Potential Traps Within Section 72(t) Early Distribution Exceptions For Qualified Retirement Plans

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by Ted D. Englebrecht, Ph.D.; Steven A. Hanke, CPA; and Karen J. Pierce, CPA

Executive Summary

- Section 72(t)(1) assesses an additional 10 percent tax on early withdrawals from qualified retirement plans. But Section 72(t)(2) provides several exceptions to this penalty tax.
- Following an overview of the statutory exceptions, this article provides an analysis of recent judicial decisions involving three highly litigated Section 72(t) exemptions. Specifically, we highlight common mistakes in attempting to use the higher education, first-time homebuyer, and qualified domestic relation order exceptions.
- We find that taxpayers frequently do not qualify for exemptions because their early withdrawals are not from the classification of qualified retirement plans as specified within the Internal Revenue Code. In addition, taxpayers are misunderstanding the IRC meanings of higher education expenses, qualified students, first-time homebuyers, and qualified domestic relation orders. Also, taxpayers sometimes fail to adhere to time period and dollar value limitations when attempting to qualify for the higher education or first-time homebuyer exemptions.
- The article also presents tax planning techniques that can assist clients in avoiding this penalty tax. These strategies include making distributions from the appropriate qualified retirement plan and ensuring that the court issues a qualified domestic relation order if divorce settlement funds are to be paid from a qualified retirement plan that is not an IRA.
While many of the issues discussed are relatively straightforward, the volume of cases indicates the need for further awareness on this misunderstood set of exceptions. Finally, we present tax planning techniques that can help clients avoid being subject to the penalty tax.

Background

Section 4974(c) defines a qualified retirement plan as one of the following:
1. Plan described in Section 401(a)
2. Annuity plan from Section 403(a)
3. Annuity contract Section 403(b)
4. Individual retirement account found in Section 408(a)
5. Individual retirement annuity cited in Section 408(b)

While all of the above are classified as qualified retirement plans, Section 7701(a)(37) defines individual retirement plans as individual retirement accounts and individual retirement annuities as described in Sections 408(a) and (b) (commonly, and hereafter, referred to as IRAs). As will be demonstrated, this is an important distinction.

As noted, Section 72(t)(1) assesses an additional 10 percent tax on early distributions from qualified retirement plans. But some early distributions qualify for statutory exceptions found in Section 72(t)(2) if they meet one of the following:
1. Made to an employee at age 59½ or after.
2. Made after the death of the employee to a beneficiary or employee’s estate.
3. Attributable to the employee’s being disabled according to Section 72(m)(7).
4. Part of a series of substantially equal periodic payments made over the life (or life expectancy) of the employee or joint lives (or joint life expectancies) of the employee and his or her designated beneficiary.
5. Made to an employee after separation from service when the employee has attained age 55. This exception does not apply to distributions from individual retirement accounts and individual retirement annuities (Section 72(t)(3)(A)).
6. Dividends paid from stock of a corporation described in Section 404(k).
7. Made on account of a levy on a qualified plan under Section 6331.
8. Paid to an employee for medical expenses, which are limited to the amount deductible under Section 213 and paid within the taxable year.
9. Paid to an alternate payee based on a QDRO. This exception does not apply to distributions from individual retirement accounts and individual retirement annuities (Section 72(t)(3)(A)).
10. Used for health insurance premiums when the individual is unemployed and distribution is exclusively from an IRA.
11. Made for higher education expenses and distributions are entirely from an IRA.
12. For qualified first-time homebuyers and the distribution is only from an IRA.
13. Made to individuals called to active duty.

Three Highly Litigated Exceptions

Certainly, each of these exceptions contains unique requirements and restrictions. Moreover, as shown in Table 1, several of the exceptions are contingent on whether the early distribution originates from an IRA. Three of the exceptions explicitly require that the distribution comes from an IRA, while two other exceptions are disallowed for IRA distributions. Even where a taxpayer receives a distribution from the appropriate retirement account, there are other traps that can prevent the use of the exceptions. Table 2 provides a summary from judiciary decisions of the most frequent reasons that foil taxpayers’ attempts to employ Section 72(t)(2) exceptions.

