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SECURE Act leaves questions about distributions for birth or adoption

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The Setting Every Community Up for Retirement Enhancement (SECURE) Act, enacted Dec. 20, 2019, as part of a government spending package ([Pub. L. No. 116-94](#)), allows parents to take early withdrawals of up to \$5,000 from their retirement accounts without penalty within a year of a child's birth or adoption. Although retirement plans can permit these qualified birth or adoption distributions (QBOADs) starting Jan. 1, 2020, the law leaves a number of practical and technical questions. Updates to this article reflect QBOAD guidance in IRS [Notice 2020-68](#) that answers some of these questions.

New category of penalty-free distributions

Withdrawals from tax-favored retirement plans prior to age 59-1/2 are generally subject to a 10% early distribution tax (in addition to regular income tax) under Section [72\(t\)](#) of the Internal Revenue Code, unless one of several exceptions applies. The SECURE Act adds a new exception for QBOADs.

Plans that can offer QBOADs

A QBOAD can be taken from any "eligible retirement plan" (as defined in Code Section [402\(c\)\(8\)\(B\)](#)) other than a defined benefit plan. This includes 401(k) and other qualified defined contribution plans, 403(b) plans, governmental 457(b) plans (early distributions from these plans aren't subject to the penalty tax) and individual retirement accounts (IRAs). Employers sponsoring these plans can — but aren't required to — offer QBOADs to employees.

Eligibility for a QBOAD

Employees can take a QBOAD during the one-year period after the date of a child's birth or legal adoption. For QBOADs, an "eligible adoptee" is anyone (other than a spouse's child) younger than age 18 or incapable — physically or mentally — of self-support.

- **What steps must plans take to verify an employee's eligibility for a QBOAD?** The statute doesn't say. However, Notice 2020-68 says that the absent actual knowledge to the contrary, the plan sponsor or administrator may rely on an employee's reasonable representation of eligibility.
- **Can QBOADs be made from elective deferrals?** Yes. The statute specifically says a QBOAD doesn't violate the rules on permissible distribution events from 401(k), 403(b) and 457(b) plans.

\$5,000 limit

QBOADs are limited to \$5,000 per individual for each birth or adoption. The limit applies to all plans in which the employee participates, including other plans within the employer's controlled group, other employers' plans in which the employee has an account balance and any IRA held by the employee. The \$5,000 limit applies to an individual — not a family — so the employee's spouse may separately receive up to \$5,000 as a QBOAD for the same birth or adoption, even if both spouses work in the same controlled group.

Although the limit seems straightforward, employers may have some practical questions:

- **Are employers responsible for determining if an employee has hit the QBOAD limit?** Yes and no. An employer needs to monitor distributions made from all controlled-group plans to ensure an employee takes no more than the \$5,000 combined limit. But the employer is not responsible for determining whether the employee has taken distributions from other employers' plans or IRAs. For example, if an employee takes a \$5,000 QBOAD from an IRA and then requests the same amount from a 401(k) plan for the same birth or adoption, the 401(k) plan won't be penalized for making the distribution.
- **Is the \$5,000 limit indexed?** It doesn't seem to be. For other retirement plan limits, cost-of-living adjustments are required by statute, but nothing in the SECURE Act calls for adjusting the QBOAD limit.
- **What if the birth or adoption involves more than one child?** Although the statute isn't clear, Notice 2020-68 confirms that the \$5,000 limit applies per child. For example, if an employee gives birth to or adopts twins, the employee can request two QBOADs (up to \$10,000).
- **Do any restrictions apply to the types of expenses employees can pay with a QBOAD?** The statute doesn't appear to require any justification for the distribution beyond the birth or adoption. However, IRS could add limitations in future guidance. Otherwise, employees could use QBOADs to

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buy a new laptop or flat-screen TV, as long as the distribution is requested within a year of the birth or adoption.

Repayment

An individual may repay a QBOAD to the distributing plan (if it accepts rollover contributions) or an IRA. The repayment is treated as a rollover contribution. However, two important limitations apply to repayments to an employer-sponsored plan. First, repayment is allowed only if the individual is still eligible to make contributions to the plan (other than QBOAD repayments). Second, the repayment amount can't exceed the QBOAD.

Again, this raises a number of practical questions:

- **Must plans accept repayment?** The statute doesn't specifically say that a plan must accept repayment. However, Notice 2020-68 confirms that the plan must let an employee repay a QBOAD taken from that plan, provided the employee is eligible to make a rollover contribution to that plan at the time the repayment is made. This is consistent with the [Joint Committee on Taxation](#) and [House](#) reports on the SECURE Act.
- **Does an employee face any deadline for repayment?** The law doesn't appear to place any time-limit on when an employee can repay a QBOAD. So an employee presumably could repay the distribution several years after taking it. However, as discussed in the next two bullets, the ability to repay a QBOAD to an employer-sponsored plan may be cut short if the employee becomes ineligible to contribute to the plan.
- **What if the employee terminates employment after taking the QBOAD?** The statute says an employee can repay a QBOAD if eligible to make contributions to the plan (other than QBOAD repayments). So if the plan accepts rollovers from terminated employees, then the plan apparently must accept repayment. If the plan doesn't accept rollovers from former employees, they can repay QBOADs to an IRA.
- **Can the repayment include interest?** The statute says the repayment can't exceed the QBOAD. This appears to mean the employee can't repay the distribution with interest. This interpretation is consistent with the statute's requirement that plans treat the repayment like a rollover (employees can't add interest to a rollover contribution). Allowing repayment with interest would arguably turn the QBOAD into a loan, which is not the law's intent. Still, clarification would be helpful.

Tax withholding

QBOADs aren't subject to the 20% mandatory withholding that applies to eligible rollover distributions (and the special tax "402(f)" notice isn't required). Instead, QBOADs are subject to the usual tax withholding rules for lump sum payments that aren't eligible rollover distributions — i.e., mandatory 10% withholding, unless the employee elects no withholding.

Relation to hardship distributions

QBOADs are not hardship distributions. They are an entirely new type of distribution subject to their own rules. But adding QBOADs to a plan might affect hardship withdrawals: To take a hardship withdrawal, an employee must take all currently available distributions from all plans maintained by the employer. This presumably will include QBOADs if an employer decides to offer them.

Implementation and plan amendments

Plans can start offering QBOADs this year. Sponsors implementing QBOADs this year will need to revise their administrative procedures immediately, including providing explanations of the distributions to participants, verifying eligibility, ensuring proper withholding and allowing for repayment.

Employers that choose to offer QBOADs will need to amend their plans accordingly. Under the usual amendment timing rules, discretionary plan amendments are due by the end of the plan year in which they take effect. However, the SECURE Act states that amendments for its changes won't be due before the last day of the first plan year beginning on or after Jan. 1, 2022 (2024 for governmental employers or certain collectively bargained plans), or a later date prescribed by IRS.

Related resources

Non-Mercer resources

- [Notice 2020-68](#) (IRS, Sept. 2, 2020)
- [Division O of Pub. L. No. 116-94](#), the SECURE Act (Congress, Dec. 20, 2019)

Mercer Law & Policy resources

- [IRS issues FAQs on SECURE and Bipartisan American Miners acts](#) (Sept. 22, 2020)
- [SECURE Act set to become law](#) (Dec. 19, 2019)

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