Steve Sternberger's
B•E•S•T
Business and Estate Strategies and Tips
"The monthly newsletter for the professional insurance representative"

As OMFN continues to grow and add bench strength to support your selling efforts, I'm pleased to introduce to you a guest contributor, Michael J. Buckner, CPC, QPA, QKA, Director of Marketing, Variable Annuity Distribution for OMFN.

Mike has been in the insurance business for 18 years. He began his career with a wealth management, retirement planning, and money management firm located in Dayton, Ohio. Since then, he has concentrated his efforts in the areas of retirement planning, distribution and income planning, estate planning and charitable planning, all primarily revolving around the sale of annuities. Mike has been a platform speaker at several financial conferences throughout the country on advanced sales topics, and has provided counsel to the NASD concerning suitable sales practices for annuities. Mike is a graduate of the University of Dayton, Dayton, Ohio.

I am certain you will appreciate Mike's initial contribution to Steve's Corner and we look forward to publishing many more of his valuable and sales-oriented articles aimed at helping you sell and service more annuities and life insurance for OMFN. -- Steve Sternberger

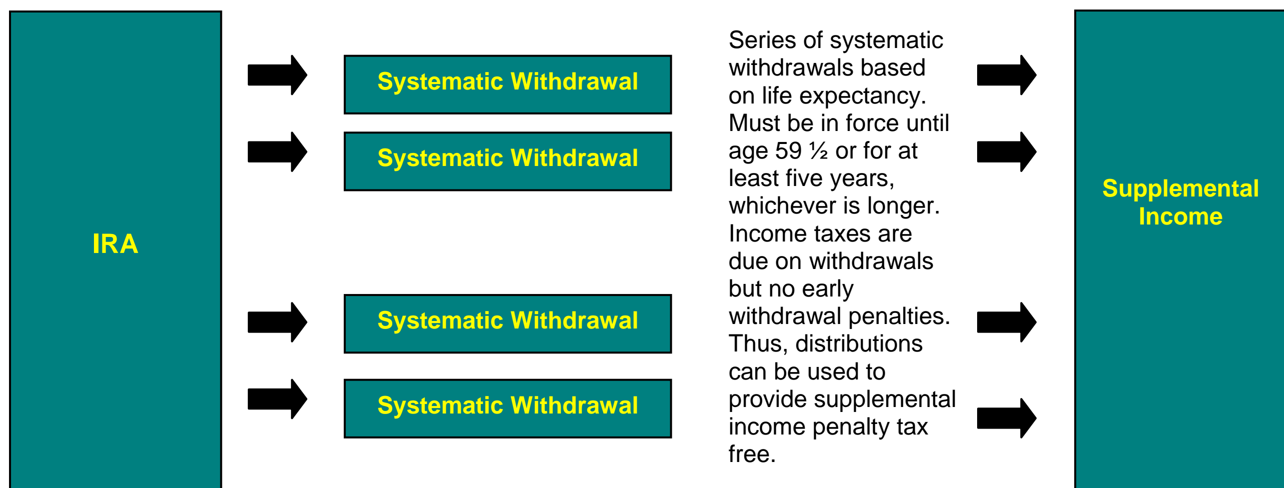
Adding Value with Advanced Sales

Retirement Planning

Avoiding Early Withdrawal Penalties from Retirement Accounts Using IRC Section 72(t)

***Concept**: Many clients are enthusiastic about the benefits of qualified retirement accounts and have contributed to them extensively over the years. These clients may find themselves in a situation where they need an income stream from that account prior to reaching retirement age. They may want to withdraw funds from their IRA accounts, but they are concerned about having to pay both income taxes AND a 10% early withdrawal penalty on those withdrawals.*

A solution to this tax-penalty dilemma is available under Section 72(t) of the Internal Revenue Code. Section 72(t) provides exceptions to the 10% early withdrawal penalty normally assessed on distributions from a qualified retirement account prior to the owner's attainment of age 59 ½. One exception requires that substantially equal periodic payments be taken from the account for a minimum of five years, or until attainment of age 59 ½, whichever term of years is longer. Many clients (and their advisors) lose sleep attempting to find creative ways of accessing account funds, but 72(t) is simple to understand, easy to implement, and available to everyone.



