Publications

IRS Guidance on New Exceptions to the Penalty Tax for Early Qualified Plan or IRA Withdrawals

ATTORNEYS & PROFESSIONALS
Kim Boberg
kboberg@groom.com
202-861-2606
Elizabeth Thomas Dold
edold@groom.com
202-861-5406
David Levine
dlevine@groom.com
202-861-5436
Eboni Onuoha
eonuoha@groom.com
202-861-6333
Jenna Russell
jrussell@groom.com
202-861-5411
Malcolm Slee
mslee@groom.com
202-861-6337
J. Rose Zaklad
rzaklad@groom.com
202-861-6626

PUBLISHED
07/01/2024

SOURCE
Groom Publication

SERVICES
Employers & Sponsors
- Fiduciary & Plan Governance
- Retirement Programs

Retirement Services

The IRS recently issued guidance in Notice 2024-55 on the application of two new exceptions to the 10% additional tax under Code section 72(t) for early withdrawals from a qualified plan or IRA, which were added by Sections 115 and 314 of SECURE 2.0 effective January 1, 2024. These exceptions are for (1) emergency personal expense distributions and (2) domestic abuse victim distributions. This guidance will assist plan sponsors and plan administrators in implementing these provisions. Formal plan amendments are not required until December 31, 2026, at earliest. This guidance fills a gap as the IRS continues to work on Code section 72(t) regulations.

The guidance, in Q&A format, goes into detail regarding the applicable rules when plans offer these distribution rights, with some of the key provisions summarized below. Notably, as these new distribution features are optional, even if a plan does not offer a new in-service distribution right, a participant can still take advantage of the relief on his or her tax return filing.

Background

Code section 72(t) generally provides for a 10% additional tax on a distribution from a qualified retirement plan (and IRAs) prior to age 59-1/2, unless the distribution falls under one of the various exceptions, which may vary depending on the plan/IRA type (*e.g.*, death, disability, certain substantially equal payments, certain post age 55/50 separation from service, IRS levy). Now, because of SECURE 2.0, in-service emergency personal expense distributions and domestic abuse victim distributions are permitted and are included in the Code section 72(t) exceptions to the 10% additional tax. Notably, SECURE 2.0 did not expressly provide for anti-cutback relief, and unfortunately the guidance is also silent on the subject. As such, it is not clear whether these new distribution features may be eliminated once added to a plan.

Emergency Personal Expense Distributions

For eligible emergency personal expense distributions ("EPED"), the guidance provides the following:

- **What is an emergency personal expense distribution?** An emergency personal expense distribution is any distribution made from an applicable eligible retirement plan to an individual for purposes of meeting "unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses." This analysis is a facts and circumstances determination for each individual, which can include medical care (including the cost of medicine or treatment), accident or loss of property due to casualty, imminent foreclosure or eviction from a primary residence, or the need to pay for burial or funeral expenses, auto repairs, or any other necessary emergency personal expenses. Notably, plan administrators (which includes IRA custodians) may rely on an employee's written self-certification (which can be made electronically) that the employee is eligible for an EPED. Although not addressed in the guidance, the expected Code section 72(t) regulations may provide for self-certification for repayments, and may provide for an exception (and related procedures) for employee misrepresentations.
- **Is the relief optional?** Yes. A plan is not required to add this new in-service distribution. However, a plan that adds this feature will not violate the Code's qualified cash or deferred rules by allowing pre-tax, QNECs (qualified nonelective contributions), QMACs (qualified matching contributions), and safe harbor 401(k) contributions to be distributed for an EPED. If offered, a plan/IRA must be amended by the SECURE 2.0 deadline (currently December 31, 2026 at earliest and later for governmental plans). But, even if a plan does not adopt these SECURE 2.0 provisions, an individual can claim the 10% tax relief on their Form 1040 for amounts that can otherwise be distributed, via Form 5329. Also, this distribution can be repaid within three years to an IRA.
- **What plans are eligible for the relief?** The following plans (and IRAs) are eligible for the relief: qualified defined contribution plans (*e.g.*, section 401(k) plans and money purchase pension plans), section 403(a) annuity plans, section 403(b) plans, governmental section 457(b) plans, and IRAs.
- **Are there limits on the amount and frequency of withdrawals?** Individuals may only take one emergency personal expense distribution per calendar year and distributions are capped at the lesser of $1,000, or the amount equal to the individual's total nonforfeitable benefit minus $1,000. The same repayment rules apply as for qualified birth or adoption distributions, so if a plan offers the feature, participants that are eligible to make rollover contributions must be permitted to return the funds to the plan within a 3-year period following receipt of the distribution (and the repayment is treated as a direct trustee-to-trustee transfer). If repayment is not made in full (or the individual has not contributed elective deferrals or employee contributions in an amount equivalent to the distribution), an individual will not be allowed another emergency personal expense distribution for the following three calendar years.
- **What is the appropriate tax treatment of the EPED?** The EPED is not treated as an eligible rollover distribution for a number of purposes. As a result, the regular rollover process, such as providing a direct rollover option, providing a rollover notice, and applying 20% mandatory withholding is not required. Instead, 10% optional withholding applies.

Domestic Abuse Victim Distributions

Similarly, for domestic abuse victim distributions (a "DAVD"), the guidance provides as follow:

- **What is a domestic abuse victim distribution?** A DAVD is any distribution from an applicable eligible retirement plan to a domestic abuse victim if made during the 1-year period beginning on any date on which the individual is a victim of domestic abuse by a spouse or domestic partner. The term "domestic abuse" includes physical, psychological, sexual, emotional, or economic abuse, including efforts to control, isolate, humiliate, or intimidate the victim, or to undermine the victim's ability to reason independently, including by means of abuse of the victim's child or another family member living in the household. The same self-certification rules available for EPEDs apply here. As such, a plan may adopt a check-the-box approach to certify that (1) a participant is eligible for a DAVD, and (2) the distribution is made during the applicable 1-year period.
- **Is the relief optional?** Yes, as with EPEDs, the relief is optional, and if not included in an eligible plan, an individual can claim the tax relief on their tax return (and repayments can be made to an IRA).
- **What plans are eligible for the relief?** The following plans (and IRAs) are eligible for the relief: a qualified defined contribution plan other than plans subject to the spousal consent requirements of Code sections 401(a)(11) and 417 (e.g., plans subject to

qualified joint and survivor annuity rules), section 403(a) annuity plans, section 403(b) plans, governmental section 457(b) plans, and IRAs.

- **Are there limits on the amount and frequency of withdrawals?** A domestic abuse victim may receive a distribution of up to $10,000 (indexed for inflation). Specifically, the total aggregate amount available to a participant is the lesser of $10,000 (indexed) or 50 percent of the individual's vested account balance. Domestic abuse victims can request distributions within the 1-year period beginning on any incident of abuse. The same repayments rights that apply to EPEDs apply to DAVDs.
- **What is the appropriate tax treatment of the DAVD?** DAVDs are subject to the same tax treatment as applicable to EPEDs and described above.

Observations

As we await the issuance of comprehensive proposed Code section 72(t) regulations, this guidance provides some helpful clarifications on these two new distribution features, which may trigger more recordkeepers and plans offering this relief. And even if not offered under the plan, taxpayers can take advantage of the relief on their tax return. The IRS is seeking comments for additional clarifications (including rules for repayments), which are due October 7, 2024.