Episode 151 Financial Strategies for Early Retirement

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SPEAKERS
Bob French, Jessica Wunder, Alex Murguia, Wade Pfau

Bob French 00:00
The purpose of retire with style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. Think there's no way around early withdrawal penalties. Alex Wade and Jessica wonder talk 72t strategies the rule of 55 and when breaking the rules just might pay off.

Alex Murguia 00:53
Hey everyone, welcome to retire with style. I'm Alex. I'm here with my trusted companion, the Wade Pfau and a very special guest, reoccurring one at that one of our advisors from McLean asset management, Jessica Wunder,

Jessica Wunder 01:11
Hi, thanks for having me

Alex Murguia 01:14
anytime. Wade. You were saying something before I was again, I went on my little roll there. I

Wade Pfau 01:19
just usually, I have to tell people my name rhymes with Wow. Just doesn't even have to do something like that. Her last name is Wunder. So wonder and wow,

Alex Murguia 01:29
look at us. Wonder. Whether you right. Hey, just this isn't it just hit me now because I was thinking about Wade, and I'm sure you heard this all the time. So Halloween is coming up, Wonder Woman. How many times?

Jessica Wunder 01:43
Yes, yeah. One year I was Wonder Woman and my husband was Wolf of Wall Street. So Alex, this is a good one for you. I feel like you like it. If you had a look, he had a wolf mask on and

then a suit. So that was kind of fun. And my daughter has been Wonder Woman quite a few years, right? That would be, you two. Should

Alex Murguia 02:05
do it. It'd

Jessica Wunder 02:09
be awesome.

Alex Murguia 02:10
You'd want to burn that picture. Quickie, I think one year I this is during the Madoff thing, the Madoff mask. You know, those masks that you almost like Hollywood thing. You can put them on. There was a pretty mad off one, and I had to buy it, but I don't think anyone would know who that is. Now, you

Jessica Wunder 02:25
know, yeah,

Alex Murguia 02:28
yeah. Well, today, everyone, we're speaking about exceptional exceptions for early withdrawals from IRAs and Wade. What am I not supposed to say? Not Roth, Alex, don't say rod.

Wade Pfau 02:51
Would be too much fun for one episode.

Jessica Wunder 02:52
Yeah,

Alex Murguia 02:54
yeah. Early withdrawals for 401 ks and IRAs. Wade, why don't you set the table up, buddy?

Wade Pfau 03:01
Okay, yeah. I mean, I mean, the basic scenario, and why we're bringing Jessica in to share her experiences is there's a lot of rules, and so how to actually apply those rules in practice becomes important. But if you're under age 59 and a half, and you've contributed money to an IRA or a qualified retirement plan, and you'd like to take it some distribution before age 59 and a half. Well, you always have to pay tax on any distributions, but there's also a 10% penalty that you may have to pay, and that can discourage people to potentially even contribute. The government's motivation is they want to incentivize saving for retirement. So if you're taking out at a younger age, and there may be many early retirees who actually want to look for these exceptions, but if you're taken at an early age, they're thinking they should penalize you with a 10% penalty. So we want to talk about how you can potentially avoid that penalty. And there's a lot of different exceptions, and I know just has that experience with one of the more complicated of the exceptions, about having a series of substantially equal periodic payments. So we want to spend a lot of time on that one, but also make sure we do cover some of the the other exceptions as well,

Alex Murguia 04:08

something I would say as we're getting as just as we're quote, unquote, professionalizing this podcast a little bit here, for those of you listening, I would we're going to have a cheat sheet of all of these exceptions in the show notes that you can have a link and download it, and you have a nice one pager that has a cheat sheet of everything we're going to say. And in retrospect, yes, we should have done this for probably all previous episodes. It's data heavy. But hey, with time. Here we are, right, but yeah, so don't go. Try not to go too crazy if you're taking notes or anything like that. We've got you covered here. All right, I just wanted to say that that way people can listen in a more relaxed manner.

