HOW YOUR IRA CAN HELP IF YOU ARE A FIRST-TIME HOME BUYER

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By Sarah Brenner, JD
Director of Retirement Education
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The real estate market is red hot right now. This can be especially challenging for first time home buyers. IRA savings are intended to be used for your retirement. However, if you are like many others, your IRA may be your biggest asset. You may need your IRA funds to make home ownership happen and there is a special break in the tax code that can help you.

Exception to the 10% Penalty

Usually, if you are under age 59 ½ and you take a distribution from your IRA, you will be hit with not only taxes but also a 10% early distribution penalty. However, there is an exception for those who are looking to take the leap and purchase their first home. The 10% penalty does not apply to your IRA distribution that you use to buy or build a principal residence if you are a first-time homebuyer. You can also use those funds to pay for the settlement fees, closing costs, and financing fees.

Qualifying as a First Time Home Buyer

Who is considered to be a first-time home buyer? The answer may surprise you. You qualify as a first-time homebuyer if you haven't owned a house in the past two years. That's right. Even if you had previously owned a home, but sold it five years ago and rented an apartment ever since, you would qualify. If you're married, your spouse also cannot have owned a home in the past two years. You may use your IRA funds to help a family member with a home purchase if they meet the definition of a first-time buyer.

$10,000 Lifetime Limit

There's a $10,000 lifetime limit on penalty-free distributions that you can use for a first-time home purchase. If you and your spouse each have your own IRAs and qualify as first-time homebuyers, each of you can take $10,000 for a total of $20,000 for the same home purchase. If you take more than $10,000 from your IRA, the amount above won't be exempt from the 10% penalty. Once you use up your lifetime limit, it is gone forever

Use the Funds Within 120 Days

You must use the distribution within 120 days from the day it is received to buy your first home. If things don't go as planned and the home purchase is delayed or cancelled, you may roll the funds back into an IRA. You have 120 days from the date of the distribution to do this rather than the 60-day period which is normally the deadline for rolling over IRA distributions.

How to Claim the Exception

Remember, your IRA distribution will still be taxable to you, unless you have basis included in the distribution. This tax break only gets you out of the 10% early distribution penalty. Your IRA custodian will likely report the distribution as an early distribution to both you and the IRS. You will want to claim the exception to the 10% early distribution penalty when you file your tax return for the year. As with all tax matters, you will want to keep good records in case the IRS decides to ask questions.