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New Options for Retirement Plan Distributions Under SECURE 2.0

by Lisa S. Boehm on May 23, 2023

This post summarizes the new distribution options, including penalty-free withdrawals, applicable to defined contribution plans under the SECURE 2.0 Act of 2022 ("SECURE 2.0") and provides a timeline of their effective dates. The new options further evidence Congress's growing appetite for approving legislation that allows greater pre-retirement access to funds intended for retirement.[1]

It is important at the outset to note the following:

- SECURE 2.0 permits, but does not require, plan sponsors to amend their 401(k), 403(b), and governmental 457(b) plans to allow penalty-free in-service emergency personal expense, disaster recovery, domestic abuse victim, and long-term care distributions as described below.[2]

- For the new penalty-free terminal illness distributions described below, SECURE 2.0 does not specifically permit in-service withdrawals from elective deferral accounts based on this circumstance alone. It appears that another distributable event (*e.g.*, termination of employment) must be present.[3]

- The new penalty-free distributions are not available to non-governmental 457(b) plans.

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[1] Prior to SECURE 2.0, Congress had passed several pieces of legislation permitting participants to access their retirement savings to help them recover from specific federally declared disasters and to weather the COVID-19 pandemic. In addition, with the Setting Every Community up for Retirement Enhancement Act of 2019, Congress approved giving participants access to their retirement savings for certain birth or adoption expenses.

[2] For money purchase pension plans, with one exception, it appears a separate distributable event (*e.g.*, termination of employment) must be present to permit the distribution. The one exception is long-term care distributions. That is, a money purchase pension plan may be amended to permit in-service long-term care distributions.

[3] It appears a separate distributable event (*e.g.*, termination of employment) also must be present to permit the distribution from a money purchase pension plan.

- All plans maintained within the plan sponsor's controlled group are taken into account for purposes of applying the applicable distribution limits for emergency personal expense, disaster recovery, and domestic abuse victim distributions.

New Penalty-Free Distributions

SECURE 2.0 creates the following new exceptions to the 10% penalty tax on early distributions. In addition, SECURE 2.0 expressly provides that emergency personal expense, disaster recovery, domestic abuse victim, and long-term care distributions are not subject to mandatory 20% withholding for federal income tax.

Emergency Personal Expense Distributions

Beginning in 2024, once each calendar year a participant in a defined contribution retirement plan may withdraw up to $1,000 (or, if less, the amount of the participant's vested account balance in excess of $1,000) for an emergency personal expense. An "emergency personal expense distribution" is any distribution from a defined contribution plan to an individual to meet an unforeseeable or immediate financial need relating to necessary personal or family expenses. A plan administrator generally may rely on an employee's written certification that the employee satisfies the conditions for an emergency personal expense distribution.

No subsequent emergency personal expense distribution may be made unless (i) the previous personal emergency expense distribution is fully repaid during the 3-year period beginning on the day after the previous distribution was received, or (ii) the aggregate amount of the participant's elective deferrals and employee contributions made to the plan after the previous distribution is at least equal to the amount of the previous distribution which has not been so repaid.

As discussed in our January, 2023 post, SECURE 2.0 also permits in-service withdrawals from pension-linked emergency savings accounts. Unlike pension-linked emergency savings accounts, which are available only to participants who are non-highly compensated employees, emergency personal expense distributions may be made to all participants.

Disaster Recovery Distributions

Effective for federally declared disasters occurring on or after January 26, 2021, affected individuals may withdraw up to $22,000 per disaster. The withdrawal generally must be made within 179 days after the date of the disaster declaration. An "affected individual" is an individual whose principal place of abode is located in the disaster area and who has sustained an economic loss due to the disaster.

The amount distributed generally may be repaid to the plan at any time during the 3-year period beginning on the day after the distribution was received.

Affected individuals may spread the amount of the distribution required to be included in gross income ratably over the 3-taxable year period beginning with the taxable year in which the distribution is made.

Distributions to Domestic Abuse Victims

Beginning in 2024, a participant in a defined contribution plan that is not subject to the minimum survivor annuity requirements and who is a victim of domestic abuse (as defined in the statute) may withdraw up to the lesser of $10,000 (adjusted for inflation after 2024) or 50% of their vested account balance. The distribution must be made during the 1-year period beginning on any date on which the participant is a victim of domestic abuse by a spouse or domestic partner. Unless the participant certifies the distribution qualifies as a domestic abuse victim distribution, an in-service withdrawal from elective deferral accounts may not be made.