Jessica Wunder 04:54
Yeah, that's good,

Wade Pfau 04:56
right? Yeah, I mean, and there's a bunch of these exceptions, so I don't. Where we want to start with all that Jess, but if maybe some that you see most commonly, we start there, or you want to work our way down the list. And yeah, with the notes, with the sheet you have available, some of these exceptions apply only to IRAs. Some apply only to qualified retirement plans. Some apply to both. And so if you get that cheat sheet that's along with the episode, you'll see those earmarked which is which as well. Okay,

Jessica Wunder 05:29
why don't we start? I don't have a list in front of me and it since you we're gonna send out the list after we could. I think that might be easier just to, like, kind of go through later, but we could talk about either the rule of 55 or Well, 70 2t strategy is much more complicated, so maybe we start with the rule of 55 that's that's an easier one, and the and one that we can see coming into play. So I think that's an easier one to go through. Then in there, we might touch on some of those exceptions to it. But then we can move on to the 70 2t All right, so the rule of 55 and just like you said in the beginning, you know, if you talk to anyone, even if you just Google and say, oh, okay, can I take money at what age can I start taking out from my either qualified plan, like a 401, K or my IRA. It's blanket statement is going to say 59 and a half. If you take it before 59 and a half, there is a penalty, 10% penalty. And, of course, taxes. We know there's taxes, but the rule of 55 is saying, let's say you're now 57 and you're going to retire early. You say, I have enough, and my nest egg, I know I can retire early. You can start taking from your it has to be a qualified plan. So it has to be a 401, K. In this case, it cannot be an IRA. The others you can but in this case, just qualified plan. You can take it from that, and it has to be your most recent 401. K, so there's, there are a few rules to this. One, it's age 55 so 54 cannot do it. So 55 to 59 and a half, obviously, those are the years that you can go ahead and tap into this. And from your most recent 401, K, you have to be separated from service, so that you know at times it it may not be as common. If you separate from service and you automatically roll it into an IRA, you can't do it. So has to be the 401 K, your most recent 401, K, and you can say, I want to start taking a distribution from there, or I need a one lump sum. You can go ahead and do that, and practice what you do. You just don't click when you're taking a distribution that it's early. Otherwise, that's what's going to go to the IRS, that it's in early distribution. So 55 to 59 that

Alex Murguia 08:00
else. So Jess and I'm gonna ask you some questions here. Some of these could be very specific, and I know they entail, if then statements, so they could I'll get back to you kind of thing, right? But let's say I'm 50. I know that I'm not long for working very much because I don't

know. I have 10 million and that's an exaggerated example. I have 5 million bucks and an IRA right in a 401, K for my company, but I'm going to take a new job, and that new job is brand new, and I'm not going to roll, I didn't roll over my previous 401, K and come 52 I only have $10,000 in that account, and that company is done. You know, it was a very bad experience. The company's bankrupt. And now I've, you know, now I'm 52 my most recent 401, K is only $10,000 yeah, I'm exaggerating here to try to accentuate points here. Yeah. What? What happens?

Wade Pfau 08:58
Well, you're, you're creating a scenario where you still can't do anything, right? Okay, okay,

Jessica Wunder 09:04
yeah, you can't take it. You cannot go back to that old 401 K, even though it's still in existence, it's not your most recent. That's why I

Alex Murguia 09:12
know Wade, that's, that's specifically

Wade Pfau 09:14
what I wanted to and with the most recent one, you're still not 55 yet. Oh, yeah,

Alex Murguia 09:19
yeah. 52 Yeah, I got confused in my own ages. Instead of 52 I meant 55 right?

Jessica Wunder 09:27
No, no, if you say you're 55 even if going to 55 you have 10,000 available to you, right? So if

Alex Murguia 09:34
somebody is in their whatever age, and they have a substantial amount in a 401, K, taking another job that's iffy or something like that could be a little tricky. If all your assets are qualified accounts, non IRR, all your assets are 401, K accounts, because you may not have enough between 55 and 59 and a half in that job. Am I thinking about this the right way?

