
10.

Education Exception to Additional Tax on Early IRA Distributions

Introduction

Generally, if you take a distribution from your IRA before you reach age 59½, you must pay a 10% additional tax on the early distribution. This applies to any IRA you own, whether it is a traditional IRA (including a SEP-IRA), a Roth IRA, or a SIMPLE IRA. The additional tax on an early distribution from a SIMPLE IRA may be as high as 25%. See Publication 560, Retirement Plans for Small Business, for information on SEP-IRAs, and Publication 590, Individual Retirement Arrangements (IRAs), for information about all other IRAs.

However, you can take distributions from your IRAs for qualified higher education expenses without having to pay the 10% additional tax. You may owe income tax on at least part of the amount distributed, but you may not have to pay the 10% additional tax.

Generally, if the taxable part of the distribution is less than or equal to the adjusted qualified education expenses (AQEE), none of the distribution is subject to the additional tax. If the taxable part of the distribution is more than the AQEE, only the excess is subject to the additional tax.

Who Is Eligible

You can take a distribution from your IRA before you reach age 59½ and not have to pay the 10% additional tax if, for the year of the distribution, you pay qualified education expenses for:

- yourself,
- your spouse, or
- your or your spouse's child, foster child, adopted child, or descendant of any of them.

Qualified education expenses. For purposes of the 10% additional tax, these expenses are tuition, fees, books, supplies, and equipment required for enrollment or attendance at an eligible educational institution. They also include expenses for special needs services incurred by or for special needs students in connection with their enrollment or attendance.

In addition, if the student is at least a half-time student, room and board are qualified education expenses.

The expense for room and board qualifies only to the extent that it is not more than the greater of the following two amounts.

1. The allowance for room and board, as determined by the eligible educational institution, that was included in the cost of attendance (for federal financial aid purposes) for a particular academic period and living arrangement of the student.

2. The actual amount charged if the student is residing in housing owned or operated by the eligible educational institution.

You will need to contact the eligible educational institution for qualified room and board costs.

Eligible educational institution. An eligible educational institution is any college, university, vocational school, or other postsecondary educational institution eligible to participate in a student aid program administered by the U.S. Department of Education. It includes virtually all accredited public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.

Certain educational institutions located outside the United States also participate in the U.S. Department of Education's Federal Student Aid (FSA) programs.

Half-time student. A student is enrolled "at least half-time" if he or she is enrolled for at least half the full-time academic work load for the course of study the student is pursuing as determined under the standards of the school where the student is enrolled.

Figuring the Amount Not Subject to the 10% Tax

To determine the amount of your distribution that is not subject to the 10% additional tax, first figure your adjusted qualified education expenses. You do this by reducing your total qualified education expenses by any tax-free educational assistance, which includes:

- Expenses used to figure the tax-free portion of distributions from a Coverdell education savings account (ESA) (see [chapter 8](#)),
- The tax-free part of scholarships and fellowships (see [chapter 1](#)),
- Pell grants (see [chapter 1](#)),
- Veterans' educational assistance (see [chapter 1](#)),
- Employer-provided educational assistance (see [chapter 12](#)), and
- Any other nontaxable (tax-free) payments (other than gifts or inheritances) received as educational assistance.

Do not reduce the qualified education expenses by amounts paid with funds the student receives as:

- Payment for services, such as wages,
- A loan,
- A gift,
- An inheritance given to either the student or the individual making the withdrawal, or
- A withdrawal from personal savings (including savings from a qualified tuition program (QTP)).

If your IRA distribution is equal to or less than your adjusted qualified education expenses, you are not subject to the 10% additional tax.

Example 1. In 2009, Erin (age 32) took a year off from teaching to attend graduate school full-time. She paid \$5,800 of qualified education expenses from the following sources.

Employer-provided educational assistance (tax free)	\$5,000
Early distribution from IRA (includes \$500 taxable earnings)	3,200

Before Erin can determine if she must pay the 10% additional tax on her IRA distribution, she must reduce her total qualified education expenses.

Total qualified education expenses	\$5,800
Minus: Tax-free educational assistance	<u>-5,000</u>
Equals: Adjusted qualified education expenses (AQEE)	\$800

Because Erin's AQEE (\$800) are more than the taxable portion of her IRA distribution (\$500), she does not have to pay the 10% additional tax on any part of this distribution. However, she must include the \$500 taxable earnings in her gross income subject to income tax.

Example 2. Assume the same facts as in [Example 1](#), except that Erin deducted some of the contributions to her IRA, so the taxable part of her early distribution is higher — \$1,000. This must be included in her income subject to income tax.

The taxable part of Erin's IRA distribution (\$1,000) is larger than her \$800 AQEE. Therefore, she must pay the 10% additional tax on \$200, the taxable part of her distribution (\$1,000) that is more than her qualified education

expenses (\$800). She does not have to pay the 10% additional tax on the remaining \$800 of her taxable distribution.

Reporting Early Distributions

By February 1, 2010, the payer of your IRA distribution should send you Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. The information on this form will help you determine how much of your distribution is taxable for income tax purposes and how much is subject to the 10% additional tax.

If you received an early distribution from your IRA, you must report the taxable earnings on Form 1040, line 15b (Form 1040NR, line 16b). Then, if you qualify for an exception for qualified higher education expenses, you must file Form 5329 to show how much, if any, of your early distribution is subject to the 10% additional tax. See the Instructions for Form 5329, Part I, for help in completing the form and entering the results on Form 1040 or 1040NR.

There are many other situations in which Form 5329 is required. If, during 2009, you had other distributions from IRAs or qualified retirement plans, or have made excess contributions to certain tax-favored accounts, see the instructions for line 58 (Form 1040) or line 54 (Form 1040NR) to determine if you must file Form 5329.