

Avoidance of a 10% Early Withdrawal Penalty from Retirement Plans for Taxpayers under age 59-1/2

There are certain circumstances in which the IRS will allow you to make an early withdrawal and not have to pay the appropriate penalty. If claiming an exception to an early withdrawal penalty from a retirement pension, traditional IRA or employer sponsored qualified retirement plan, click on the TaxSlayer “Other Taxes” menu to access Part 1 of Form 5329. An excerpt from Form 5329 Part 1 follows:

Part I - Additional Tax on Early Distributions

Form belongs to
Taxpayer

SIMPLE Retirement Distributions that are not subject to 25% Tax

Early Distributions that are not subject to 10% tax

Select the reason for exemption

A distribution code 1 on 1099R forms is used to identify early withdrawals from retirement pensions, traditional IRAs, and employer sponsored qualified retirement plans. A distribution code J is used to identify early distribution code from Roth IRAs. A distribution code S is used to identify early distribution from a SIMPLE IRA.

Withdrawals from a Roth IRA taken before age 59-1/2 and/or held less than 5 years are classified as an early distribution (or nonqualified distribution). The earnings portion of Roth IRA taken early may be subject to a 10% early-distribution penalty unless an exception applies.

Early distributions from Employer sponsored Qualified Retirement Plans (401k, & 403b) are prorated between taxable and nontaxable amounts (Designated Roth) amounts by the Employer Plan and should appear on 1099-R forms. It is possible that the amounts in Block 1 and Block 2 are different if some of the distribution is prorated from a nontaxable Designated Roth. 457b plan is a government retirement plan that is not classified as a qualified retirement plan. Distribution from a 457b plan is not subject to early distribution penalties.

A distribution code J is used to identify an early distribution from a Roth IRA. A distribution code T is used to identify an early distribution from a Roth IRA with exceptions. If the distribution code J or T is incorrect, open a Form 5329 and apply a code 12 exception to show the early distribution penalty does not apply. Distribution codes J or T are out of scope if codes are correct.

Caution: Rules for exempting early withdrawal penalties from (a) retirement pensions, (b) traditional IRAs, (c) Roth IRAs, and (d) employer sponsored qualified retirement IRA plans are different. Counselors must understand what kind of retirement plans the early distributions come from before applying an early distribution exception. TaxSlayer provides warnings when an exception may not apply. Do not ignore these warnings.

Use the following table to determine if an exception applies for the type of retirement savings account from which an early distribution has been taken. Enter the dollar amount of the exception into TaxSlayer form 5329 part I if allowed by the IRS. Exception code 12 should be used if more than one exception applies

Exception	Retirement Pension Exception Allowed	Traditional IRA Exception Allowed?	Roth IRA Exception Allowed?	Employer Qualified Retirement Plan (401k, 403b) Exception Allowed?
01 Separated from service & \geq age 55 (age \geq 50 PSO)	Yes	No	No	Yes
02 Series of substantial equal payments	Yes	Yes	Yes	Yes
03 Disability	Yes	Yes	Yes	Yes
04 Death	Yes	Yes	Yes	Yes
05 Med Expenses > 7.5% AGI	Yes	Yes	Yes	Yes
06 Made to alt payee (spouse) by court order	Yes	N/A	No	Yes
07 Health Insurance while receiving unemployment benefits	No	Yes	Yes	No
08 Higher Educ Expense	No	Yes	Yes	No
09 Purchase of 1st home (up to \$10K lifetime)	No	Yes	Yes	No
10 IRS Levy (unpaid tax)	Yes	Yes	Yes	Yes
11 Reservists on active duty > 180 days	Yes	Yes	Yes	Yes
12 Other (Incorrectly identified or combination of several codes 1, J or S listed above)	Yes	Yes	Yes	Yes