Higher Education Distributions

Section 72(t)(2)(E) states that distributions are not subject to the 10 percent additional tax when made from an IRA,
Table 2: Important Aspects of the Three Most Highly Litigated Section 72(t)(2) Exceptions

| Higher Education Distributions | • The distribution must originate from an IRA. |
|                               | • Distribution from a non-IRA account will not qualify even if the taxpayer had available and sufficient funds within an actual IRA account at the time of the distribution. |
|                               | • Distribution must occur within the same year as the higher education expenses are paid. |
|                               | • Distribution is exempt only up to the amount that the related education expenses are limited to under Section 529(e)(3)(B)(i). |
|                               | • Education expenses must be as defined under Section 529(e)(3)(B)(ii). |
|                               | • Must be for a qualified student within Section 25A(b)(3)(B).** |
|                               | • The exemption covers the portion of the distribution used for higher education expenses, but not the portion of the distribution used to pay ordinary income taxes on the distribution. |

| First-Time Homebuyer Distributions | • The distribution must originate from an IRA. |
|                                   | • It is not valid to argue that a distribution from a qualified retirement plan that is not an IRA should qualify if the difference between it and an IRA is only a matter of form. |
|                                   | • This exemption is applicable for only the first $10,000 of distributions that are includable in gross income. |
|                                   | • The distribution must be used to acquire the home within 120 days of the distribution date. |
|                                   | • An individual (and if married, the individual’s spouse) must have had no ownership interest in a principal residence during the two years prior to the acquisition of the new home to meet the requirement of first-time homebuyer. |

| Qualified Domestic Relations Orders | • The distribution must not originate from an IRA. |
|                                    | • It is invalid to argue that an involuntary distribution occurred because the Family Court ordered that a payment be made to the ex-spouse. |
|                                    | • It is critical for a divorce judgment to specify the former spouse as being an alternate payee, clearly specify the amount or percentage of the non-IRA account to be paid to the former spouse, and recognize the rights that the former spouse has to the non-IRA account. |

*Section 529(e)(3)(B)(i) limits qualified higher education expenses to the greater of the following two amounts: First, the allowance applicable to the student for room and board included in the cost of attendance (as defined in Section 472 of the Higher Education Act of 1965 (20 USC 1087b)), as in effect on the date of the Economic Growth and Tax Relief Reconciliation Act of 2001, as determined by the eligible educational institution for such period. Second, the actual invoice amount the student residing in housing owned or operated by the eligible educational institution is charged by such institution for room and board costs for such period.

**Section 25A(b)(3)(B) defines "eligible student" as a student who is carrying at least one-half the normal full-time workload for the course of study the student is pursuing.

and the funds are used to pay higher education expenses of the taxpayer for the taxable year.

Only IRAs. It is critical that withdrawals for higher education expenses are only taken from IRAs. In Uscinski,7 the taxpayer withdrew $161,447 from his 401(k) plan during 2000 to pay higher education expenses. Mr. Uscinski argued that he was not liable for the penalty tax because he used the funds to pay higher education expenses as stipulated under Section 72(t)(2)(E).

But the Internal Revenue Service determined that the distribution was in fact subject to the additional 10 percent tax. The IRS noted that Section 72(t)(2)(E) expressly provides that it covers distributions to an individual from an IRA. Consequently, Mr. Uscinski’s distribution was not exempt because it was from a qualified 401(k) plan instead of an IRA. The Tax Court sided with the IRS, noting that a 401(k) account does not fall within the IRA category of plans described in Section 408.8 The court also noted that it was the intent of Congress to limit the higher education exception to only IRAs.9

**Actual, not potential, distributions.** The additional 10 percent tax must be paid if funds for higher education expenses are withdrawn from any non-IRA account, even if there are available funds within an IRA at the time of the distribution. In addition, the IRS is not bound by incorrect advice given by its agents.