Jessica Wunder 10:02
That's right in the for, for that strategy, for that strategy, if you're if you only have 10,000 in the new IRA, but 10,000,000k for sorry, in the new 401 K, and you have 10 million in the old one, that 10 million you can't tap into for the rule of 55 there's other strategies that you can tell I just wanted to go for this one. No, no,

Wade Pfau 10:26
you can do a rollover into the that new employer plan. Then you'll be okay.

Alex Murguia 10:33
Yes, yeah.

Wade Pfau 10:34
But also this only works too if your plan allows for discretion. Yeah, I

Jessica Wunder 10:38
should say that in all of the cases, it's rather the plan allows it. First and foremost, the plan has to allow these types of distributions.

Wade Pfau 10:47
Okay? And there's probably one other important point to make on this too. It's not that you turned age 55 so suppose you separated from work at 53 you left the money in the 401, K, you're waiting for your 55/55 birthday, thinking you can then begin to take these distributions without penalty. That's not the rule. That's correct. You have to separate from service correct after age 55

Jessica Wunder 11:11
Yeah, exactly. So it's hard at 54 and a half, right, right, right.

Wade Pfau 11:16
Hang in there.

Alex Murguia 11:17
Hang in there. Show up at nine. Go to the office. Go to the office for six months. Whatever you can do, you can do it. We've been given you.

Jessica Wunder 11:30
Yeah? So, I mean, there are some it can be a bit strict, you know, on the rules, but you you are able to take assets out before 59 and a half without penalty.

Wade Pfau 11:46
Okay, yeah, I think great. That covers the rule of 55

Jessica Wunder 11:50
Yeah, Yeah, that one's pretty straightforward. And

Wade Pfau 11:54
though, to just emphasize again too, this doesn't work for IRAs, because it is only for that 401, K plan, right? And

Jessica Wunder 12:02
the most recent, 401, K plan. So almost everything has to fall into the right place for that to work out.

Wade Pfau 12:08
But if it does allow rollovers, you can wrap everything back into that plan if you want. You can't always do that

Jessica Wunder 12:17
right? And that can

Wade Pfau 12:19
help at the margin to get you through 59 and a half,

Jessica Wunder 12:24
it can, yeah, yeah, it can.

Alex Murguia 12:26
And so that's kind of the exception that you have on 401 Ks, but not IRAs. Is there something with IRAs that you have, but not with 401 Ks? Are there exceptions there for early withdrawals that don't apply to both just the IRAs and not the 401, K, I'm thinking home purchasing things like that.

Wade Pfau 12:49
Before you jump to that, though, we know there's one other exception, just for the qualified plan emergency workers, and that's for public safety employees and secure act 2.0 added a lot of new categories, right? Well, so certain public safety employees are able to there's a whole set of rules, different types of jobs and so forth. But can also potentially at even younger ages,

Jessica Wunder 13:10
right age 50, like firefighters, EMTs, police officers,

Wade Pfau 13:15
or now even with 25 years of service. So if they start at a young enough age, even younger than 50, but yeah, that would be the other one for just qualified plans, right,

Jessica Wunder 13:23
right? That's what I thought you were saying with your example. When you said age 50, I'm like,

Alex Murguia 13:29
no, no. I was just trying to see if you know, for people, the tricky part of that rule of 55 is like you have to be kind of fired. Is the bad news and good news kind of thing

Wade Pfau 13:43
fired,

Jessica Wunder 13:45
the age you have to be, yeah, it's, it's pretty strict in the the type of account and the in your age.

Alex Murguia 13:56
Okay, what are the exceptions in the IRA that you see that you don't see in the fall in case,

Wade Pfau 14:04
yeah, there are three there that you're probably referring to, and it's not something that everyone necessarily memorized. So just, I don't know if you had that list in front of you, no exceptions, but

Alex Murguia 14:14
there's an exception for the home. There's 100 there's a 10,000 for first time home buying, it

Jessica Wunder 14:20

right for your primary home, right? Yeah, and

Alex Murguia 14:24
yeah, there's been within 120 days to turn that around. So you don't see that in foreign case, you see that with traditional IRAs. And

Wade Pfau 14:32
that one's more strict too, that you have to actually directly pay for the home with that distribution. It can't go into your bank account. And then other money used is used to pay for the right up to $10,000 for the first time home purchase, or if it's been at least two years,

Jessica Wunder 14:47
two years, right exactly,

Alex Murguia 14:51
there's one for medical insurance premiums.

