Can I Access My IRA Savings For Early Retirement?

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If you are an early retiree looking to tap into your IRA prior to age 59 ½, then a substantially equal periodic payments (SEPP) withdrawal program might be an attractive option as it allows you to avoid early withdrawal penalties.

The Basics of SEPP Withdrawals

A (SEPP) program is nothing more than you agreeing to take withdrawals from an IRA account for a set time period. Although the IRS generally imposes a 10% penalty on withdrawals from IRAs prior to age 59 ½, SEPP withdrawals are one of the exceptions to this penalty. (You are still on the hook however to pay ordinary income tax.)

The catch with SEPP withdrawals is that once you start taking them, you must continue for a minimum of five years or until you reach age 59 ½, whichever comes ***later***. Failure to do so results in a 10% penalty on all amounts withdrawn, plus interest on the deferred penalties from prior tax years.

The IRS provides three methods to calculate the SEPP withdrawal amount, each method resulting in slightly different amounts. You can choose the one that best suits your needs (more on this below), but you must stick with it for the entirety of the SEPP program (with limited exceptions).

Another critical rule to be aware of is that once you start a SEPP program, you may not make any contributions to or withdrawals from the IRA account for the duration of the program, notwithstanding the SEPP withdrawals themselves. Any changes to the account balance, other than for the SEPP withdrawals, investments gains/losses, and required account fees, could be cause for disqualification by the IRS and result in penalties and interest charges.

SEPP Withdrawal Methods and Rules

You must stick with one of the three methods below for the entirety of the SEPP program. The exceptions to this are 1) your death, 2) permanent disability, 3) a one-time switch from the amortization or annuitization methods over to the RMD method.

1. Required minimum distribution (RMD) method

Creates a dynamic withdrawal amount that changes from year-to-year. Calculated by dividing your prior year-end balance by an age-based factor found on IRS mortality tables. This method requires that you recalculate the required withdrawal amount each year based on your new prior year-end balance and age.

2. Fixed amortization method

Creates a fixed withdrawal amount for all years. Calculated similarly to a mortgage payment. You take the most recently reported account balance and designate a reasonable interest rate. Then, create an annual payout schedule based on the appropriate life expectancy table.

3. Fixed annuitization method

Creates a fixed withdrawal amount for all years. Calculated similarly to a lifetime annuity payout. You take the most recently reported account balance and divide by an annuity factor.

Adjusting Your Initial IRA Balance

Notably, none of the above methods allows you to empty your account or select your specific payment amount directly. But you may be able to achieve your desired amount by adjusting the balance in your IRA account ***before*** beginning the SEPP program. For example, if you have multiple IRAs, you could consolidate them to increase your IRA balance and achieve larger SEPP withdrawal amounts. Conversely, you could split a large IRA into multiple smaller IRAs and then take SEPP withdrawals from just one of the new, smaller IRA accounts to achieve a smaller SEPP amount.

Choices You Face in Signing Up for a SEPP Program

1. The starting account balance in your IRA

This is the most consequently decision you face, as your IRA account balance is a major determinant of your SEPP withdrawal amount for all three SEPP withdrawal methods. You can consolidate or divide IRA accounts to manipulate your initial IRA balance, but only prior to starting the SEPP program.

2. SEPP withdrawal methodology

I generally recommend going with one of the two fixed payment methods. They are easier to administer since you do not need to recalculate the required withdrawal amount each year, thus removing a potential future mistake. You also preserve your optionality of switching to the RMD method later on—you cannot switch from the RMD method to one of the fixed payment methods.

The RMD method produces a dynamic withdrawal amount that changes each year based on the prior year-end balance. Assuming the account value grows steadily over time, so too will your SEPP withdrawal amount using the RMD method. Typically, the RMD method yields the lowest withdrawal amount in years 1-4, but a higher amount in years 5+. The key point to remember is that the RMD method's payment will fluctuate with your account balance while the payment for the two fixed methods stays fixed.

3. Frequency of payment

You can elect to receive your payment monthly or annually. This is mostly a matter of personal preference.

Am I A Good Candidate for SEPP Withdrawals?

The ideal candidate for SEPP withdrawals is someone who has most of their portfolio in an IRA account and little to no taxable money to live on prior to age 59 ½. SEPP withdrawals can be a nice way to bridge the gap between early retirement and the commencement of Social Security, pension, and/or annuity income streams.

The main advantage to SEPP withdrawals is avoidance of the 10% early withdrawal penalty. However, signing up for a SEPP program means that you are committed to SEPP withdrawals for a minimum of 5 years, possibly much longer. For example, if you are 50 years old, you would be forced into taking withdrawals for 9.5 years (at which point you reach age 59 ½). If for whatever reason you no longer need the withdrawals by, say, age 55 (e.g., you receive an inheritance or decide to take on a part-time job), you would still be forced to take them or face penalties for all of your prior withdrawals.

Bottom Line

SEPP withdrawals may be a good way to finance early retirement or any need you may have prior to age 59 ½. But they do come with some strings attached and so careful analysis is typically needed to ensure the program is going to work for you. Please get in touch if you would like to learn more.

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