In Barbee,9 the taxpayer also withdrew funds from a non-IRA account for higher education expenses. Specifically, Mrs. Barbee received disbursement of $13,817.18 during 2000 for the payment of her husband’s tuition at the University of North Texas. The withdrawal originated from the Employees Retirement System of Texas, a qualified plan under Section 401(a). But Mrs. Barbee presented two arguments that were not present in Uscinski as to why she was not liable for the additional 10 percent tax the IRS imposed. First, sufficient funds were within her husband’s IRA at the time of the withdrawal. Thus, if she had been aware of the distinction between retirement plans, her husband would have taken the distribution from his IRA. Second, her actions were founded on the advice received from employees and agents of the IRS.

The IRS’s position was that the taxpayer’s potential of withdrawing the funds from an IRA account did not overrule her actual actions of making the distribution from a 401(a) plan. Also, the advice given by either employees or agents of the IRS did not carry authoritative weight.

The Tax Court concurred with the IRS and held that it is only able to rule on the taxpayer’s actual course of action and not on actions she did not choose. Therefore, it is irrelevant that the taxpayers had sufficient funds within a separate IRA account at the time of distribution. Last, citing Estate of Emerson,10 the judiciary reiterated that the IRS is not bound by inaccurate representations of its agents or employees.

**Distribution versus payment year.** The distribution from an IRA must be used to pay higher education expenses in the same year as the withdrawal. In Duronio,12 the taxpayer’s son was a full-time student at New York University for the 2002 spring and fall semesters. Mrs. Duronio made an
$18,000 tuition payment in December 2001 and her son obtained a $19,263 loan in the fall of 2002. Also, during 2002, Mrs. Duronio received a $19,900 early distribution from her IRA. She contended that the $18,000 tuition payment in 2001 was funded by the 2002 IRA distribution. Further, she argued that the loan guarantee of $19,263 received in 2002 is analogous to a payment of higher education expenses. On audit, the IRS determined that the 2002 IRA distribution was subject to a penalty tax because no actual higher education expenses were paid during 2002.

The Tax Court rejected the taxpayer’s arguments. Citing Lodder-Beckert, the court ruled that early IRA distributions subject to the penalty tax cannot be reduced by higher education expenses paid in any year other than the year of the early distribution. The court did not address Duronio’s claim that the loan guarantee should be treated as a payment because it stated that there was no credible evidence that the guarantee was actually made in 2002.

Qualified expenses. All costs incurred are not considered qualified education expenses, and others are limited as illustrated in the following case. In El-Bibany, the taxpayer took an early distribution of $48,720 from his retirement fund for multiple purposes, including higher education expenses for his wife, who became a full-time graduate student at San Jose State University. Mr. El-Bibany argued that the early distribution was not subject to the additional 10 percent tax to the extent of the following higher education costs: $42,275 for room and board for family, $1,981 for transportation to the university, and $846 for books and supplies.

The IRS conceded that the $846 spent on books and supplies met the requirements of qualified higher education expenses under Section 72(t)(2)(E). Furthermore, in the trial memorandum, relying upon Income Tax Regs. 1.221-1(e)(2)(i), the IRS initially conceded that transportation costs were qualified higher education expenses. However, on brief, the IRS admitted that its original position on transportation expenses was misguided. To explain, it asserted that for purposes of Section 72(t)(2)(E), qualified higher education expenses are defined under Section 529(e)(3) as being tuition, fees, books, supplies, equipment, and room and board.

In addition, the IRS admitted that the room and board expenses are limited under Section 529(e)(3)(B)(ii). This section allows such costs up to the minimum amount of room and board in the cost of attendance as specified within 20 USC Section 10871(i). Because the taxpayer was an off-campus student, the IRS determined that the room and board expenses that qualified as higher education expenses were limited to $2,500. The judiciary agreed with the IRS that El-Bibany’s room and board expenses were limited to $2,500. The court also held that transportation costs were not qualified higher education expenses because they were not listed as such under Section 529(e)(3)(B)(ii).

To summarize, the taxpayer was allowed to claim $3,346 ($846 + $2,500) as qualified education expenses and was held liable for a 10 percent additional tax on the remaining $41,756 ($1,981 + ($42,275 − $2,500)) of nonqualified education expenses.

