

## Tapping into IRAs...Smartly

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The tax advantages associated with IRAs are well established. Walk into the lobby of any bank, insurance agency, or wirehouse and you're likely to find a glossy brochure touting the synergistic benefits of compounding one's earnings in a tax-advantaged environment. Along with a pitch as to why that particular IRA may be more attractive than the IRA being offered down the street, the brochure may also make cursory mention of the fact that a 10% penalty could apply to certain withdrawals made prior to the perplexingly unround age of 59 and ½ years.

From my limited investigation there appears to be a shortage of glossy brochures explaining how one might tap into one's IRA before the age of 59½ (which the IRS could have expressed as 119 half-years) without having to endure the often-mentioned-but-rarely-explained 10% penalty. If you find yourself in the position of needing to rely upon the funds within a traditional IRA (as opposed to a Roth or SIMPLE IRA) prematurely, it's worth knowing how to play the game.

First of all, the 10% early withdrawal penalty may not be as onerous as it sounds because it is not necessarily assessed on the entire distribution. In actuality, it is only assessed on the *taxable* portion of the distribution. Therefore, if you have an IRA (again, we're talking traditional IRAs here) which consists 70% of after-tax contributions and 30% earnings, only 30% of each dollar prematurely withdrawn would be subject to the 10% early withdrawal penalty (along with ordinary income taxes). In this example, this "10%" penalty would amount to only 3% of the total amount withdrawn.

The lesson? If you have more than one IRA where one account contains a higher percentage of after-tax contributions than the other and you need some of the money prematurely, you may want to invade that account first. In accounting parlance, it is generally more tax efficient to take premature distributions from "high basis" IRAs before tapping into "low basis" ones. If you need help, most any tax advisor should be able to point you in the right direction in short order.

Next time, I'll discuss ways to sidestep IRA early withdrawal penalties in their entirety.

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