Wade Pfau 14:54
If you're unemployed, you're unemployed, yeah, yeah, you can pay for medical insurance premiums for you. And. Eligible family members through the IRA, not through the 401, K, but through the IRA. And

Jessica Wunder 15:06
there's a few more way that you mentioned too coming up, I think, whether it's 2025 2026 long term care

Wade Pfau 15:15
paying 2026 that's for both. You can pay for long term care from both IRAs and qualified plans. Yeah, the

Alex Murguia 15:23
one that's specific for traditional IRAs is, like I said, the buying the home, the medical expenses, and there's a piece on education expenses as well, right? And

Wade Pfau 15:35
that one's less strict. You don't have to send the money directly to the educational you said educational, right, yeah. And so you can distribute up to the amount of those qualified educational expenses for you or eligible family members without penalty from your IRA.

Bob French 15:54
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Alex Murguia 16:22
So So before we get into the ones that affect both types of accounts, just to be clear, I'll reiterate it and chime in. You know, I'm somewhat lazy when I'm putting my phrases together, but the

exceptions that apply for 401, KS that don't apply effectively for IRAs are the rule of 55 that's kind of it. And there are exceptions for public safety employees, both. And there's many things within that, yeah, but those are that that you can withdraw early if you have a 401, K, and you're subject to those, but you can't do that within an IRA account. Within an IRA account you can withdraw early, you know, with with issues regarding buying a home, $10,000 distribution for qualifying educational expenses, and lastly, the medical insurance premium expenses. So you can do that. You can tap into IRAs there early. But you can't do that within 401 k, so when I say foreign, case, I mean qualified plans in general. But so that's level setting here, right? Yeah, the ones that apply for both early withdrawal, early distributions that apply to both of these are drum roll. And then, you know, there we can break out the examples and stuff like that.

Wade Pfau 17:40
Lot of them? Yeah, there's

Jessica Wunder 17:41
a lot. I mean, it's death

Alex Murguia 17:45
one at a time. Let's start with a big one.

Jessica Wunder 17:50
We've covered this, yeah, Elizabeth,

Alex Murguia 17:52
it's the big one. Let's start with that one, yeah, the Sanford and Son exception, right, right?

Jessica Wunder 18:00
The exception that nobody wants to use is death, and also, you know, disability as well. Permanent disability, that's an exception as well. When I think you mentioned terminal illness, you know, all the not so great things, you know, let's knock those off the top. You know, obviously death, disability, illness, and we'll get to, I don't know if we want to talk about it now, but the 70 2t because that's one also that covers both. That's taking equal payments from an IRA or a 401, K, that's complicated. So I don't know if we want to get go through the list, the rest of the list, that's not as complicated, and then circle back you tell me,

Wade Pfau 18:46
Well, yeah, let's save the best for last, because right, yeah. But then there's also for deductible medical expenses. Yes, this would be the amount over seven and a half percent of your AGI. You don't have to actually deduct them, because it might still fall in your standard deduction. But what would be deductible medical expenses is an exception. There's now, with recent law changes, you've got things like $5,000 you can take out with a newborn for eligible expenses for a newborn, you've also got, yeah, that's definitely a new one. That's yeah, with secure act 2.0 there's some, some new exceptions, emergency withdrawals, up to $1,000 that actually just in 2024 it's the first year that one exists, as well as some, some potential benefits for victims of domestic abuse to be able to take distributions without penalty,

Jessica Wunder 19:41
right? And that's 2020 new in 2024

Wade Pfau 19:45
and then just, could you talk a little too about that the disaster recovery? Yes,