The amount distributed generally may be repaid to the plan within the 3-year period beginning on the day after the distribution was received.

Long-Term Care Distributions

Effective for distributions made after December 29, 2025, defined contribution plan participants may receive distributions to pay for certain long-term care insurance, provided a long-term care premium statement (as defined in the statute) has been provided to the plan.

The amount that may be distributed during the taxable year may not exceed the least of the following: (i) the amount paid by or assessed to the participant during the year for certified long-term care insurance (as defined in the statute) for the participant or the participant’s spouse (or other family member, as permitted under Treasury regulations); (ii) 10% of the participant’s vested account balance; or (iii) $2,500 (adjusted for inflation).

Terminal Illness Distributions

This new exception to the 10% penalty tax is effective for distributions after December 29, 2022, to a terminally ill participant on or after the date the participant has been certified by a physician to be terminally ill.

A “terminally ill participant” is a participant who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death within 84 months or less after the date of certification. A participant will not be considered to be a terminally ill participant unless the participant provides sufficient evidence to the plan administrator in such form and manner as the Secretary of the Treasury may require.

A terminally ill participant generally may repay the amount distributed to the plan within the 3-year period beginning on the day after the distribution was received.

This penalty-free distribution appears to require a separate distributable event (*e.g.*, termination of employment) for distributions from elective deferral accounts and from money purchase pension plans. Further clarification from Congress or in regulations (or other agency guidance) would be welcome.

New Options Relating to Hardship Distributions

SECURE 2.0 permits 403(b) plans to distribute qualified nonelective contributions, qualified matching contributions, and earnings on those contributions *and* on elective deferrals in the event of a hardship. It also provides that 403(b) plans participants are not required to obtain any available loan under the plan before receiving a hardship distribution. These changes are effective for plan years beginning after December 31, 2023, and conform the 403(b) rules governing hardship distributions to the 401(k) rules.

In addition, effective for plan years beginning after December 29, 2022, plan administrators of 401(k), 403(b), and governmental 457(b) plans generally may rely on a participant's written certification: (i) that the participant has a financial need that is deemed to be an immediate and heavy financial need under the applicable regulations (or, in the case of a governmental 457(b) plan, that the participant is faced with an unforeseeable emergency of a type described in the applicable regulations), (ii) that the distribution is not in excess of the amount required to satisfy the financial need or emergency need, as applicable, and (iii) that the participant has no alternative means reasonably available to satisfy the financial need or emergency need, as applicable.

SECURE 2.0 authorizes the Secretary of the Treasury to prescribe regulations for exceptions to participant self-certification in cases where the plan administrator has actual knowledge to the contrary of the participant's certification and for procedures for addressing cases of participant misrepresentation.

As a reminder, hardship distributions are subject to the 10% penalty tax unless an exception to the tax applies.

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Timeline of Effective Dates

January 26, 2021
penalty-free disaster recovery distributions

December 30, 2022
penalty-free terminal illness distributions

plan years beginning after December 29, 2022
participant self-certification of hardship and unforeseeable emergency distributions

January 1, 2024
penalty-free emergency personal expense distributions and domestic abuse victim distributions

plan years beginning after December 31, 2023
additional sources available for hardship distributions from 403(b) plans

December 30, 2025
penalty-free long-term care distributions

Document when SECURE 2.0's New Distributions Options Are Made Available under Your Plan

The deadline for adopting formal plan amendments made pursuant to SECURE 2.0 is a long way off (*e.g.*, December 31, 2025 for a non-collectively bargained 401(k) plan with a calendar year plan year). Because plan amendments will need to include effective dates, we recommend that plan sponsors document the date any of SECURE 2.0's new distribution options are made available under their plans as soon as they are made available. For example, if, in operation, a plan permitted in-service disaster recovery distributions effective March 1, 2023, it may be difficult to recall that exact date at the end of 2025 without having documented it.

Please contact a member of the Employee Benefits & Executive Compensation Group if you have any questions regarding SECURE 2.0's expanded options for retirement plan distributions.

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