
# Taking a closer look at SECURE 2.0's penalty-free distribution provisions

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The SECURE 2.0 Act of 2022 (Div. T of Pub. L. No. 117-328) includes several provisions allowing defined contribution (DC) plan participants to access a portion of their retirement savings — with no 10% early withdrawal penalty — in certain situations. Plan sponsors can offer penalty-free distributions to participants who are affected by major disasters, have experienced domestic abuse, have personal emergency expenses, have a terminal illness or owe premiums on certified long-term care insurance. This GRIST separately examines each distribution's eligibility provisions and any limitations on the distribution's amount or timing. The article then discusses common provisions of the distributions, including a plan's ability to offer them as separate options, participants' ability to repay distributions, and their tax treatment for plans and participants.

## Building on earlier legislation

SECURE 2.0's distribution provisions build on Congress's willingness in recent years to give retirement plan participants access to their retirement savings. The act's relief for disaster victims is similar to what Congress has allowed plans to offer for specific hurricanes, wildfires and other natural disasters, as well as the COVID-19 pandemic. The distributions for participants experiencing domestic abuse, personal emergencies or terminal illness include many of the same provisions as the penalty-free qualified birth or adoption distributions (QBOADs) authorized by the Setting Every Community Up for Retirement Enhancement Act of 2019 (Div. O of Pub. L. No. 116-94) (SECURE 1.0).

## Major disasters

Sponsors of 401(k), 403(b), governmental 457(b) and money purchase pension plans can now offer penalty-free distributions — referred to as "qualified disaster recovery distributions" (QDRDs) — and certain other relief to participants affected by federally declared disasters. Sponsors can offer the relief

permanently so it's automatically available whenever participants are affected by an event that the president declares a major disaster. The penalty-free tax treatment applies to distributions for disasters occurring on or after Jan. 26, 2021.

**Eligible participants.** To be eligible for a QDRD, a participant's "principal place of abode" must have been in the disaster area at any time during the incident period, and the participant must have sustained an economic loss because of the disaster. (The Federal Emergency Management Agency (FEMA) defines the disaster area and the incident period in a disaster declaration.) The statute does not address whether or how participants must substantiate their economic loss to the plan administrator.

**Dollar limitation.** The maximum distribution that a participant can take without penalty is $22,000 per disaster. (This amount is not indexed, but SECURE 2.0 requires the Government Accountability Office to report on participants' utilization of this relief, including the adequacy of the $22,000 limit.) The limit applies in aggregate to all of the participant's accounts under employer-sponsored retirement plans and individual retirement accounts (IRAs). However, a sponsor is responsible for ensuring only that the participant takes no more than $22,000 per disaster from all plans in the sponsor's controlled group. For example, if an employer has separate 401(k) plans for its salaried and hourly employees and an employee affected by a disaster has accounts under both plans, the employer must ensure the participant's distributions in total don't exceed the maximum. If the participant takes the maximum distribution from a sponsor's plan (or plans) but also takes a QDRD from an IRA or a different employer's plan, the sponsor's plan won't be treated as violating the Internal Revenue Code (IRC) (but the participant will face tax consequences).

**Timing.** A QDRD must be made within 179 days after the later of (i) the first day of the incident period or (ii) the date of the disaster declaration. For major disasters occurring on or after Jan. 26, 2021, and before SECURE 2.0's enactment on Dec. 29, 2022, eligible individuals can take a QDRD until June 27, 2023, if that date is later than the date that otherwise applies under the statute.

**Other disaster relief.** SECURE 2.0 allows 401(k), 403(b) and governmental 457(b) plans to temporarily double the maximum plan loan to the lesser of $100,000 or 100% of the participant's vested benefit. Those plans can also suspend loan repayments due during the incident period for up to one year (with a corresponding extension of the loan term). Section 401(k) and 403(b) plans can let participants repay unused hardship distributions that were taken to purchase a principal residence in the disaster area.

# Domestic abuse

Starting in 2024, sponsors of 401(k), 403(b) and governmental 457(b) plans can offer penalty-free distributions to people experiencing domestic abuse. Unlike SECURE 2.0's other distribution provisions, these distributions are permitted only from plans exempt from the IRC's qualified joint-and-survivor and preretirement-survivor annuity requirements.

**Eligible participants.** A participant must have experienced domestic abuse by a spouse or a domestic partner. The statute provides a detailed definition of domestic abuse, which also includes abuse of the

participant's child or another family member living in the same household. Participants can self-certify their eligibility.