Jessica Wunder 19:50
yeah, that's also somewhat timely, unfortunately. But with the hurricanes, there is a. Disaster Recovery relief, also, that's an exception, an exception to to the early distribution. That's one that I think we certainly this year, I can imagine people are thinking about. And you know, we've seen it just with clients in North Carolina, with quite a few clients in Florida as well, but mostly North Carolina that got hit there Asheville that, you know, this is a good way to be able to, you know, unfortunately, have to tap into those assets for an unfortunate reason. But you can starting, I think it was, it's not this year, but within the it's relatively new, the disaster recovery relief, and I think it's up to 22,000 going by memory.

Wade Pfau 20:48
Yeah, yeah. So now that saves tonight,

Alex Murguia 20:52
just, just, and then say these all at once. So then the exceptions that apply to both and again, chime in. I'm trying to give it the overview here death of a participant, obviously, you know, that's an exception. Now, there are beneficiary workflows that happen afterwards that we won't get into in this episode, because it can get complicated, but just know, for purposes of this it, and it's stating the obvious, but there's an exception for early withdrawals, if you die before 59 and a half?

Wade Pfau 21:24
Right? Yeah, just permanent. One more sentence to that. So spousal beneficiaries have a lot of options to them, and they need to be careful, because if they're under 59 and a half, they don't want to just roll it over into their name right away, because then they'll be exposed to penalties, and

Alex Murguia 21:39
that's why there's a lot of things that happen afterwards. It comes with its own thing. Permanent disability of a participant is another one. And there's, there's like things that you have to qualify for to be able to permanently, permanently disabled. Terminal illness, again, this is a terrible list to read. Yeah, terminal illness, and that's a doctor. There's a certain number of years, I don't know, the top my head, wait, the doctor will say it doesn't say it again, seven, I

Wade Pfau 22:10
believe. So there's

Alex Murguia 22:11
certain number of years that the doctor will give you a life expectancy, yeah. And you play off of that, and then you just talked about the medical expenses. And so that those though

Wade Pfau 22:22
that lot, that one was the back with the IRA only, oh,

Alex Murguia 22:26
I meant, sorry, distribution less than the deductible from, yeah, I'll be trying to do it quickly. So yeah, I only call,

Wade Pfau 22:35
oh, you're no, you're right, yeah. Meta, not right. Meta, deductible, medical expenses, yeah,

Alex Murguia 22:39
and you don't need to take the deduction, they just need to be quote, unquote deductible. Yes, all right,

Wade Pfau 22:46
that means over seven and a half percent of AGI, not just any like eligible medicals got you

Alex Murguia 22:53
Yes, thank you. And so that's the ones that apply to both. And then there's one more that you were gonna we're gonna now flesh out a little bit more right now,

Wade Pfau 23:01
well, and there's the newborn expense, yeah? So, yeah, there's the newborns, okay? And there's the emergency with victims of domestic abuse.

Alex Murguia 23:11
Like I said, there's two more

Wade Pfau 23:14
disaster recovery.

Alex Murguia 23:16
I can't memorize these. Man I think we fit. Yeah, we

Jessica Wunder 23:27
did we do? Well, I guess it's newborn, but birth or adoption, there's, yeah, okay, so there's a few. We'll have the list there. There's actually a pretty lengthy list, which is helpful. It's

Alex Murguia 23:41
helpful. Yes, yes. All right, so Jess, what go on and now what's the big one that you were going to discuss? Okay,

Jessica Wunder 23:50
so the big one that's pretty complicated is the 70 2t approach, and that's taking substantially equal payment plan that it doesn't have the same rule of 55 so when you said age 50, I thought that's what you were getting into. Um, this is pretty complicated, and it's one that you don't want to mess up, because if you trigger something or do something off of the rules, you'll end up with a penalty for the full amount. They'll go back from when you started, and you'll have a penalty that 10% will apply to the full amount. So I can it's a great strategy. I'll walk through just a scenario of what we've done in the past, and just disclaimer, I've done it about two times in 25 years. It's not common for our client base, but it really is a great strategy, if it works out. And

Alex, I'll use yours of you know you have, let's say, a tremendous amount of 5 million whatever that is. Mean, my

Alex Murguia 24:58
personal example. This is you. We're

Jessica Wunder 25:02
gonna use that because Wade knows it's

Alex Murguia 25:04
definitely much, much, much more correct

Wade Pfau 25:10
earlier.