Qualified student. An individual must be an eligible student to qualify for the higher education expenses exemption. In Dunn, among other issues, the taxpayer received an early distribution during 1998 and used a portion of the funds to pay fees to the University of Phoenix. She was enrolled in one class from September 30, 1998, through November 4, 1998, and another course between November 11, 1998, and January 6, 1999. The taxpayer contended that she was not subject to the 10 percent additional tax to the extent of her higher education expenses paid in 1998.

Conversely, the IRS noted that the taxpayer was not eligible for Section 72(t)(2)(E) relief because it is only applicable for qualified higher education expenses as defined by Sections 72(t)(7)(A) and 529(e)(3)(A). Furthermore, the individual must be an eligible student per Section 25A(b)(3)(B), “carrying at least ½ the normal full-time workload for the course of study the student is pursuing.” Due to the fact that the taxpayer was only enrolled in one course at a time and maintained full-time employment as a nurse throughout the year, the IRS argued that the taxpayer was not an eligible student, and the Tax Court agreed.

Funding taxes. When a withdrawal is made from an IRA, regular income tax is due on the withdrawal. Additional funds withdrawn to pay the regular tax are not eligible for the 72(t)(2) exemption. In Urban, one disputed issue was that the $30,000 early distribution from the taxpayer’s IRA was used to pay higher education expenses of $15,716 for his daughters and himself as well as the regular income tax assessed on the IRA withdrawal. Mr. Urban argued that the 10 percent penalty tax should not apply to funds drawn from an IRA to pay the regular income tax on the distributions that qualify for the higher education exemption.

The IRS determined that Section 72(t)(2)(E) exempts only distributions used to pay actual higher education expenses, not funds withdrawn to pay the regular income tax on those distributions.
The Tax Court held in favor of the IRS, and it noted that there is nothing in the legislative history of Section 72(t)(1) or in the case law to support the taxpayer's position.

**First-Time Homebuyer Distributions**

Section 72(t)(2)(F) provides that qualified first-time homebuyer distributions from an individual retirement account are exempt from the additional 10 percent tax on early withdrawals. According to Section 72(t)(8)(A), a qualified first-time homebuyer distribution is one that is used within 120 days of the distribution date. Moreover, the distribution must be used to pay qualified acquisition costs for a principal residence of a first-time homebuyer who is the individual, spouse of the individual, child, grandchild, or ancestor of the individual or the individual’s spouse. Section 72(t)(8)(B) limits the amount to $10,000 for any taxable year.

**Only IRAs.** The first-time homebuyers’ exemption is only available on early withdrawals from IRAs. In Fenton,23 the taxpayer received $68,583 from a 401(k) plan. Mr. Fenton asserted that a portion of the disbursement was used for a down payment on a home and therefore was not subject to the penalty tax. But the IRS determined that the taxpayer was subject to the additional 10 percent tax on the entire withdrawal because the distribution did not originate from an IRA. The Court held in favor of the IRS.24

**Form is important.** If the potential exists, non-IRA qualified retirement plans should be rolled over into an IRA before making first-time homebuyer distributions. In Jones (2),25 the taxpayer resigned as an accountant from Deloitte & Touche to pursue his Ph.D. from the University of Arizona in September 1999. Subsequently, in 2001, Mr. Jones withdrew $30,368 from his 401(k) plan for multiple purposes, including the purchase of his first home. The taxpayer asserted that the distribution was not subject to the additional 10 percent tax because he had the potential to roll his 401(k) over into an IRA. Furthermore, he stated that Section 72(t)(2)(F) should apply to the disbursements used to pay for his first home because the difference between a 401(k) and an IRA account is only a matter of form.

