Mariner
WEALTH ADVISORS

Early Retirement

How Will You Fund It?

Some people want to retire early. Or circumstances, such as health or job layoff, may drive the decision. No matter how you get there, retiring early means creating a strategy for which accounts to withdraw from to generate income while minimizing potential penalties and taxes.

Advantages of Waiting Until Age 59½

Wealth advisors generally recommend that you wait until at least age 59½ to retire, because taking premature distributions from a traditional IRA may result in a 10% early withdrawal penalty. In addition, income tax will be withheld.

Roth IRA Considerations

With Roth IRAs, because you fund them with after-tax contributions, those contributions may be withdrawn anytime and are not subject to the early withdrawal penalty or taxes. However, you have to wait five years to take a withdrawal on earnings, otherwise you pay a penalty for early withdrawals. There are some exceptions. Please work with a wealth advisor to determine whether you qualify for an exception.

Exception to Penalty for Early Withdrawals

If you are under age 59½ and need to take withdrawals from an IRA, 401(k) or 403(b) or other tax-advantaged retirement account, there is what the IRS refers to as "Substantially Equal Periodic Payments" or the "72(t) exception." In that case, you are allowed to make withdrawals at least once a year and must keep taking withdrawals for at least five years or until you reach age 59½, whichever is later. Remember, though it is only the penalty you are potentially avoiding. The distributions would still be subject to federal income taxes.

Leaving Money in a Company Plan

You can leave the money in your employer-sponsored retirement plan and take your withdrawals from there. The reason for this is that distributions from your company plan, when you leave the company in the year you turn age 55 or later, are not subject to the 10% early distribution penalty if you no longer work for that company (or what the tax code refers to as "separation from service"). The rule is sometimes called the "age 55 rule."

Projecting How Long Funds Will Last

When considering whether to retire early, estimating your approximate life expectancy will help determine how much you may need during retirement. In the United States, as of June 2020, the average life expectancy was 77.8 years.[1] Family health history and longevity also factor into your estimate, along with other variables, but of course no one can predict life expectancy.

Estimating Your Rate of Return

Applying an estimated rate of return on your portfolio (based on historical averages) may help you determine if your funds may potentially last long enough to support you through your life expectancy. You'll also want your wealth advisor to run various investment return scenarios based on a variety of market conditions. Because markets are cyclical, you won't earn a consistent rate of return year over year—it will vary.

Rule of Thumb for Annual Withdrawals

Many wealth advisors recommend that clients not withdraw more than 4% per year. By that rule of thumb, if you have $1 million in retirement assets, your annual withdrawal amount should not exceed $40,000, including any applicable taxes. You may have years when your return is lower and need to consider withdrawing less than 4% and years when your return is higher and you could withdraw above 4%. You'll also need to factor in the current rate of inflation, which you should strive to outpace with the growth of your investments.

Work With Your Advisor

As you think about retiring early, be sure to check in with your wealth advisor first to map out a plan for which retirement accounts to withdraw from when with the goal of minimizing taxes and potential early withdrawal penalties.

At Mariner Wealth Advisors, your wealth advisor will work with you to create a strategy designed to fit your financial situation.

For more information visit: marinerwealthadvisors.com

1 "Provisional Life Expectancy Estimates for Jan. Through June 2020"
"Early Withdrawal Penalties for Traditional and Roth IRAs"