

What Employers Should Know About Distributions Under the SECURE Act

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The Setting Every Community Up for Retirement Enhancement Act of 2019 (“SECURE Act”),¹ the sweeping tax legislation that was signed into law on December 20, 2019, includes provisions that amend various sections of the Internal Revenue Code of 1986, as amended (“Code”), related to tax-qualified retirement plans. This Advisory summarizes the key information that employers need to know about the following changes to the Code’s provisions related to several types of distributions from retirement plans:

- Qualified birth or adoption distributions
- Increase in the age for required minimum distributions
- Timing of distributions following death
- In-service distributions for defined benefit plans
- Prohibition of plan loans through credit cards
- Disaster relief distributions

Qualified Birth or Adoption Distributions

The SECURE Act adds an in-service withdrawal option for “qualified birth or adoption distributions” from defined contribution plans. This withdrawal provision permits an employee to take qualified birth or adoption distributions up to a total amount of \$5,000 from the defined contribution plans in the employer’s controlled group. A qualified birth or adoption distribution is a distribution to an employee during the one-year period beginning on the date on which a child of the employee is born or on which the legal adoption by the employee of an individual who is not age 18 or is physically or mentally incapable of self-support is finalized. Given that employers may provide limited benefits to cover the cost of adoption and certain expenses related to the birth of a child, employees should welcome this addition to the Code. Qualified birth or adoption distributions are available for distributions made after December 31, 2019.

¹The SECURE Act, Public Law No. 116–94, is part of the Further Consolidated Appropriations Act, 2020, available at <https://www.congress.gov/bill/116th-congress/house-bill/1865/text>.

An employee who receives a qualified birth or adoption distribution may repay that distribution by making one or more contributions to a plan in which the employee participates, up to the amount of the distribution. If the employee makes such contributions, the employee will be treated as having taken an eligible rollover distribution up to the amount of the contribution and as having transferred that amount in a direct transfer to the plan within 60 days following the distribution.

Employers that want to offer qualified birth or adoption distributions will need to amend their plans to add this new distribution feature. Additionally, employers that wish to permit repayment of these distributions may need to amend the plans' rollover provisions.

This provision of the SECURE Act raises several questions, including the following:

- Can an employee get a \$5,000 distribution for a birth and then another \$5,000 distribution for an adoption?
- Does a "qualified birth" include birth via a surrogate? The reference in the SECURE Act's definition of qualified birth to "a child of the individual" suggests that birth via a surrogate may be a "qualified birth."
- Is there a timeframe during which an employee is permitted to repay a qualified birth or adoption distribution? Since other sections of the SECURE Act expressly provide a timeframe for repayment of a distribution, it appears reasonable to assume that there is no timeframe for repayment of a qualified birth or adoption distribution; however, the distribution will have tax consequences if not repaid.
- Will an employee be permitted to self-certify that he or she is eligible for a qualified birth or adoption distribution? Given the January 2020 changes to the substantiation requirements for hardship withdrawals, the U.S. Department of the Treasury ("Treasury") may take a similar approach with these distributions.
- Is the amount of a qualified birth or adoption distribution limited by the employee's unreimbursed expenses due to the qualified birth or adoption?

Subsequent Treasury guidance will most likely address and clarify many of these issues.

Increase in Required Minimum Distribution Age

One of the better-known provisions of the SECURE Act is the amendment to Section 401(a)(9) of the Code increasing the age on which required minimum distributions ("RMDs") must begin, from 70½ to 72. The policy behind this requirement is to ensure that employees spend their retirement savings during their lifetime and do not use their retirement plans for estate planning purposes to transfer wealth to beneficiaries. However, the age 70½ maximum was first applied in the early 1960s and has never been adjusted to take into account increases in life expectancy. Given the aging baby boomers,

this increase should be welcome, although it will not apply to all baby boomers. The increase's application is limited to employees who turn 70½ after December 31, 2019.

The SECURE Act does not limit or modify the excise tax for failure to timely take a RMD. Therefore, baby boomers who turn 70½ after December 31, 2019, may want to flag their calendars now to be sure that they don't miss the deadline that their first RMD is due. Plan sponsors should ensure that they have updated their RMD procedures and plan documentation to properly address the new RMD population in their plans.