Jessica Wunder 25:13
Well, let's in this scenario, and there is actually the two separate scenarios with different situations, but let's make the assumption that it's someone can retire early. They know I have the financial freedom, and they they're ready to retire. They know they have more than enough in their nest egg, in their retirement. Retirement Account, IRA or 401, K, can be used for both or retirement plan. I said 401, K, but we'd like you said it does cover all qualified plans. So IRAs qualified plants. In this case, there was a significant amount of assets there. We knew that this would work. I do want to bring up, and I probably talk about it at the end, but I'll bring it up quickly here that taking money out, you know, and then wait, Alex, you know this better than anyone here, that retirement can last 30 to 40 years. Taking out a chunk in your early 50s can really change that your your long term retirement plan. Just throw it out there. Let's say I can bring up examples, but you take 50,000 out at age 50, at age 65 that could be almost $200,000 yeah, it's invested, but just throw that out there. I'm

Alex Murguia 26:35
a trick, the acolyte of the Fire Nation. So

Wade Pfau 26:39
yeah, that's what this is in the fire community. That's where you'll see the most discussion of this, because it's for people who are retiring before they're 59 and a half. It's if you just need a one time distribution. You don't want to set I think you'll get into that, yeah,

Jessica Wunder 26:53
you don't want to set this up, right? This is for we've and in this case, you know, we've exhausted all the other options. So the rule of 55 just doesn't apply. Whether it's in an IRA or maybe they're not. 55 doesn't apply. Can't do that. I know we didn't touch on any of this, but a 401, k loan doesn't apply. A HELOC other options where there's no other taxable funds, an emergency fund that there should be, but we're just gonna none of it's there. None of it is there. Last

Alex Murguia 27:25
Resort kind of thing. It is, in

Jessica Wunder 27:27
my opinion, this is more of a last resort, although it works well, it works well, but I would look at the other options before doing this. But let's make the assumption we have a good amount of money. We're gonna start doing this. So what we want to do this, there's a multi step approach to it. And I'll go back to why, after I walk through the process of it, why it's there's a multi step approach to it, one is figuring out. So in this case, sat down with the client and said, Okay, how much do you need? How much do you need from annually? Let's come up with an annual number. It 40 to 50,000 I'm going to say just 40,000 a year. Let's just pick it 40,000 and we know we need that amount each year. There's a calculator, a 70 2t calculator, if you Google, it'll pop up quickly. Actually, bank rate has it. I think any of the custodians has it. You can go, go and click on there, and you put in your information, and I don't, I'm not going to dig into the calculator, because we'll be here another hour going through the calculator. But you say, What? What? What we're trying to figure out is, what is the lump sum needed for those annual payments? And there's also a few different options that you can choose for these payments. One the easiest one, and the one I'd recommend is taking it like a required minimum distribution. So we know at age 73, out of your IRA, you're forced to take a required minimum distribution. So this is the easiest way to do this. This is just saying based on the value of the account on December 31 the year prior, and then it's divided by life expectancy factor that we find on the IRS website, the calculator will figure this out for you. So I'm giving you information. You don't need it. You just go to the calculator, plug it in, and it'll spit out your three different options. One most the recommended, easiest one to do. Second one is fixed amortization, so that's just taking the account amortizing it over your life expectancy. Third is fixed annuitization, which is basically the same thing. Essentially, it's more complicated because then there is a separate calculator that will pick up, as if this was an annuity for the case that I've done in the past. Just pick the R and D. It's the simplest one to do. And you can actually, well, amount.