The IRS disagreed with the taxpayer’s arguments and contended that the exception was not applicable because the distribution was not from an IRA. The Tax Court did not give a direct response regarding the potential of rolling over the 401(k) into IRA. But, as in Barbee,26 it is reasonable to assume that the judiciary decided it could only rule on the actual rather than the potential actions of the taxpayer. As for Mr. Jones’s second argument, the Court expressed its sympathy to the taxpayer because the differences between a qualified retirement plan and an IRA are highly technical. Nonetheless, the Court reiterated that it is limited by the statutory exceptions enumerated in Section 72(t)(2).27

**$10,000 limit, 120 days requirement, and IRA source funds.** To qualify for the first-time homeowner exemption, the early withdrawal must be used to acquire the home within 120 days of the distribution date. In Smart,28 the taxpayer received a $30,000 distribution from his 401(k) account during 2002 to help acquire his first home in the fall of 2004. The IRS determined that the entire withdrawal was subject to the 10 percent penalty tax.

The judgment decision regarding the $30,000 used to buy the taxpayer’s first home was a two-step process. Initially, the court determined that the maximum amount that could qualify for an exemption was $10,000 as specified in Section 72(t)(8)(B)(1). In 2003, the Tax Court found that Mr. Smart did not use the distribution to acquire his first home within 120 days of the distribution date.29 The taxpayer asserted that he had intended to use the distribution to buy his first home sooner but was delayed because his brother passed away in 2003. The court expressed sympathy for the taxpayer’s loss but noted that they were bound by the statutory language, and consequently ruled that no portion of the taxpayer’s distribution was eligible for the first-time homebuyer distribution exception under Section 72(t)(2)(F).30

Mr. Smart presented one final argument that the distribution should be exempt from the 10 percent tax because it consisted of employee and matched employer contributions rather than earnings on the 401(k) account. Citing that no distinction is made between contributions to and subsequent earnings on retirement accounts, the court ruled that both sources of funds are equally applicable to Section 72(t)(1).31

**Individual first-time homebuyer.** For a married couple, both individuals must meet the definition of a first-time homebuyer. In Olup,32 Mr. Olup was the sole owner of a townhouse from April 1995 to April 2003. During 2001, he married; his wife had no prior ownership interest in real estate. Subsequently, he withdrew $20,617 from his IRA during 2002 to begin construction on a residence for the newly married couple. The taxpayer excluded the first $10,000 from the 10 percent additional tax. Specifically, he argued that the “married unit” qualified within the intent and meaning of first-time homebuyers as defined in Section 72(t)(8). In the notice of deficiency, the IRS stated that Mr. Olup was not a first-time homebuyer. The Tax Court ruled in favor of the IRS, noting that Section 72(t)(8)(D)(1) defines a first-time homebuyer as an individual (and if married, the individual’s spouse) who does not have ownership in a principal residence within two years of acquiring the new principal residence.33 Furthermore, the court indicated that its position is supported by the legislative history of Section 72(t)(8)(D). As the House and Senate reported: “The bill requires that the spouse of the individual also meet this requirement as of the date the contract is entered into or construction commences.”34

**Qualified Domestic Relations Orders**

Section 72(t)(2)(C) exempts early distributions from the 10 percent additional tax if those withdrawals are made as the result of a qualified domestic relations order.
(QDRO) as defined within Section 414(p)(1). A domestic relations order is a judgment that relates to providing child support, alimony, or marital property rights to a spouse, former spouse, child, or other dependent of a participant, and is made pursuant to a state domestic relations law. Furthermore, a domestic relations order is deemed to be a qualified domestic relations order if it creates an alternate payee’s right to receive all or part of the benefits payable from a participant under a plan, clearly specifies certain facts, and does not alter the amount of benefits under the plan. An alternate payee is defined as any spouse, former spouse, child, or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan to such participant.

Not IRAs. The QDRO exception does not apply to IRAs. In Moyer, the taxpayer had $11,572 distributed from his IRA account during 2002 for arrears child support obligations as ordered by the Child Support Division of Marshall County, Indiana. The additional 10 percent tax was not paid because Mr. Moyer asserted the disbursement met the criteria of a QDRO under Section 72(t)(2)(C). The IRS, on the other hand, determined that the withdrawal did not satisfy the requirements of a QDRO.

The Tax Court noted that the law excludes distributions from the penalty tax if they are made pursuant to a QDRO within the meaning of Section 414(p)(1). But at the same time, the exception does not apply to IRAs. As such, the court held that the taxpayer was liable for the additional 10 percent tax.