**Dollar limitation.** The maximum amount a participant can receive without penalty is the lesser of $10,000 (indexed after 2024) or 50% of the participant's vested account balance. This limit applies in aggregate to all of the participant's accounts under all plans in the sponsor's controlled group.

**Timing.** The distributions must be made within one year after the date the participant experiences domestic abuse.

# Emergency expenses

Starting in 2024, sponsors of 401(k), 403(b) and governmental 457(b) plans can offer small penalty-free distributions to participants who incur emergency personal expenses.

**Eligible participants.** To be eligible for a distribution, a participant must have unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses. The plan administrator can rely on a participant's written self-certification.

**Dollar limitation.** The maximum distribution that a participant can take without penalty is the lesser of $1,000 or the participant's nonforfeitable benefit reduced by $1,000. For example, if the participant's vested account balance is $1,250, the emergency distribution can't exceed $250.

**Timing.** Plans can offer only one emergency distribution per year. However, a participant who takes such a distribution can't take another in the next three calendar years without first fully repaying the distribution or making salary deferrals to the plan equal or exceeding the amount of the distribution.

**Emergency savings accounts.** SECURE 2.0 includes a separate provision that allows sponsors to offer nonhighly compensated employees an emergency savings account linked to their retirement plan account. Sponsors can offer this option for plan years starting after Dec. 31, 2023, in addition to or instead of annual emergency distributions. Participants experiencing an emergency can withdraw their entire savings account balance — which is limited to $2,500 — without penalty. Although these accounts give participants greater access to their savings in an emergency, the accounts also increase administrative complexity for the sponsor — for example, the plan will have a separate salary deferral, and the sponsor will have to match savings deferrals like elective contributions. (A full discussion of these accounts is beyond the scope of this article.)

# Terminal illness

SECURE 2.0 lets sponsors offer terminally ill employees penalty-free distributions from their retirement plans. The provision is effective for distributions made on or after Dec. 29, 2022 (SECURE 2.0's enactment date).

**Eligible participants.** A physician must certify that the employee has an illness or physical condition reasonably expected to result in death within 84 months. The employee must furnish "sufficient

evidence" of terminal illness to the plan administrator in accordance with forthcoming IRS guidance. Unlike the SECURE 2.0's other distributions, the statute appears to limit eligibility to employees, which suggests that this option might not be available to former employees or a plan participant's beneficiaries.

**No dollar or timing limitations.** The statute doesn't limit the amount or number of penalty-free distributions that a terminally ill employee can take, so the entire account balance is apparently eligible for the special tax treatment.

# Long-term care insurance

Starting Dec. 30, 2025, qualified DC plans (including 401(a), 401(k) and 403(a) plans), 403(b) plans and 457(b) plans can offer penalty-free "qualified long-term care distributions." The distributions must be used to pay "certified long-term care insurance" premiums for an employee, the employee's spouse or any other family members allowed under Treasury regulations. SECURE 2.0's use of "employee" in this provision suggests that only active employees may receive the distributions.

**Eligible distributions.** Employees must use the distributions to pay premiums for certified long-term care insurance under one of the following:

- A qualified long-term care insurance contract under IRC Section 7702B(b)
- A life insurance or annuity contract with a rider or other provision that covers qualified long-term care services and is treated as a separate long-term care insurance contract under IRC Section 7702B
- A life insurance contract with a rider or other provision providing accelerated death benefits to pay the costs of qualified long-term care services if the insured becomes chronically ill

The coverage must provide "meaningful financial assistance" in the event the insured needs home-based or nursing home care. Coverage isn't considered meaningful unless it's adjusted for inflation and provides consumer protections, including protection in the event the coverage is terminated.

**Dollar limitation.** Every year, employees can take qualified long-term care distributions up to the least of the following amounts:

- The premium paid by or assessed to the participant during the year
- 10% of the employee's vested account balance
- $2,500 (indexed after 2024)

**Timing.** Employees must take distributions in the same taxable year in which the premiums are paid or assessed.

**Statement to plan administrator.** An employee who takes a distribution must file a long-term care premium statement with the plan administrator that includes the following information:

- Insurer's name and taxpayer ID
- Statement that the coverage is certified long-term care insurance
- Identification of the employee as the owner of the coverage, the individual covered by the insurance and the individual's relationship to the employee
- Premiums owed for the calendar year
- Any other information that Treasury may require

The statute doesn't set a deadline for an employee to file this statement. The insurer must issue the statement upon the employee's request. The plan administrator can't accept the statement unless the insurer has filed a disclosure with Treasury for the insurance product to which the statement relates. SECURE 2.0 directs Treasury to issue the forms and guidance needed to collect this disclosure.

