Substantially equal periodic payments

Wealth Management

Tap into your IRA before age 59½ without a penalty

If you are thinking about retiring before you reach age 59½, or need a stream of income for any other reason, you can start taking substantially equal periodic payments from your IRA without penalty.

What are substantially equal periodic payments?

The phrase comes from Section 72(t) of the Internal Revenue Code that allows individuals to take regular payments from their IRAs without penalty. Substantially equal means you always calculate the amounts of the payments in the same manner using your life expectancy. Periodic means you take regular payments at least annually. Many people calculate the payments to be quarterly or monthly. So, at any age, and for any reason, IRA owners can start a stream of income from their retirement account without paying the extra 10% penalty, but only if they take the payments according to the rules set up by the IRS.

Are the rules complicated?

Not really. There are four basic requirements. The payments must:

- Be part of a series of substantially equal payments made regularly (monthly, quarterly or annually).
- Be calculated according to one of three IRS approved methods: life expectancy, amortization or annuitization. The interest rate that may be used is any interest rate that is not greater than 5%, or 120% of the federal mid-term rate for either of the two months immediately preceding the month in which the distribution begins.
- Continue for at least five years or until the account owner reaches age 59½, whichever is longer.
- Once payments commence under an approved calculation method, no further contributions (including transfers) to the account, partial transfers from the account, or rollovers of any kind from the account are permitted. (This rule is in effect until December 31, 2023.)

SECURE 2.0 Act updates

- On December 29, 2022, as part of the Consolidated Appropriations Act of 2022 (P.L. 117-328), President Joe Biden signed the SECURE 2.0 Act into law. Section 323 of the act (effective in 2024) creates an exception to the current IRS rules that prevent an individual from making partial rollovers or transfers of accounts from which Section 72(t) distributions are made.
- Prior to this rule change, partial rollovers or transfers were considered a “modification” which triggers retroactive 10% penalties on all pre-59½ distributions taken pursuant to the Section 72(t) substantially equal periodic payment plan. Taxpayers will be allowed to make such transfers and rollovers (effective 2024), provided that the total distributions from the two accounts after the partial transfer are equal to the amount that would have otherwise been required to have been distributed.

How do the calculation methods differ?

One method, the life expectancy method, requires that payment amounts be recalculated annually based on the account balance and your remaining life expectancy. This method—at least initially—provides the smallest payment amounts. The other two methods, annuitization and amortization, require that the payment amount be calculated when payments start and then remain fixed at that amount. Most people use one of these two calculation methods because they provide higher payment amounts and are easier to administer.

Are payments based on the performance of the investments in the account?

Yes and no. Since the life expectancy method requires a new calculation each year, your investment performance will influence the amount of the payments. The other two methods use a calculation done only when the payments start. So future performance of the investments will not affect the amount of the payments.

Must I add all of my retirement accounts together when calculating my substantially equal payments?

No. The payments are determined using only the value of the account from which they will be taken. This gives you a lot of flexibility in fine-tuning the amount of your payments. Alternatively, you may select a specific or "desired" distribution amount based on a calculated "alternative balance." In turn, you will be required to transfer this new balance into a segregated IRA account specifically set up to generate your desired distribution amount. The remaining balance stays in your original IRA and is a source of income for future needs.

Can the payments be changed?

Yes. An individual who begins distributions using either the fixed amortization method or the fixed annuitization method may make a one-time irrevocable switch to the life expectancy method, which will reduce the required amount to be distributed. Once the switch is made to the life expectancy method, it must be used in all subsequent years. Any other change would be considered a modification and may result in penalties. Partial transfers or rollovers of any kind to or from the account are also considered to be modifications.

The IRA owner has three life expectancy tables to choose from: the uniform lifetime table, the joint and last survivor table, or the single life expectancy table. Once a table is selected, the same table must be used in all subsequent years.

What happens if I die or become disabled?

If you die or become disabled, payments can be changed or discontinued without penalty.

How RBC Wealth Management can help you

Your RBC Wealth Management financial advisor can work with you to determine whether substantially equal periodic payments are appropriate for your situation. We can assist you and your tax advisor in calculating the payment amount you may receive.

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RBC Wealth Management does not provide tax or legal advice. All decisions made regarding the tax or legal implications of your investments should be made in connection with your tax or legal advisor.

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