if you have held the account for at least five years.³

In addition to your retirement funds, you will need health coverage. A decade may pass before you are eligible for Medicare, so what are your options past 18 months of COBRA?

The health insurance exchanges may be your best resource to find coverage at a decent cost. In fact, you may qualify for health insurance subsidies because your income will drop when you leave work. Retirement (and the loss of employer health coverage) counts as a “qualifying life event,” giving you a special 60-day enrollment window outside the usual November-December enrollment period.⁴

In the best-case scenario, your employer keeps you on its group plan for a few years after your retirement. (If you have paid for your own health insurance for years, you can keep doing so.)

You may appreciate having a health savings account. Contributions to HSAs are tax deductible, and the assets within them grow tax-free. HSAs are sometimes called “backdoor IRAs” because you can use the money within them for any reason without penalty once you turn 65, not just for qualified health care expenses. (All HSA withdrawals are taxable.)⁵

Think about a conservative retirement income withdrawal rate. The standard 4% baseline may be too optimistic; 3% or 3.5% may be more realistic if you feel you will be retired for 30 years or longer.

Should you claim Social Security at 62? You can, as long as you are prepared for the trade-off: the probability of proportionately smaller monthly benefits over the rest of your life compared with larger monthly benefits you could receive by claiming later.

Any early retirement decision should prompt a consultation with a qualified financial or tax professional. This is a critical financial juncture in your life, and whether you find yourself at it by choice or by chance, your decisions could have lifelong impact.

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Citations.

1 - cnbc.com/2017/07/05/three-retirement-savings-strategies-to-use-if-you-plan-to-retire-early.html [7/5/17]

2 - forbes.com/sites/greatspeculations/2017/08/28/the-basics-of-taking-hardship-distributions-from-self-directed-iras/ [8/28/17]

3 - schwab.com/resource-center/insights/content/thinking-of-taking-an-early-401-k-withdrawal-think-again [8/2/17]

4 - investopedia.com/articles/personal-finance/080516/top-3-health-insurance-options-if-you-retire-early.asp [9/9/17]

5 - investopedia.com/articles/retirement/060116/early-retirement-strategies-make-your-wealth-last.asp [8/23/17]