Notice 97-60

Education Tax Incentives

July 1997

SECTION 4. USING IRA WITHDRAWALS TO PAY HIGHER EDUCATION EXPENSES

Beginning January 1, 1998, a taxpayer may make withdrawals from an individual retirement account (IRA) to pay the qualified higher education expenses for the taxpayer, the taxpayer's spouse, or the child or grandchild of the taxpayer or taxpayer's spouse at an eligible educational institution. The taxpayer will owe federal income tax on the amount withdrawn, but will not be subject to the 10 percent early withdrawal tax that applies when amounts are withdrawn from an individual retirement account before the account holder reaches age 59 1/2.

Q1: When can an individual first make a withdrawal from an IRA to pay for qualified higher education expenses without paying the 10 percent early withdrawal tax?

A1: On or after January 1, 1998, an individual can make withdrawals from his/her IRA to pay for qualified higher education expenses for academic periods beginning on or after January 1, 1998, without paying the 10 percent early withdrawal tax. See Notice 97-53, 1997-40 I.R.B. 6 (October 6, 1997). The 10 percent early withdrawal tax does not apply to a distribution from an IRA to the extent that the amount of the distribution does not exceed the qualified higher education expenses during the taxable year for the taxpayer, the taxpayer's spouse, and the child or grandchild of the taxpayer or the taxpayer's spouse at an eligible educational institution. For purposes of this rule, the term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the student at an eligible educational institution. Qualified higher education expenses also include room and board if the student is enrolled at least half-time. Qualified higher education expenses paid with an individual's earnings, a loan, a gift, an inheritance given to the student or the individual making the withdrawal, or personal savings (including savings from a qualified state tuition program) are included in determining the amount of the IRA withdrawal which is not subject to the 10 percent early withdrawal tax. Qualified higher education expenses paid with a Pell Grant or other tax-free scholarship, a tax-free distribution from an Education IRA, or tax-free employer-provided educational assistance are excluded.

Q2: What are the requirements for an "eligible educational institution".

A2: An "eligible educational institution" is any college, university, vocational school, or other postsecondary educational institution that is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) and, therefore, eligible to participate in the student aid programs administered by the Department of Education. This category includes virtually all accredited public, nonprofit, and proprietary postsecondary institutions. (The same eligibility requirements for institutions apply for the Hope Scholarship Credit, the Lifetime Learning Credit, and Education IRAs. (See Sec. 1, Q&A4, Sec. 2, Q&A3, and Sec. 3, Q&A16.))

Q3: When are IRA withdrawals usually subject to the 10 percent early withdrawal tax?

A3: Generally, if a taxpayer makes a withdrawal from his/her IRA before reaching age 591/2, the taxpayer must pay the 10 percent early withdrawal tax on all or part of the amount withdrawn.

Q4: In addition to the Education IRA, TRA '97 also created the Roth IRA. May a taxpayer make a withdrawal from a Roth IRA to pay for his/her child's qualified higher education expenses without paying the 10 percent early withdrawal tax?

A4: Yes. A taxpayer may make a withdrawal from a Roth IRA, as they can from other IRAs, to pay qualified higher education expenses without paying the 10 percent early withdrawal tax.