Looking for a way to supplement your income?

IRS Rule 72(t) may be the solution

Penalty-free distributions from your IRA

Many investors find themselves needing access to their IRA assets earlier than anticipated for reasons that range from early retirement to loss of employment. Under Section 72(t) of the Internal Revenue Code, individuals can take distributions from an IRA prior to age 59½ without paying the early withdrawal penalty of 10%. However, certain conditions must be met.

Rule 72(t) allows IRA owners to avoid the early withdrawal penalties if:

- Distributions are established as substantially equal periodic payments
- The payment schedule is continued for five years or until the account owner reaches age 59½, whichever is longer
- The withdrawal amount is calculated using one of three IRS-approved life expectancy determination methods

The method makes a difference

Rule 72(t) provides individuals with the flexibility to choose one of three calculation methods to determine withdrawals, and the level of income you receive depends upon the method you choose. Withdrawals are calculated on an annual basis, but income can also be taken monthly or quarterly.

It's important to work closely with your financial representative to establish a distribution strategy that meets your individual needs. As with all Traditional IRA withdrawals, payments taken under 72(t) are taxable to the owner as income in the year they are received.

- **Life expectancy method:** The life expectancy method divides the IRA account balance by a divisor from an IRS single or joint life expectancy table. This method results in payment amounts that fluctuate each year, and typically allows the IRA owner to withdraw the least amount of income.
- **Annuity method:** The annuity method uses an annuity factor, provided by the IRS, to calculate substantially equal periodic payments. This method provides individuals with steady fixed annual payments.
- **Amortization method:** The amortization method calculates the annual distribution amount by amortizing your account balance over single or joint life expectancy. This method, which provides fixed annual payments, may be appropriate for individuals who would like to withdraw as much as possible from their IRA.

Comparison of distribution methods*

Distribution	Life expectancy	Annuity	Amortization
Year 1	$2,924	$3,681	$3,699
Year 2	3,148	3,681	3,699
Year 3	3,400	3,681	3,699
Year 4	3,661	3,681	3,699
Year 5	3,940	3,681	3,699
Total	**$17,073**	**$18,405**	**$18,495**

* Hypothetical example assumes a 50-year-old traditional IRA owner, an account balance of $100,000 with an 8% annualized rate of return, and an interest rate of 1.4% for the annuity and amortization methods, in conjunction with the IRS mortality table. Performance is not indicative of any Putnam fund and will fluctuate.

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Don't like the calculation method you've chosen?

If you find your current distribution method is providing you with more income than you need and you're concerned about depleting your IRA, the IRS permits individuals to make a one-time conversion from a fixed-dollar calculation method to the life expectancy method without a tax penalty. Once an account is converted, that method must be used in all subsequent years, and periodic payments must continue for five years or until age 59½, whichever is longer (with credit given for any previous years' payments).

More income than you need?

Some IRA holders may find that even with the life expectancy calculation method, which results in the smallest annual distributions, their withdrawals will amount to more than they need. If so, dividing retirement assets into two IRAs may be an attractive solution. Establishing a 72(t) IRA can provide income generation while allowing the second IRA account to focus exclusively on tax-deferred growth.

Consider the hypothetical case of an investor, age 50, with a $500,000 IRA, who needs income prior to retirement, but doesn't want to be forced to take more income than necessary.

	Scenario 1 **72(t) program on a single $500,000 IRA account**	Scenario 2 **72(t) program splitting IRA into two $250,000 accounts**
Ending account value after 5 years	$617,462	$676,063
Total income generated over 5 years	$92,490	$46,245

Example assumes an 8% growth rate compounded monthly over five years using the amortization method. For illustration purposes only. Does not represent the performance of any Putnam fund or product.

Instead of establishing a 72(t) withdrawal program for the entire $500,000 IRA account, the investor could consider dividing the assets between two IRAs.

By dividing the assets between two IRAs, the investor receives the necessary amount of income while preserving more assets to grow tax deferred within the IRA account. Though the investor receives less income over the five-year period, the remaining account balance is almost $100,000 greater. If more income is needed in the future, a 72(t) withdrawal program could be established on the IRA account set aside for growth.

Important considerations

Taking premature distributions from your IRA requires careful consideration. Early withdrawals result in higher current taxes and reduce the amount of money ultimately available during retirement. Also, once withdrawals begin under rule 72(t), you must continue taking them for five years or until you reach age 59½, whichever is longer. Failure to take distributions in this time frame, or taking more or less than the established withdrawal amount, will retroactively trigger the 10% early withdrawal penalty that rule 72(t) was intended to prevent. Finally, when 72(t) distributions are under way, you are not permitted to make contributions or rollovers into or from the specific IRA you designate for withdrawals.

Given the complexities surrounding this feature, be sure to work closely with your financial representative or tax advisor to determine whether early withdrawals from your IRA make sense for you.

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