**Voluntary versus non-voluntary withdrawals.** The additional 10 percent tax is intended to prevent voluntary distributions. Withdrawals are classified as voluntary whenever the individual is active in and has control over or possession of the distribution. Therefore, withdrawals for seemingly non-voluntary financial needs can easily be classified as voluntary distributions. In Czepiel, the taxpayer took $30,300 from his IRA accounts during 1995 and paid the funds to his ex-wife as partial fulfillment of their divorce judgment. It is important to note that the divorce judgment did not stipulate that the funds had to come from the taxpayer’s IRA. Mr. Czepiel argued that his withdrawal was exempt from the 10 percent additional tax because the distribution was involuntary. Specifically, the taxpayer contended that the distributions occurred because the Family Court required him to make payments to his ex-wife. In support of this position, Mr. Czepiel relied upon Larotonda and Murillo. In both of these cases, the Tax Court agreed that the taxpayers were not liable for early withdrawal taxes because the distributions were an involuntary act. The IRS’s position was that those cases did not apply here because they were fundamentally different from the present case.

The court concurred with the IRS, stating that neither Larotonda nor Murillo applied to the current case. Rather, the Commissioner in Larotonda assessed a tax deficiency against the taxpayer and subsequently levied it on his retirement plan. Then, the Commissioner asserted that the levied funds were subject to the early withdrawal tax under former Section 72(m)(5)(B). In Murillo, the taxpayer was required to forfeit his IRA funds because he had entered into a plea agreement for several financial crimes. Therefore, in Murillo, the court held that Larotonda was controlling since the taxpayer in Murillo also did not possess or have control over how the IRA disbursements were used. Mr. Czepiel, in contrast, was active in the withdrawal of the distributions, had possession of the funds, and had control over their usage. As a result, the involuntary-act defense is not valid when the taxpayer actively takes control of the distributed funds and is responsible for how they are used.

**Tax Planning Opportunities**

If a client is considering or has already taken an early distribution from a qualified retirement plan, he or she should be advised of the following in order to avoid the Section 72(t)(1) tax:

- If the client intends to use the distribution for higher education expenses or is a first-time homebuyer, make sure the distribution is from an IRA.
- If a client has already mistakenly taken funds from a non-IRA plan for higher education expenses and the IRS is willing to allow any portion of the distribution to qualify as an exception to Section 72(t)(1), it might be advantageous for the taxpayer to settle rather than take it to court. As illustrated in Gibbons, the IRS first challenged the taxpayers solely on the basis of whether the $67,552 withdrawal from their Section 403(b) plan was entirely for qualified educational expenses. The IRS was willing to allow $37,112; however, the taxpayer took the issue to court. Once at trial, the IRS contended that no portion of the distribution qualified for higher education expenses because it did not come from an IRA. The Tax Court, citing Uscinski, held in favor of the IRS and disallowed the entire distribution.
- Clients should make sure an IRA distribution taken for higher education is...
Consequently, in the event that a client faces the possibility of making payments in a QDRO-like scenario, it is important to request that the court specify the former spouse as being an alternate payee, the amount or percentage of the non-IRA account to be paid to the former spouse, and the rights that the former spouse has to the non-IRA account.

Remember that payments pursuant to a QDRO can only qualify for an exception to the 10 percent additional tax if the distribution does not come from an IRA.

- A client should clearly understand the conditions under which he or she may be classified as a first-time homebuyer. Also, distributions from an IRA must be used to buy the home within 120 days of the withdrawal date.

Conclusion

Clients may be assessed an additional 10 percent tax on early distributions from their qualified retirement plans even if the purpose of the distribution initially appears to be exempt under Section 72(t)(2). Often this unexpected result is due to the withdrawal/distribution not originating from a sanctioned retirement plan or because the taxpayer failed to meet all of the specifics within the exception they intend to use. Therefore, planning is essential to ensure that clients do not miss the opportunity to take advantage of the Section 72(t)(2) exemptions.

