Sam's Economics

Retire before 59½ without the 10% penalty

How a SEPP / 72(t) plan works, how the three payment methods compare, how long you're locked in, and what one change to the payment really costs.

ONE EXTRA WITHDRAWAL, GREG'S BILL

$18,029 now, $45,836 in all

Greg took $1,500 more than his scheduled SEPP payment in year three. The plan broke backward to his first payment: about $18,029 due with that year's taxes, and $45,836 in penalties if he keeps living off the account until 59½.

1. What a SEPP plan is

Withdrawals from an IRA before age 59½ normally owe a 10% additional tax on top of income tax. Section 72(t)(2)(A)(iv) of the tax code waives the 10% if you take **substantially equal periodic payments**, calculated by an IRS-approved method, at least once a year, and keep them unchanged for **whichever is longer: five years, or until you reach 59½**. Payments are still taxed as ordinary income.

> **Not the same as the age-55 rule.** If you leave a job in or after the year you turn 55, that employer's 401(k) may let you withdraw without the 10%. That rule doesn't apply to IRAs. SEPP works for IRAs at any age.

2. The three methods ($850,000 at age 52)

METHOD	HOW IT WORKS	YEAR-ONE PAYMENT
Required minimum distribution (RMD)	Balance ÷ life-expectancy factor (Single Life Table: 34.3 at 52). Recalculated every year, so the payment changes.	$24,781
Fixed amortization	Balance spread over life expectancy like a mortgage, at your chosen interest rate (5.5% here). Same payment every year.	**$55,614**
Fixed annuitization	Uses the IRS mortality table and the same rate. Level payment, usually close to amortization; have a CPA calculate it.	≈ amortization

The interest-rate cap

Under IRS Notice 2022-6, the rate for the fixed methods can be any rate up to the **greater of 5% or 120% of the federal mid-term rate** for either of the two months before your first payment. In fall 2026 that cap is about 5.5%. A higher rate means a larger fixed payment. Check the current federal mid-term rate before you start.

3. How long you're locked in

STARTING AGE	RMD YEAR ONE	AMORTIZATION AT 5.5%	ANNUAL PAYMENTS	LOCKED IN UNTIL
50	$23,481	$54,612	10	59½
52	$24,781	$55,614	8	59½
55	$26,899	$57,304	5	60
57	$28,523	$58,643	5	62

$850,000 IRA. Start at 57 and you're held past 59½, the age when the penalty would have stopped anyway. Annual payments counted from the starting age; your exact end date depends on your birthday and payment dates.

4. Elena and Greg: same plan, two endings

Both are 52 with $850,000 in an IRA. Both choose fixed amortization at 5.5%: $55,614 a year, eight annual payments, the last one at 59.

	ELENA	GREG
Cushion outside the plan	Separate taxable brokerage account	None
Bad year	New roof and a health scare, paid from the brokerage account	Car repair and braces in year three: takes $1,500 extra
Result	**Plan ends on schedule, $0 penalty**	Plan broken; penalties below

Greg's bill

ITEM	HOW IT'S FIGURED	AMOUNT
Recapture on years 1 and 2	10% × 2 × $55,614	$11,123
Interest on the recapture	About 7% a year (IRS underpayment rate), compounded	≈ $1,195
10% on the year-three withdrawals	10% × ($55,614 + $1,500)	$5,711
Due with that year's taxes		**≈ $18,029**
10% on the five later payments before 59½	5 × 10% × $55,614, if he keeps taking them	$27,807
Total penalties	Set off by one $1,500 withdrawal	**≈ $45,836**

The recapture tax is in section 72(t)(4). Income tax on every payment is owed either way; these are penalties on top. Death or disability are the exceptions that don't trigger recapture.

The one safety valve. If you started with fixed amortization or annuitization, you may switch **once** to the RMD method without breaking the plan (Rev. Rul. 2002-62 and Notice 2022-6). It usually lowers the payment. It only goes in that direction, and only once.

Things that can break a plan: taking more or less than the scheduled amount; adding money to or rolling money out of the SEPP IRA; missing a year's payment; a calculation error. Keep the SEPP IRA separate from your other IRAs.

5. Is SEPP a fit for you?

GOOD FIT	POOR FIT
Retiring well before 59½	Income needs may change
IRA large enough that the payment covers real living costs	This account is all you have
Won't need to change the amount	Tempted to treat the payment as a guideline
A separate emergency cushion outside the plan	Retiring at 55+ with the money in a former employer's 401(k) (the age-55 rule may be simpler)

6. Checklist

- [ ] I ran all three methods with the rate allowed in the month I start.
- [ ] I know my lock-in date: five years or 59½, whichever is later.
- [ ] I have a separate cushion outside the plan, so the payment never has to change.

- [ ] I will never take more or less than the scheduled payment.
- [ ] If the fixed payment becomes too high, I'll use the one-time switch to RMD, with professional help.

7. My numbers

ITEM	VALUE
Age at first payment	
Balance in the SEPP IRA (on a date near the first payment)	
Interest rate allowed (greater of 5% or 120% of mid-term)	
RMD / amortization / annuitization payment	
Method chosen and annual payment	
Lock-in end date	
Size of my separate cushion	

Questions for your CPA or tax professional

1. Which balance date and which life-expectancy table should we use, and how do we document the calculation?
2. What interest rate is allowed in the month I start, and should I use the full cap?
3. Should I split my IRA so only the amount I need is in the SEPP account?
4. How do we report the payments (Form 1099-R code 2, and Form 5329 if needed)?
5. If my portfolio falls, when would the one-time switch to RMD make sense?

Sources: Internal Revenue Code §72(t)(2)(A)(iv) and §72(t)(4); IRS Notice 2022-6; Rev. Rul. 2002-62; IRS Single Life Expectancy Table (Treas. Reg. §1.401(a)(9)-9); IRS underpayment interest rate, 2026. Figures are illustrations rounded to the dollar; the fixed amortization payment uses $850,000, 5.5% and a 34.3-year factor.

General information, not tax, legal or financial advice. SEPP rules are technical and the allowed rate changes monthly. Set up a plan with a CPA or fee-only advisor who runs your actual numbers. Free calculator: aitaconsultinginternational.com · YouTube: @samseconomics