

FACTS OF THE QUALIFIED HIGHER EDUCATION IRA PENALTY EXCEPTION

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Higher education expenses can be steep. Fortunately for those under the age of 59 ½ who need to dip into retirement savings to cover these costs, there is an exception to the 10% early withdrawal penalty. Before tapping your IRA, be sure to understand the fundamentals of this penalty exception. Here are the basics:

- The 10% penalty exception applies to IRAs only. It does not apply to workplace retirement plans like a 401(k) or 403(b).
- The exception only allows the IRA owner to avoid the early distribution penalty. Any pre-tax distributions taken will still be taxed as usual.
- There is no dollar limit for qualified higher education expenses.
- Qualified education expenses must be incurred in connection with a student's enrollment in an "eligible educational institution." If there is a question about eligibility, the educational institution should be able to tell you if it qualifies.
- The institution does not need to be located within U.S. borders.

- The 10% higher education penalty exception is not available to cover costs associated with primary or secondary school, e.g., high school.
- The higher education costs must be for the IRA account owner or his spouse, child, or grandchild of either the owner or spouse. Nephews, cousins and siblings do not qualify.
- “Qualified higher education expenses” are tuition, fees, books, supplies and equipment required for the enrollment or attendance of a student at an eligible educational institution. This also includes expenses for special-needs services incurred by or for special-needs students in connection with their enrollment or attendance.
- A person must be considered at least a half-time student for room and board to qualify as higher education expenses.
- Computer or other computer-related expenses qualify, even if the school does not require a computer as a condition of enrollment.
- IRA distributions must be made in the same calendar year that the bill is paid.
- The IRA custodian will issue Form 1099-R showing an early distribution. There will be nothing on this form to indicate that an exception to the 10% early distribution penalty applies. It is up to the taxpayer to properly claim the exception on their tax return.
- There is no age limit on who can qualify for the qualified higher education IRA penalty exception.