Timing of Distributions Following Death

The SECURE Act makes another change to Section 401(a)(9) of the Code by revising the required minimum distribution rules for defined contribution plans following the death of the employee, if the death occurs after December 31, 2019. The SECURE Act generally provides that distributions to designated beneficiaries must be made no later than 10 years following the end of the year in which the employee dies. Prior to the SECURE Act, a retirement plan could allow designated beneficiaries to take a distribution over the beneficiary's remaining life expectancy, which provided a significant tax advantage to these beneficiaries.

There are exceptions to the general rule. Distributions to a beneficiary who is a surviving spouse, a disabled or chronically ill individual, an individual who is not more than 10 years younger than the employee, or a child of the employee who has not reached the age of majority may be made over the life expectancy of the beneficiary. Old rules continue to apply such that if the participant died prior to his or her required beginning date, distributions to nondesignated beneficiaries must be made by the end of the fifth year following the year of the death of the participant.

Employers will need to determine if the new limits on distributions to beneficiaries will require amendments to their defined contribution plans. If plan amendments are required, the SECURE Act provides anti-cutback relief. Whether or not amendments are required, employers will need to communicate the new restrictions on distributions to employees, as they will want to be sure that their designated beneficiaries fully understand them and their distribution options.

Earlier In-Service Distributions from Defined Benefit Plans

The SECURE Act provides for an earlier minimum age for in-service distributions from qualified defined benefit plans and governmental 457(b) plans. For plan years beginning after December 31, 2019, a defined benefit plan may permit employees to take in-service distributions as early as age 59½. Currently, the earliest age for in-service distributions in a defined benefit plan is age 62 (and age 70½ in a governmental 457(b) plan). Although many defined benefit plans do not permit in-service distributions, employers with plans that do permit such distributions may welcome this change.

No Plan Loans Through Credit Cards

The SECURE Act prohibits the distribution of plan loans through credit cards or similar arrangements. The objective of this change is to preserve retirement savings by ensuring that plan loans are not used for routine or small purchases. The prohibition against the distribution of loans through credit cards is effective for loans made after the enactment of the SECURE Act. However, since plans generally do not include provisions for distributing plan loans through credit cards, this new section of the SECURE Act should have minimal impact on plans that permit participant loans.

Disaster Relief Distributions

The SECURE Act permits employees to take qualified disaster distributions up to an aggregate amount of \$100,000, which are not subject to the 10 percent early distribution tax penalty. A qualified disaster distribution is a distribution to employees who suffered losses in a “qualified disaster area” (as defined in the SECURE Act) beginning after 2017 and ending 60 days after the enactment of the SECURE Act. These distributions must be taken within 180 days of the enactment of the SECURE Act.

Employees taking a qualified disaster distribution can pay the tax on the distribution ratably over three years. Additionally, these employees generally will have up to three years to make one or more contributions to the plan in which the employee participates to repay the distribution. Special rules apply to repayment of a distribution that was intended to be used to purchase or construct a principal residence in a qualified disaster area, but which was not so used on account of the qualified disaster. An employee who repays the distribution will be treated as having received the distribution in an eligible rollover distribution and as having transferred the amount to a plan in a direct trustee transfer within 60 days of the distribution. If the employee does not repay the qualified disaster distribution, it is not treated as an eligible rollover distribution.

The SECURE Act includes disaster relief related to participant loans and loan repayments. An employee who lived in a qualified disaster area and sustained an economic loss will be eligible to take a loan of up to the lesser of \$100,000 or 100 percent of the present value of the employee’s vested account balance. Prior to the SECURE Act, a loan to an employee in a disaster area was subject to the general rule that a loan cannot exceed the lesser of \$50,000 or one-half of the employee’s vested account balance.

Additionally, the SECURE Act permits an employee to delay loan repayments until the later of one year and 180 days after the enactment of the SECURE Act (“Loan Extension Period”) and extends the maximum loan term beyond five years for general purpose loans by the Loan Extension Period. Interest accrues on the loan during the Loan Extension Period.

In order for employees to take advantage of this relief provided by the SECURE Act, employers will have to review their plans to determine the extent of the amendments

needed. Such amendments may include provisions to permit qualified disaster distributions and amendments to the plan's rollover provisions and plan loan provisions.

What Employers Should Do Now

- Begin as soon as possible to assess the impact of the changes required by the SECURE Act on your retirement plans.
- Determine which optional provisions of the SECURE Act you desire to incorporate into your plans, and address operational compliance for all applicable provisions.
- Once the above assessments and determinations are completed, begin to consult with your counsel on the timing of plan amendments, given that the Treasury may issue additional guidance.
- Consider the timing and content of employee communications and updates to the summary plan descriptions.

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