3 Exceptions to the Early Distribution Penalty That Only Apply to IRAs

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Penalty-Free Distributions

One important factor for you to think about is whether you can access your funds without penalty. Generally, if you are under age 59 ½, and you take a distribution from your retirement plan, you will be subject to a 10% penalty. However, there are some exceptions to the penalty. While some of the exceptions apply to both IRAs and company plans, some apply just to company plans, and some apply just to IRAs. Here are three exceptions to the early distribution penalty that are available only with an IRA.

Higher Education

No one can deny that paying for higher education is an ever-growing challenge for many. If you are considering using your retirement assets to pay for college costs, you should be aware that there is an exception to the early distribution penalty for distributions used to pay for qualified higher education costs. This exception applies only to your IRA and **not** to your company plan. Qualified higher education costs include post-secondary tuition, fees, books, supplies, and required equipment. Computers and related equipment also count as long as the student uses them during the year that he or she is in school. Room and board can also count. The education expenses can be for you, your spouse, your children or grandchildren. The expense and the distribution from your IRA must be in the same tax year. That's a lot to absorb. Don't make these mistakes.

First Home Purchase

If you are in the market to buy a home, you will want to know about the exception to the early distribution penalty for IRA distributions that are used for a first-home purchase. For this exception, the definition of a first-time home buyer is anyone who has not owned a home in the two years prior to the purchase date.

The first-time home buyer can be the IRA owner, a spouse, or a child, or grandchild. There is a $10,000 lifetime limit for this exception.

Both you and your spouse must qualify as a first-time homebuyer. In addition, you can each take $10,000 from your respective IRAs and have $20,000 toward your first home.

Health Insurance for the Unemployed

If you are facing unemployment after leaving your job, the exception to the early distribution penalty for the payment of health insurance premiums while unemployed may be helpful to you. To qualify, the distribution must come from an IRA and must be taken during a tax year or the year following a year in which you receive unemployment compensation under federal or state unemployment compensation law. The distribution cannot exceed the amount paid for health insurance for you, your spouse or a dependent.

Is a Rollover Right for You?

There are many considerations when deciding whether a rollover to an IRA is right for you. If you think that you may want to use one of these three IRA-only exceptions to the early distribution penalty, that may be a factor in your rollover decision. Everyone's situation is different. To find out what is best for you, it is always a good idea to consult with a tax or financial advisor who is well-versed in the retirement plan rules.

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