

Tax Court Finds Exception to Early Withdrawal Penalty Limited

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In *Jones v. Commissioner*, T.C. Summary Opinion 2003-153; No. 12825-02S (10/20/2003), a participant in a pension plan withdrew funds from his 401(k) account. After a careful analysis of the facts, the court found that the entire withdrawal of \$50,674 was a taxable distribution to the taxpayer. Whether the taxpayer had basis in the distribution was decided by the court, but will not be discussed in this article.

The taxpayer claimed that an exception to the penalty for first-time homebuyers applied, but the court disagreed because the exception is limited as to the type of plan that can furnish the distribution for such a home purchase.

§ 72(t)(1) imposes an additional 10 % income tax on the gross amount of withdrawals by any participant of a “qualified retirement plan” before reaching age 59½. The tax is increased to 25% in the case of certain SIMPLE IRA plans. However, there are several useful exceptions to this tax. The tax is imposed on only that part of a distribution includible in gross income.

At issue was whether a tax of \$5,067 applied (a 10 percent tax on \$50,674).

The definition of “qualified retirement plan” under § 4974(c) is incorporated by reference for purposes of the early withdrawal tax. That definition includes qualified plans provided by employers under § 401(a), including § 401(k) plans, annuity plans and contracts under § 403(a) and (b), Individual Retirement Accounts and individual Retirement Annuities under § 408(a) and (b). Since Roth IRAs under § 408A are, by definition, individual retirement accounts within the meaning of § 408(a) (except as otherwise provided in § 408A), they, too, are included in the definition of “qualified retirement plan.”

§ 72(t)(1)(F) provides an exception to the early withdrawal tax, where “[d]istributions to an individual from an individual retirement plan are qualified first-time homebuyer distributions.” It is the specification that the distribution be from an “individual retirement plan” that the court analyzed.

The opinion notes that the term, individual retirement plan, is defined under § 7701(a)(37) for purposes of the Internal Revenue Code.¹ The definition states: “The term “individual retirement plan” means -- (A) an individual retirement account described in section 408(a), and (B) an individual retirement annuity described in section 408(b).”

There is a difference between the language of § 72(t)(1) that imposes the tax on certain distributions from “qualified retirement plans (as defined in section 4974(c))” and the language the § 72(t)(1)(F) exception, requiring that the distribution be from “an individual retirement plan. Note that heading to § 72(t)(1)(F) refers to “distributions from certain

¹ More precisely § 7701(a) provides that its definitions apply when used in the Internal Revenue, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof.

plans,” which might be read to mean something more limited than qualified plans in general, but § 7806², which prohibits using might not permit such an analysis.

In the end, the Tax Court in Jones found that the retirement plan that was the source of the distribution could not qualify for the first-time homebuyer exception to the early withdrawal tax, that plan being neither an individual retirement account described in section 408(a), nor an individual retirement annuity described in section 408(b).

² § 7806(b) provides, in relevant part: No inference, implication, or presumption of legislative construction shall be drawn or made by reason of the location or grouping of any particular section or provision or portion of this title, nor shall any table of contents, table of cross references, or similar outline, analysis, or descriptive matter relating to the contents of this title be given any legal effect.