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How to Make an IRA Your Financial Backstop

For many older workers the recession has been especially tough. Salaries and benefits have been cut, insurance costs have risen. That slimmer paycheck isn't going as far as it used to.

But there is one little known, if troublesome, way that some older workers might be able to make up some of the shortfalls: You can tap into your nest egg a little early.

Tapping Your IRA Early

There are different ways to structure "substantially equal periodic payments" from your IRA. Here's an example using the 72t calculator at Bankrate.com:

Account balance	$250,000
Distribution interest rate	3.25%
Projected earnings rate	3.25%
Your age	50
Beneficiary age	50
Life expectancy table	single life expectancy
Distribution method	fixed amortization method
Post 72t distribution	0%

Your 72t distribution is $12, 217 per year

The law dictating when you can use your retirement money is straightforward: Funds withdrawn from a traditional tax-deductible individual retirement account before age 59 1/2 are subject to a 10% penalty, plus regular income taxes. But there's a loophole, part of Section 72t of the federal tax code, under which the penalty doesn't apply if the money is paid out in set amounts over time.

Be careful. Whether using this exemption is a good financial decision isn't so straightforward -- it *is* tapping savings that you will need for many years to come. Still, when you feel the wolf is at the door…

To qualify, you must take what the Internal Revenue Service calls a series of "substantially equal periodic payments" (SEPP) from your IRA. (Roth IRA contributions aren't penalized.)

This is where the simple part ends.

"Periodic payments" means taking installments at least annually for a minimum of five years or until age 59 1/2, whichever is longer. So if you're 50 years old, the SEPP will be in effect for almost a decade before you can stop. Someone who is 57 years old will be bound to the plan until age 62, well past the time when the 10% penalty would no longer have applied.

"Substantially equal" means the periodic payments must adhere to one of three formulas: a required: "minimum distribution," "amortization" or "annuitization."

What's the difference? The size of payments can

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be substantial. Minimum distribution gives the lowest payment but fluctuates with the value of your account, whereas the other two options supply higher, fixed payments.

These calculations are based on savings, age, life expectancy and a government-supplied "reasonable" interest rate. You don't have to do the m ath -- many financial-planning Web sites have handy 72t calculators. Check out Bankrate.com or, for a comprehensive guide, go to 72t on the Net (72t.net).

Here's how it works: Say you turn 50 in May and have $100,000 in your IRA. The government's single life-expectancy table puts your remaining life expectancy at 34.2 years, and the interest rate for initial distributions in May, according to the IRS, is 3.25%.

Both the amortization and the annuitization methods will provide just over $400 a month, while you'll pocket about $245 a month with the distribution method. If you have $250,000 in a retirement account, those fixed payments top $1,000 a month.

So far, so good -- but don't get carried away. While the SEPP is exempt from the 10% penalty, t he payments are still taxed as ordinary income.

And pay attention to that fixed number; "equal" really means "exact" -- if you take more or less money, you'll be on the hook for the 10% penalty not only in the year you slipped up, but from the time you began the SEPP. To avoid uncomfortable surprises, set up automatic payments from a bank or brokerage firm.

Moreover, the SEPP slaps participants with limitations that many savers would find onerous. For instance, if you find a new job or your salary increases, you can't opt out without paying the 10% penalty.

Or, if $400 a month isn't enough and you need $800 every time, you'll be dinged 10% on both the extra amount and the prior withdrawals. The IRS does allow a one-time change -- to the distribution method from the two fixed methods, which lowers payments and prevents an account from being depleted too quickly.

"Once you start this, you're stuck until you're 59 1/2," cautions Robert Keebler, a partner in accounting firm Baker Tilly in Appleton, Wis. His advice: Give yourself leeway by shifting only a portion of your retirement account into a new IRA and use that for the SEPP.

That's because payments are figured based on a specific IRA account, not the total of multiple IRAs. If you want a smaller payment, you might divide an IRA into multiple accounts and start the S EPP from one of them. You could decide to tap another IRA later on. For example, if you have $250,000 in an IRA and want to take $400 a month, fund the SEPP with $100,000, according to the calculator. If later you need more money, you can establish a second, independent SEPP.

Is a SEPP for you? The answer depends on your age, financial circumstances and how much you've saved. Raiding your IRA now means there will be less gold for your golden years, and, indeed, you run the risk of outliving your money.

"It's a high-stakes game for people who are doing it out of serious financial need," says Natalie Choate, a Boston attorney who specializes in estate and retirement planning. "You're eating up your retirement plan, but if that's where your money is, maybe you don't have a choice."

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