

Tax Tips: Early IRA/TSP Withdrawal, More Expensive Than You Think

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The Heidelberg Tax Center is committed to the complete and accurate completion of the community's taxes. In this difficult economic time it may be tempting to withdraw money from either your Individual Retirement Account (IRA) or your Thrift Savings Plan (TSP). Keep in mind that the primary purpose of a retirement savings account is to withdraw money during retirement. Taking money out of your traditional IRA/TSP account may alleviate some financial difficulties now but there are tax consequences that will cost more than you probably think over the long term.

What is an IRA?

An IRA is a trust or custodial account created/organized in the U.S. for exclusive benefits of an individual or his/her beneficiaries.

What is TSP?

A TSP is a retirement savings and investment plan for civilians employed by the United States Government and members of the uniformed services designed to help save for the future. The retirement income one withdraws from a TSP account will depend on how much was contributed to the account during working years and the earnings on those contributions.

Consequences of IRA distribution

Taking an IRA distribution (withdrawal) before the age of 59 ½ is called a Premature Distribution/Withdrawal. The amount taken out of your IRA will face federal tax withholding based on the current tax bracket rather than the lower tax bracket most persons fall into during retirement. Plus you will pay an additional 10% tax penalty.

Consequences of TSP Withdrawal

An in-service withdrawal is a withdrawal one makes from a TSP account while one is still actively employed in federal civilian service or the uniformed services. There are two types of in-service withdrawals: financial hardship withdrawals and age-based withdrawals. Both withdrawals are treated as taxable income.

Financial Hardship Withdrawal

This withdrawal has a minimum of 10% federal tax withholding and an additional 10% federal penalty tax for any withdrawal before the age of 59 ½. TSP

does not allow further contributions for 6 months following this type of withdrawal. Essentially you lose the amount initially withdrawn and any earnings that would have accrued from that amount up until retirement. Plus you lose any money that would have been contributed during the six months afterwards, plus interest.

Age-Based Withdrawal

This withdrawal is taken at the age of 59 ½ or older but while still actively employed in federal civilian service or the uniformed services. Age-based withdrawal has a minimum of 20% federal tax withholding.

Before you decide to make a withdrawal from your IRA or TSP account while still employed or before retirement age, carefully consider not only the impact of your decision on the immediate need but also its impact on your future well-being. Live within your means. If you find yourself in a desperate financial situation, consider all the resources at your disposal before withdrawing from a retirement account. Following this advice will save money over the long term.

Tax season is almost here. Start gathering the following documents for your return: W-2 or 1099, Social Security Cards or ITIN and picture ID. Additional documents you may need to bring, if applicable: Economic Stimulus Dollar Amount, Child Care Provider's Information and Child Care Costs, Rental Property, Mortgage Interest Statements and 2007 tax return. If married filing jointly both tax filer and spouse must be present to file the tax return. If one spouse can not be present, then he/she will need to visit the legal assistance office to acquire a power of attorney.

The Heidelberg Tax Center opens for the 2008 Tax Season on February 2, 2009 and we look forward to your visit. Starting January 26, 2009, please call 370-7510 for an appointment with a certified tax preparer.