

Details of the SECURE Act: Withdrawals for Birth or Adoption



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SECURE Act: Birth or Adoption Withdrawals

In late December of 2019 President Trump signed into law a budget bill to fund the government for the remainder of the fiscal year. Included as an addition to the bill was the SECURE Act (Setting Every Community Up for Retirement Enhancement Act of 2019). The intent of the Act is to amend the Internal Revenue Code of 1986 to encourage retirement savings.

Section 113 of the Act amends the tax laws to allow employees to take a penalty-free withdrawal for qualified birth or adoption expenses.

Section 72(t) of the Internal Revenue Code provides that withdrawals from a qualified retirement plan are subject to a 10% tax on early distributions, with certain exceptions. Included in the list of exceptions are distributions made after attainment of age 59 ½; distributions on account of disability; distributions after separation from service after age 55; distributions for certain medical expenses; and distributions made to an individual called to active military duty.

The SECURE Act amends the tax code to add an additional exception from the 10% early distribution tax:

- **any qualified birth or adoption distribution**

Of course, as with most tax laws, there are practical administrative considerations with respect to this change. We are waiting for additional guidance on how to proceed with offering these withdrawals, but here are some of the details that are known:

- ***\$5,000 limit*** – the aggregate amount which can be treated as “qualified” with respect to any birth or adoption cannot exceed \$5,000. This limit applies to all plans maintained by the employer or any member of a controlled group of employers. Employers with multiple plans will need to make sure that an employee is not allowed to exceed the \$5,000 limit by withdrawing from more than one plan. This limit is for each individual, so it would be possible for each spouse to request a \$5,000 distribution from his/her respective plan or IRA for each birth or adoption.
- ***Applicable plans*** – the distribution may be taken from an IRA or a qualified employer plan, including a 401(k), 403(b) or governmental 457(b) plan, but not a defined benefit plan.
- ***1-year window*** – the distribution must be made during the 1-year period beginning on the date the child is born or the date the adoption is finalized.



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- **Eligible adoptee** – the adoption may be for any individual who is under the age of 18 or is incapable of self-support due to physical or mental limitations. An “eligible adoptee” does NOT include the child of the taxpayer’s spouse (in other words, legally adopting a step-child would not qualify).
- **Repayment available** – the distribution amount may be repaid to an eligible retirement plan or IRA to which the individual is eligible to contribute a rollover contribution. The repayment can be accomplished via one payment or multiple payments, not to exceed the amount of the distribution. The taxpayer is treated as having received the distribution as an eligible rollover distribution and if it is repaid, the repayment is treated as a direct rollover made within 60 days of distribution. No time limit is prescribed for making the repayment, so the taxpayer could repay the distribution at any time in the future. The Act is not specific about how the repayment will be handled on the tax return for the year(s) in which it is repaid.
- **Separate distribution event** – distribution under this provision may be allowed regardless of whether other in-service distributions are allowed.
- **No 20% mandatory withholding** – The distribution is not rollover eligible so the automatic 20% withholding does not apply, instead the 10% optional tax withholding will apply, meaning the employee will have 10% federal tax withholding taken, unless he opts out or elects a different percentage. It is important to note that the distribution is not tax-free, it will be taxed when the individual files his/her annual tax return. Also, the taxpayer is not required to get a Special Tax Notice.
- **Special tax reporting** – the taxpayer will be required to report information about the child on the tax return filed for the year of the distribution (name, age and TIN). The recently released 2020 Instructions for Forms 1099-R and 5498 address the tax reporting requirements for distributions and repayments for qualified birth or adoption. The 1099-R code to report the distribution for a taxpayer under age 59 ½ is code “1”. The taxpayer will then have to further indicate that the distribution qualifies for the birth or adoption exception. Repayment of a birth or adoption distribution will be reported on Form 5498 with a code “BA”.

EFFECTIVE DATE: This new exception to the 10% tax will apply to distributions made after December 31, 2019. The distribution could be for a birth or adoption that occurred in 2019 – for example, parents of a child born on June 1, 2019 could take the distribution between January 1 and June 1, 2020.

As of the date of this writing, additional guidance is needed for plan sponsors and service providers to understand exactly how this withdrawal option should be administered. It is expected that the

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addition of this withdrawal type is optional and that plans will need to be amended if an employer wants to add this type of distribution. It is unclear at this time, what – if any – documentation will need to be provided to show that the individual qualifies for the distribution. It is also unclear how the repayments will work, if there is a limit on repayments, whether the repayment option is mandatory, and how repayments are handled for tax purposes.

In a quick on-line search of this topic, I noticed some adoption agencies are already touting this new distribution option, but until we have more guidance, it would be wise to move slowly with allowing this type of withdrawal.



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