

## How Do Distributions from Retirement Accounts Respond to Early Withdrawal Penalties? Evidence from Administrative Tax Returns

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### Key Findings and Policy Implications

This paper examines how people respond to the removal of the 10 percent withdrawal penalty on Individual Retirement Accounts (IRA), when they are no longer subject to the penalty at age 59½. It uses tax and informational return data from the Internal Revenue Service (IRS) for tax years 1999-2013, combined with information on date of birth, gender and date of death from the Social Security Administration (SSA). The paper finds that:

- Crossing the age 59½ threshold leads to an approximately \$1,500 increase in annual distributions from Individual Retirement Accounts (IRAs), on average. This represents an increase of approximately 93 percent relative to annual withdrawals prior to age 59½. The increase is primarily due to additional people taking withdrawals after the penalty is lifted rather than higher distributions among those who were already making withdrawals prior to age 59½.
- The study also develops a methodology for converting data at a lower frequency into a higher frequency event study by exploiting variation by date of birth. For instance, someone with a birthday in July turns age 59½ in the beginning of a calendar year and thus has greater exposure to penalty-free withdrawals in that year than someone with a birthday in June, who turns age 59½ at the end of a calendar year. Building on that intuition, we develop and apply a novel method for using annual data to parametrically recover an event study at age 59½.

As a policy tool, pre-retirement withdrawal penalties are a mechanism for balancing the long-term goal of retirement wealth accrual with the potential need for financial liquidity in the short-term. Put differently, they discourage pre-retirement leakages of savings accumulations without prohibiting them. The study helps to understand their behavioral implications by looking at what people do in the year those penalties are removed.

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