Alex Murguia 29:59
It will delete a caveat there, and again, this is a last resort type of thing, so it's people that are and I'm saying that I'm exactly, yeah, yeah, kind of like doing a I'm generalizing. I shouldn't, but yeah, 80% of the time it's one of these where something has hit a ventilation system. And so you need just

Wade Pfau 30:22
if you are an early retiree, this could be part of a responsible retirement plan. So yeah, it could be last resort. But it could also be someone could be saying, Hey, this is not last

Alex Murguia 30:31
year. Yeah, right,

Jessica Wunder 30:33
yes, but yeah,

Alex Murguia 30:35
that being the case, what you're ultimately getting at there is that you can lock in with, with the RMD approach, you can lock in the thing, and so with the amortization and with the other one, is there one that's usually higher? Yes, the other, I say that to lead into, you know, if you need this because there's maximization of amount, then what should that person be thinking of?

Jessica Wunder 31:04
The not the RMD one, that's probably going to be the lowest out of the three, but is the easiest one not to mess up. You know for sure, the easiest one not to mess up. The other two are going to be similar payouts, and they'll be higher.

Wade Pfau 31:20
You are allowed to start with one of those other two and switch and switch

Jessica Wunder 31:23
to the R. Yes, there's a one time switch that you can if you start with the other two, you can go back to the RMD. You can go back that way. So let's assume you've done the calculator. You're going to pick one of the three, you know, your lump sum. This, the next step is pretty important, and you don't have to do this, but I recommend doing this, and I'll tell you why in a second, taking that lump sum out. So if it's $200,000 whatever the amount is, putting that into a separate IRA. So you're leaving if you have this massive IRA, you only take out the portion that you know you need for. You have to keep it in this plan for five years. Five years, 59 and a half. You have to keep it in this plan whichever is older, yes, oh, yeah, whichever is longer, whichever is longer. So you start at 58 you have to keep it there until 63 so you take whatever that that lump sum is, you move it into this IRA, and you start taking your distributions come tax time, they it is not coded. Make sure it is not coded as an early distribution, otherwise you're going to get hit with that 10% penalty. But the important piece, and why I say to move that chunk into a separate IRA is because you really do lose flexibility out of those assets. So if you need more than that, you you can't get it once you do that, if you trigger and this, what I said, it can be complicated, and also, if you mess it up, you're going to owe penalties on all of that amount if you need more, and you're taking it from your large IRA, you can't tap into it. We're making the assumption that there's no other assets for you to tap into. So if there's an emergency, you can't get to those assets. Um, so if, but if you have it in a separate IRA, you have that 200,000 that is now paying you those that payment over the next five plus years. Then if something else pops up, you can go and tap into the other IRA and take out of that. Now you'll have the penalty there, but if you it just gives you more flexibility. So it's pretty important, and it's not a step that you have to do, but I recommend making sure that you do it that way, and that we've seen, and like Wade said, that it, it can be, I think you use responsible or responsible retirement, retirement plan, it we're making the assumption There's two things, two ways to look at it is, one is that it's, there's a cash flow need, and it's kind of an emergency type of situation where we don't want to take out, but this is our last resort. But also could be, which is how we have used it in in the past. Is, I have more than enough. I want to retire. I want to go do things. I want to retire. I know I have more than enough. We've done the financial plan. You're set sure you can start doing something like this. This makes sense,

Alex Murguia 34:30
more than enough, but concentrated in an account, correct, correct,

Jessica Wunder 34:35
correct. This is always the assumption that the assets that you can tap into are just tax deferred, whether qualified plan or an IRA, that's it. But you know, Alex on that, it does lend to thinking about saving in, not just in a tax deferred account, whether it's an IRA, but you know, there's, there's even, I know we weren't going. Talk about it, but a Roth, I may you know, there's options there, just making sure that as you're saving for retirement, that it's not just in tax deferred

assets. And many, many of us, that's all we do, and that's okay, but it can lead to this type of situation where you're stuck trying to find an exception to take out of those types of plans before 59 and a half without penalty.