Which of your clients will benefit by taking substantially equal periodic payments under Section 72(t)?

Market: Clients with existing qualified IRA accounts (or funds available for rollover from qualified employer plans or other IRAs) who need to access their money prior to retirement, or those who want to use their retirement assets to pay for life insurance premiums, mortgage payments, and/or other ongoing expenses.

Case Study: Walter (age 53) is the owner of an IRA rollover account that he funded at retirement with his 401(k) plan balance. He had planned to live off his other, non-qualified assets until age 59 ½ (when he knew he could tap into his IRA rollover account for income without subjecting himself to the 10% early withdrawal penalty). Unfortunately, due to a change in circumstances, he finds himself needing to access his IRA rollover account in order to cover his cash flow needs. He makes an appointment to meet with you, his financial advisor, to discuss his situation.

Primarily, he is concerned about the 10% early withdrawal penalty on distributions made prior to age 59 ½. This penalty is imposed on premature distributions from retirement accounts, except under named exceptions, including death, disability, and the substantially equal periodic payments addressed above. You explain to Walter that these payments would be based on his life expectancy at the time that distributions from the account commence and depending on the distribution method chosen, a specified interest rate (See discussion of IRS Notice 89-25 and Technical Issues below). Walter learns he can take distributions from the account every year from now until he reaches age 59 ½ and avoid the 10% early withdrawal penalty on the entire income stream.[1] Once he reaches 59 ½, the early withdrawal penalty is no longer applicable and he is free to do as he wishes with the remaining account balance.

Solution: Walter elects to take substantially equal periodic payments from his retirement account. IRS Notice 89-25 and Revenue Ruling 2002-62 address the acceptable withdrawal calculation methods available to Walter under section 72(t). Distributions under 72(t) can be calculated three different ways: under the life expectancy, amortization, or annuitization methods. Once the distribution stream begins, it usually cannot be altered in any way without triggering retroactive penalties AND interest. It is important then, that the client make the correct choice in selecting a distribution method upfront. The annuitization method will usually generate the largest distributions (and doesn't actually require that the funds be in an annuity or that the annuity be annuitized). Alternatively, withdrawals under the life expectancy method produce the smallest payment and will increase each year. You obtain an illustration of all three methods in one easy-to-compare illustration thereby helping you and your clients identify the distribution method best suited to their financial situation and objectives.

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[1] Distributions payable for five years or until owner reaches age 59 ½, whichever is longer.

We know that by taking systematic distributions under 72(t), the client will avoid the 10% early withdrawal penalty normally associated with distributions taken from a qualified retirement account prior to the owner's attainment of age 59 ½. There are other benefits, as well:

- **Using an Annuity Contract.** If the client's retirement assets are held in an annuity contract, then annuitization will provide an income stream that's guaranteed for life and will also provide a means by which the client can use his annuity to fund an "early" retirement, without incurring a 10% early withdrawal penalty. Also, use of a guaranteed minimum withdrawal benefit in conjunction with the rules of 72(t) provides a guaranteed income stream for life while avoiding the 10% early withdrawal option, if annuitization is not a desired option.

- **Life Insurance Maximization.** Often, clients will take substantially equal periodic payments under section 72(t) in order to use their retirement account distributions to fund life insurance premiums while they're at relatively younger ages and still insurable. As mentioned before, the distributions are taxable as ordinary income (but not subject to the 10% early withdrawal penalty). Once taxes have been paid, the balance of the distribution is applied to premium. As premiums are paid, the cash value in the life contract accumulates and can be used to serve the client's future financial needs.

Technical Issues: IRS Notice 89-25 was modified by Revenue Ruling 2002-62 which specified that distributions under 72(t) be calculated using an interest rate that is not more than 120% of the mid-term rate determined in accordance with IRC Section 1274(d) for either of the two months immediately preceding the month in which the distributions begin.

Action Steps:

1) Explain 72(t) to clients that may wish to access their existing qualified retirement account balances prior to attaining age 59 ½.
2) Acquire a 72(t) illustration for interested clients.
3) Complete and submit paperwork for an annuity contract and 72(t) distributions.
4) If applicable, complete a life application and submit it to underwriting.

Stay tuned for an upcoming article in which we'll talk about similar rules that deal with early distributions from nonqualified annuities!

As edited by --

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