ED SLOTT'S IRA ADVISOR

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Tax & Estate Planning for Your Retirement Savings

WHAT'S INSIDE?

Join the Retirement Planning Conversation

Emergency Access to Retirement Funds

Inflation may be slowing, but prices are still elevated across the board, and most of us have felt the pinch. Unfortunately, some Americans get squeezed more than others. In May 2024, the Board of Governors of the Federal Reserve System published their report, Economic Well-Being of U.S. Households in 2023, which examines the financial lives of adults and their families. According to the report, inflation made the financial lives "worse" for 65% of households, and "much worse" for 19%. Many adults reported they could not pay all their bills, skipped meals and delayed medical care. *What is a person to do when facing a financial emergency?*

Kohl Case

For some, dipping into retirement savings is the only way to keep their head above water. But there are consequences if these retirement withdrawals are not handled properly. Taxes will be due if the withdrawn funds are pre-tax, and there is a 10% early distribution penalty for those under age 59½ (unless an exception applies).

Oftentimes, IRA owners and retirement plan participants think they can avoid the 10% early withdrawal penalty by claiming "hardship." But such is not the case. There is no specific exception to the 10% penalty for hardship, and this argument has failed repeatedly in court.

In fact, the Kohl case, *Caren Kohl v. Commissioner; No. 26962-21S; T.C. Summ. Op. 2024-4*, (released April 2024), documented yet another situation where a person in dire need of funds was dinged for the taxes due and 10% penalty. In 2018, Caren Kohl, who was in her early 50s, found herself in financial straits. To pay past rent and avoid eviction, she took a distribution of $10,342 from her retirement plan. She did not pay taxes or the 10% early distribution penalty. The IRS pursued her for both, and she ended up in Tax Court.

Kohl conceded she did owe taxes on the distribution. However, she argued that the new penalty exception under SECURE 2.0 for financial emergencies applied, so she should not owe the 10% penalty. Unfortunately for Kohl, this argument was quickly dismissed. The new exception was not effective until 2024, and Kohl's distribution occurred in 2018.

Financial Emergencies: New 10% Penalty Exception

What is this new exception referred to in the Kohl case? Effective in 2024 and applicable to both workplace retirement plans and IRAs, the "Financial Emergencies" exception is no windfall, but it could help a person make ends meet until the next paycheck. Capped at $1,000, SECURE 2.0 created this exception for certain distributions necessary to