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SECURE 2.0 and Exceptions to the Early Distribution Penalty

Posted on February 13, 2023

Absent an exception, the Internal Revenue Code (IRC) imposes a 10% penalty on distributions (includible in gross income) from qualified retirement plans made prior to the individual attaining age 59½. *See IRC Section 72(q).*

Prior to the Securing a Strong Retirement Act of 2022 (SECURE 2.0) enacted December 29, 2022, exceptions to the premature distribution penalty for distributions from qualified plans***** included distributions made:

- to a beneficiary on account of the participant's death;
- to a disabled participant;
- as part of a series of substantially equal periodic payments made over the life of the participant or joint lives of participant and beneficiary which begin after the participant separates from service;
- after the participant separates from service after attaining age 55;
- to an alternate payee pursuant to a qualified domestic relations order;
- for certain medical expenses;
- as part of a qualified reservist distribution;
- to a qualified public safety employee (e.g. police, firefighter, emergency medical services) from a governmental defined benefit plan who separates from service after attaining age 50; and
- up to $5,000 for qualified birth or adoption

***A word of caution:** the exceptions for IRA distributions overlap, but are not the same as the qualified plan exceptions in each instance.

SECURE 2.0 expands the list of exemptions to the early distribution penalty by adding the following:

- The public safety employee exception has been expanded to include private sector firefighters who separate from service after attaining age 50. A private sector firefighter could be employed by a private sector fire company engaged to provide protection for a community or to protect properties or commercial buildings during wildfires or other disasters. In general, the training and duties are on par with the training and duties of public service firefighters.
- The public safety employee exception has been expanded to include public safety employees under age 50 who have at least 25 years of service under the plan.
- The definition of public safety employee is expanded to include corrections officers and forensic security personnel employed by state or local governments.
- Beginning in 2027, an annualized excludable disability amount distributed to disabled law enforcement officers, firefighters, paramedics and emergency medical personnel (qualified first responders) may be excluded from gross income after the disabled first responder reaches retirement age.

- Beginning in 2024 distributions from 401(k), 403(b) and 457(b) plans to victims of domestic abuse. The distribution may not exceed the lesser of $10,000 (to be indexed) or 50% of the vested account balance and must be made within the one year period beginning on the date the individual is a victim of the domestic abuse. Plan participants may self-certify to being a victim of abuse.
- Distributions to terminally ill employees are exempt from the premature distribution penalty. “Terminal illness” must be certified by a physician as a condition or illness that is reasonably expected to result in death in 84 months or less after the date of certification.
- The 10% penalty for early withdrawals is removed if withdrawals are made as a result of a federally declared disaster and the withdrawal is made within 180 days of the disaster, provided that the participant’s primary residence is within the declared disaster area and the participant has sustained an economic loss as a result of the disaster.
- Beginning in 2024, plan participants may withdraw, penalty free, up to $1,000 per year from the retirement plan to cover any unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses. Any additional withdrawals may be taken in subsequent years only if the prior distributions have been re-paid in full, or cumulative employee contributions and deferrals since the emergency withdrawal equal to or exceed the amount of the emergency withdrawal. If neither applies, then the next emergency withdrawal can be made only 3 years after the previous emergency withdrawal.
- SECURE 2.0 also allows plan sponsors to add emergency savings accounts to their 401(k) and 403(b) plans. Such emergency savings accounts will be linked to the existing employer plans with individual balances. Only non-highly compensated plan participants can contribute to the emergency savings accounts. The maximum amount held by such emergency savings account is $2,500, but plan sponsors may set a lower balance amount. The IRS is required by law to provide more guidance within 12 months on how to administer such accounts, including how to account for distributions. The contributions are treated as Roth elective deferrals. Congress specifically exempted distributions from emergency savings accounts from 10% penalty. The plans will be required to allow at least one distribution per month and no fees for distributions may be imposed on at least the first 4 distributions.

Before taking any distribution prior to attaining age 59½, every participant and IRA owner should review the available exemptions from the premature distribution penalty and confirm that an available exemption applies.

If you have a question about early distributions or related issues, please contact Nadia Havard, or call us at 814-459-2800.

Nadia A. Havard

Nadia A. Havard concentrates her practice in all areas of qualified and nonqualified retirement plans and employee benefits; transfer taxes; fiduciary income tax and trust administration; business; as well as estate planning and administration. She also helps nonprofits obtain and maintain their tax-exempt status.

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