Alex Murguia 35:25
And I think we've, we've always, just as a general matter, and wait, I think we have, when we talk about tax diversification, from the standpoint of what types of accounts should you fill up, we kind of always default to just keep it balanced. Because if you don't have anything that's taxable, you run into, you could potentially run into spending sort of issues that you can't resolve right away because of the logistics of having something in a qualified account, if you will, wait. I think that's kind of our our theme usually,

Wade Pfau 36:03
yeah. I mean, it'd be helpful to have some taxable assets as well. And, yeah, as Jeff was pointing out, I mean, in principle, there's nothing wrong with this, other than there's so many ways you can make a mistake and then get a big penalty. So that's real danger of setting up a substantially equal periodic payment. Yeah.

Alex Murguia 36:20
And for the client that we're talking about, yeah, this was, this was somebody that they were going to spend more money than their kids could even use. And it's one of those. They worked for a company. The company took off like a rocket, right? And it happened to be everything in the 401, k, and this person was just a normal, probably not making more than 110,000 in any given year for the entirety of their career. And so it was one of those that and was living, you know, nicely, but nothing opulent, nothing overly restrictive, so like a normal thing, but you hit a big in the 401 K land, and that person wanted to call it a day. I forgot how old that person was. Yeah, right, early 50s and and so yeah, we implemented it simply because it served the cash flow needs of having money until 59 and a half, and at that point they can, you know, a better decision could be, it could be like as an inflection point to then review again.

Wade Pfau 37:30
Yeah, and you right. You just have to take it out for the longer. So if you started this at 50 you can stop. You're no longer required to take those distributions once you're 59 and a half, exactly. You started it at 58 though you are required to continue it for five years, so until 63 before you right?

Jessica Wunder 37:46
Yeah, that is a big one. That's a big one because I think people would automatically see, no, I'm 59 and a half. I don't need to do this anymore. Well, you do if you started this type of plan

Wade Pfau 37:57
at least

Jessica Wunder 37:58
five years? Yeah, right, right. Right, but it's a good way. It's a good way to start tapping into those retirement assets before 59 and a half without penalty, making the assumption that that is the last, the last place you can get it from the last resort. Okay,

Alex Murguia 38:25
notice, yeah,

Wade Pfau 38:27
yeah. At one point it did come up, just in 2026 they're going to add a new exception with the qualified long term care expense distributions. But we're still a couple years until then and until, I wonder if

Jessica Wunder 38:41
that one, I mean, I'm probably bringing up more of a long term care expenses would probably hit under the medical expenses. I wonder if that would hit the seven and a half anyway, but that's well,

Wade Pfau 38:51
and this is also relevant if you're under 59 and a half, right? Need long term care, so, right, normal Long Term Care scenario, yeah,

Alex Murguia 38:59
all right. And again, we'll have a cheat sheet in the show notes to make sense of all of this for you folks. So feel free to knock it out. You know, you have a link and you can go to it. Thank you, everyone. Thank you, Jess, for giving us you know the lowdown on this. Really appreciate it way, yeah.

Wade Pfau 39:21
And Jess, if there's anyone listening who'd like to reach out to you to talk about, potentially, like working with you as a financial planning relationship, how can they best do that?

Jessica Wunder 39:32
Our website is the best, the best way to go about that, and our website is McLean. Am.com

Wade Pfau 39:39
Okay? And as I said, it's a difficult nobody knows how we still in the clean So,

Jessica Wunder 39:45
L, E, A, N, and then a, I always have to say, am is an asset management.com

Alex Murguia 39:49
I make the same mistake, oh, yeah, not the same mistake. But I always go right, like, yeah,

Wade Pfau 39:54
you want to put an am calm, and then

Alex Murguia 39:58
you have to explain, am is. Really been all right. All right, everyone. Thank you for listening. Catch you next week on retire with Style. Thanks you.

Bob French 41:26

Wade. Wade and Alex are both principals of McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities to determine which investments may be appropriate for you. Consult your financial advisor. All investing comes with a risk, including Risk of Loss past performance does not guarantee future results you