ED SLOTT'S IRA ADVISOR

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Tax & Estate Planning for Your Retirement Savings

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WHAT'S INSIDE?

A Persistent Misunderstanding of Disability

The exception to the 10% penalty for disability, applicable to both IRAs and plans, continues to befuddle retirement account owners. Guided by erroneous internet information or a complete misunderstanding of the rules, IRA owners and plan participants alike consistently fail to follow exception protocols...and end up 10% lighter in the wallet. As we see in one court case after another, basic guidance from a financial advisor could have eliminated unnecessary pain and anguish, not to mention the tax penalty involved when people get sideways with the disability 10% penalty exception rules.

Disability Exception Applicable to Account Owner Only

If a person is under age 59½ when he takes a distribution from an IRA or company plan, a 10% early distribution penalty will apply. However, this penalty can be avoided if the account owner qualifies for one of the myriad available exceptions. One such exception is "disability," yet eligibility for this exception remains a high hurdle. The definition is strict. From Tax Code Section 72(m)(7):

> *"Meaning of Disabled - For purposes of this section, an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he furnishes proof of the existence thereof in such form and manner as the Secretary may require."*

Simply retiring from a job "on disability" or collecting a disability pension does not necessarily qualify for the disability exception. There are levels of disability. This played out in the Dollander case (*Eugene Dollander et ux. v. Commissioner; T.C. Memo. 2009-187; No. 4936-08, August 19, 2009*). Mr. Dollander legitimately retired from his job "on disability," took a distribution from the Thrift Savings Plan (TSP), and claimed the 10% disability exception. He did not qualify because he subsequently took another full-time job.

Additionally, some penalty exceptions apply to the account owner only, and some apply to the account owner and certain extended family members (e.g., higher education and first-time homebuyer). The disability exception is available only to the account owner. This misconception became evident in the Merrell Case (*Tracey Rene Merrell et vir v. Commissioner, No. 14862-18S, T.C. Summ. Op. 2020-5, January 16, 2020*).

Tracey Merrell was legitimately disabled and receiving Social Security benefits. Her husband, Christopher, who was not disabled and under age