

First-Time Homebuyer Exception to 10% Penalty Doesn't Apply to 401k Distribution

Lily worked for the State of New York during 2015. She participated in a 401(k) set up by the employer. During 2015 Lily requested and received a distribution from her 401(k) to help finance the down payment on her first home. She did not report the distribution on her tax return, nor did she report the 10% early distribution penalty. IRS assessed the tax and the penalty.

Lily and her husband, Justin, took the matter to Tax Court. Part of her petition explained that they had taken the distribution to buy their first home. She also pointed out issues dealing with the IRS assessment stating “penalties and fees are too high”, “We spent the money purchasing our very first house”, “We just need a break. We have worked very hard and put ourselves through school. We could use a break.” Unfortunately for Lily & Justin, Tax Court is not a place to appeal for a break. Tax Court is supposed to apply the tax law to the given circumstances.

First, Tax Court the receipt of the funds from the 401(k) plan was a distribution, not a loan. Therefore, it is subject to income taxes.

Second, Tax Court discussed the exception to the 10% early distribution penalty under the first-time homebuyer provision. This exception to the penalty is limited to distributions from an IRA and does not apply to distributions from a qualified plan. Therefore, the penalty applied to this distribution.

[Editor's note – it is important to remember that some of the exceptions to the 10% penalty apply only to IRAs, some apply only to qualified plans, and some apply to both.]

Lily Hilda Soltani-Amadi & Bahman Justin Amadi, TC Summary Opinion 2019-19. This case can be found by going to www.ustaxcourt.gov, clicking on the Opinion Search tab, and entering Soltani in the Case Name Keyword box.

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