# Distribution events

Retirement plans ordinarily may distribute benefits only when certain specified events occur, such as the participant's retirement, death, disability or financial hardship. SECURE 2.0 states that distributions to participants affected by a major disaster satisfy the distribution rules for 401(k), 403(b), governmental 457(b) and money purchase pension plans. Distributions triggered by domestic abuse and emergency expenses likewise satisfy the rules for 401(k), 403(b) and governmental 457(b) plans (but not money purchase plans). Distributions to pay for certified long-term care premiums are new distributable events for DC 401(a), 401(k), 403(a), 403(b) and 457(b) plans. Plans can offer these distributions to participants who otherwise haven't had a distribution event under the plan.

Curiously, SECURE 2.0 doesn't include similar language for distributions to employees diagnosed with a terminal illness, raising questions about whether this provision adds a new distribution event. This omission may be unintentional, since the statute requires employees to submit evidence of their illness to the plan administrator and allows repayment (similar to the other new distribution options). Sponsors considering offering a separate distribution option for terminally ill employees should consult with legal counsel.

# Repayment options

Participants who take any of the above distributions — except for qualified long-term care distributions — have the option to repay all or part of the distribution during the three-year period starting the day after the distribution is received. (SECURE 2.0 added a three-year repayment limit for QBOADs as well, which previously had no deadline for repayment under SECURE 1.0.) The repayment rules are similar — but not identical — for the different distributions.

For purposes of repayment, the distributions are treated as eligible rollover distributions, and repayments are treated as satisfying the requirements for a 60-day rollover. Repayments can be made to an employer-sponsored plan (other than a defined benefit plan) that accepts rollovers or to an IRA. Repayments of distributions for domestic abuse, personal emergencies and terminal illness can be made to an employer-sponsored plan only if the participant is otherwise eligible to contribute to the plan. This limitation doesn't apply to repayments of QDRDs to an employer-sponsored plan.

SECURE 2.0 doesn't specify whether plans must accept repayments of any of the distributions. However, IRS has addressed this issue for similar distributions in the past — with inconsistent results. For example, in Notice 2020-50, IRS said it expected plans that accept rollovers would accept repayments of coronavirus-related distributions made under the Coronavirus Aid, Relief and Economic Security Act (Pub. L. No. 116-136). However, in Notice 2020-68, IRS said that plans offering QBOADs had to accept repayments from a QBOAD recipient who was eligible to make a rollover contribution to the plan. Sponsors that prefer not to accept distribution repayments should consult with legal counsel.

# Tax treatment

Disaster distributions are included in a participant's income ratably over three years, unless the participant elects not to have the three-year rule apply. Distributions for domestic abuse, emergency expenses and terminal illness are included in income in the year received. Although the statute isn't entirely clear, SECURE 2.0 appears to suggest that qualified long-term care distributions are excludable from a participant's income as long as they don't exceed the total premiums paid for the year.

Although distributions for disasters, emergencies and domestic abuse are treated as rollovers for repayment purposes, these distributions are not considered rollover distributions for purposes of the mandatory 20% withholding and rollover notices. Qualified long-term care distributions are not considered eligible rollover distributions for any purpose. Therefore, the default 10% withholding rate on nonperiodic payments applies to these distributions (unless the participant elects a different rate or no withholding), and plans don't need to give a 402(f) rollover notice to participants receiving these distributions. The statute does not address the withholding and rollover notice requirements for distributions to a terminally ill employee.

# Plan amendments

The plan amendment deadline for SECURE 2.0's provisions — including the new penalty-free distribution options — is the end of the first plan year beginning on or after Jan. 1, 2025 (2027 for governmental and collectively bargained plans). This deadline applies to sponsors that offer any of the new distribution options before that date. For sponsors that first offer any of the distribution options after the amendment deadline, the usual discretionary amendment timing rule will apply (i.e., amendments will be due by the end of the plan year in which the sponsor first offers the option).

# Related resources

## Non-Mercer resources

- Div. T of Pub. L. No. 117-328, SECURE 2.0 Act of 2022 (Congress, Dec. 29, 2022)

## Mercer Law & Policy resources

- User's guide to SECURE 2.0 (March 7, 2023)
- Alert: SECURE 2.0 retirement reforms set to become law (Dec. 20, 2022)
- Delving into CARES Act relief for retirement plan participants (June 22, 2020)

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