Endnotes

2. Section 408(a) defines the term “individual retirement account” as a trust.

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created or organized in the United States for the sole benefit of an individual or his beneficiaries, but it has to meet the additional requirements under this section. Under Section 408(b), "individual retirement annuity" is an annuity contract or endowment contract issued by an insurance company that meets the requirements of Section 408(b)(1) through 408(b)(4). Also, our discussion of IRAs excludes Roth IRAs because Roth IRA distributions are governed by a distinct set of rules under Section 408A(d).

3. Section 72(t)(2)(G) was added to the list of exceptions as part of the Pension Protection Act of 2006.

4. Sections 72(t)(2)(D)(E), and (F). The IRA restriction is also stated in Section 72(t)(2)(G). However, active duty military reservists' distributions attributable to elective deferrals under a 401(k) plan or a 403(b) annuity are also exempt from the 10 percent penalty as stipulated under IR-2006-152, 9/26/06.

5. Sections 72(t)(2)(A)(x) and (C).

6. These three exceptions were determined as being the most problematic for taxpayers after reviewing court cases from 1999 through 2007 involving disputes over the assessment of the additional 10 percent tax under Section 72(t)(1).


13. The same issue and resulting court decision was present in Ambuta, T.C. Summary Opinion 2005-93, and Dunn, T.C. Summary Opinion 2002-108.


16. The court noted that the parties do not describe Mr. El-Bibany's retirement plan, and hence are conducting the case as if the distribution came from an IRA.

17. $2,500 was the minimum amount of room and board explicitly allowed within 20 U.S.C. Section 10872(3), which is the maximum amount deductible under Section 529(e)(3)(B)(ii). The court did mention that the $2,500 limit is no longer effective for tax years beginning after December 31, 2001; however, the tax year in dispute in El-Bibany was 2001.

18. See Dunn, supra note 13.

19. Section 72(t)(7)(A) defines qualified higher education expenses as tuition, fees, books, supplies, and equipment required for enrollment or attendance of the taxpayer or taxpayer's spouse or child, among others, at an eligible educational institution.

20. Section 529(e) limits room and board benefits to individuals who are eligible students as defined in Section 25A(b)(3).

21. It is noteworthy that for students who attend a higher educational institution for only a portion of the year, Section 25A(b)(2)(B) states an individual must be "an eligible student for at least one academic period which begins during such a year."


23. Supra note 8.


25. Supra note 8.


27. See, for example, Arnold, 111 T.C. 250, 255-256 (1998); Schoof, 110 T.C. 1, 11 (1998).


29. Another case with this issue and resulting court ruling is Tussey, T.C. Summary Opinion 2003-47.

30. Section 72(t)(5)(A).

31. If Smart had realized he could not buy the house within the first 60 days of his 401(k) withdrawal, he could have rolled over the funds into an IRA. Subsequently, he could have withdrawn the funds from the IRA to buy the home as long as it was within 120 days of the purchase date.

32. See Section 61(a)(11).


34. The court noted that the maximum amount of a distribution that may be treated as a qualified first-time homebuyer distribution is $10,000. Therefore, a married couple is not allowed to double up the exclusion amount to $20,000 when one of the spouses makes a withdrawal.


37. T.C. Memo 1999-289.

38. It is important to bear in mind that the Section 72(t)(2)(1) penalty could have been avoided. That is, it would have been exempt under Section 408(d)(6) had the divorce decree stipulated that the IRA must be split.

39. 89 T.C. 287 (1987)


41. Another case with similar issues and resulting court rulings is Bougas, T.C. Memo 2003-194.

42. Supra note 8.

43. T.C. Memo 2003-194.

44. Likewise, failure to name the ex-spouse as an alternate payee and make disbursements to the ex-spouse has resulted in the disallowance of the exception provided under Section 72(t)(2)(C) in Simpson, T.C. Memo 2003-294, and Ahmad, T.C. Summary Opinion 2005-103. In a similar fashion, the court did not allow the Section 72(t)(2)(C) exception for the taxpayer in O'Brien, T.C. Summary Opinion 2001-148 because the ex-wife was a participant in rather than an alternative payee of the plan.