SECURE 2.0 ACT UPDATES TO PENALTY AVOIDANCE FOR EARLY RETIREMENT PLAN WITHDRAWALS

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ABSTRACT

Tax law provides for retirement accounts with tax preferences for both individual and employer sponsored plans. Because these plans are designed for retirement income, early withdrawals are subject to a 10% tax penalty, with some possible exceptions. This paper reviews exceptions to the 10% early retirement plan withdrawal penalty prior to SECURE 2.0 and describes and discusses the additional exceptions to the 10% penalty legislated by the SECURE 2.0 Act.

Keywords: Secure 2.0 Act, Retirement Plans, Early Withdrawal Penalties

INTRODUCTION

The SECURE 2.0 Act of 2022, part of the Consolidated Appropriations Act, 2023 (P.L. 17-328), made many changes to the tax law to promote employer retirement plans and encourage retirement savings. This paper explores the changes made related to exceptions to the 10% tax penalty on early retirement plan withdrawals.

The government purpose of tax-deferred retirement accounts is to encourage individuals to save for retirement. To discourage individuals from withdrawing funds from retirement accounts before retirement, withdrawals from these accounts prior to age 59½ are considered early withdrawals and are subject to a 10% early withdrawal penalty (in addition to any income tax) unless a specific exception applies. Distributions from tax-deferred qualified employer plans or traditional IRAs are taxable when the money is withdrawn from the account unless the amount is rolled over to another tax-deferred account. Distributions from accounts set up as Roth accounts, either through employer plans or as Roth IRAs, are generally not taxable. However, even early withdrawals from Roth accounts can also be subject to the 10% early withdrawal penalty under certain circumstances.

While the government has its overarching purpose to these accounts, it also recognizes the need for some limited flexibility for individuals who find themselves needing access to these funds prior to retirement. To this end, built into the tax code are exceptions to the 10% penalty. Providing these exceptions not only allows individuals penalty-free access in certain circumstances but could also lead to increased participation in tax-deferred retirement savings opportunities as individuals' reservations of locking funds up long-term are reduced. While early withdrawals are not necessarily a good idea for those saving for retirement as they reduce amounts that could grow substantially over a long working period to provide retirement income, they do provide more flexibility for individuals who meet the exceptions. If individuals do not end up needing to make early withdrawals, they may have saved more money in their retirement accounts than would have been there had they been reluctant to make retirement plan contributions.

Several of the exceptions to the 10% penalty existed prior to the passage of the SECURE 2.0 Act. However, SECURE 2.0 added several new exceptions and adjusted some that existed previously. This paper will first review the exceptions to the 10% tax penalty that existed prior to SECURE 2.0. It will then describe and discuss the new exceptions and adjustments to previous exceptions that were legislated by the SECURE 2.0 Act. This information is valuable to individuals who may otherwise be reluctant to contribute to a tax-deferred retirement account or to individuals who are contemplating early withdrawals under any of the new exceptions. This information is valuable to employers as they coordinate with plan administrators to determine which of these early distributions to allow in their plans and make appropriate plan amendments. It is also valuable to retirement plan administrators, as they will need to be ready to adjust their systems for an increasing number of early withdrawals, making sure that any tax law and plan requirements are in place to make early payouts as justified by individuals making early withdrawals.

EXCEPTIONS PRIOR TO SECURE 2.0

Internal Revenue Code (IRC) Section 72(t)(1) imposes a 10% penalty on any amount withdrawn from a qualified retirement plan which is includible in gross income. For tax-deferred accounts, this would include the entire withdrawal amount, as it is all taxable. For Roth accounts, it would only include the earnings withdrawn from those accounts if timing restrictions are not met, as the contributions are not taxable since they have already been taxed. However, IRC Section 72(t)(2) provides for several exceptions to this 10% penalty. While alternate tax code sections provide a handful of other exceptions (corrective distributions, returned IRA contributions, permitted withdrawals from plans with automatic enrollment features, and qualified in-plan Roth rollovers or eligible distributions rolled to other qualified plans on a timely basis), these other exceptions are not the focus of this paper. Instead, the exceptions in IRC Section 72(t)(2) both before and after passage of the SECURE 2.0 Act will be the focus.

Exceptions Based on Circumstances

Some of the exceptions are based on circumstances more than on a voluntary withdrawal for a specific purpose or hardship. Perhaps the most important exception is based on age—if the withdrawal is made after the plan participant or IRA owner is at least 59½ years old at the time of the withdrawal (IRC, Section 72(t)(2)(A)(i)), the withdrawal is not subject to the 10% penalty. (For a Roth IRA, the individual must also have had a Roth account open for at least five years to avoid the penalty.) By this age, the law assumes the individual is old enough to be retired, meaning the withdrawals can be considered retirement withdrawals rather than early distributions. However, there are also other age-related exceptions. If distributions are made from an employer plan to an employee who separated from service after reaching age 55, these payments are also exempt from the 10% penalty (IRC, Section 72(t)(2)(A)(v)). This last exception only applies to employer plans and does not apply to individual retirement plans. Furthermore, if the distributions are made from a governmental plan to a qualified public safety employee, the employee can separate after reaching age 50 and qualify for the exception (IRC, Section 72(t)(10)). Qualified public safety employees include those who provide police protection, firefighting services, or emergency medical services for a state or political subdivision. That category also includes the following federal employees: law enforcement officers, customs and border protection officers, firefighters, air traffic controllers, nuclear materials couriers, members of the United States Capitol Police, members of the Supreme Court Police, or any diplomatic security special agent of the Department of State.

Death or disability are also situations that allow the penalty to be avoided. Distributions made to the beneficiary(ies) or estate after the death of the plan participant or IRA owner are exempted from the 10%

penalty (IRC, Section 72(t)(2)(A)(ii)). If the individual becomes disabled, distributions are not subject to the penalty (IRC, Section 72(t)(2)(A)(iii). For this purpose, "an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration" (IRC, Section 72(m)(7)).

Other circumstances that provide an exception to the 10% penalty include the following: (1) payments to an alternate payee from an employer plan under a qualified domestic relations order (QDRO) (IRC, Section 72(t)(2)(C)), (2) payments which are "part of a series of substantially equal periodic payments. . .made for the life. . .of the employee or the joint lives. . .of such employee and his designated beneficiary," (3) distributions which are part of an IRS levy of the qualified retirement plan, and (4) dividends paid from stock owned in an employee stock ownership plan (ESOP) (IRC, Section 72(t)(2)(A)).

Exceptions for Specific Purposes

Besides the circumstances discussed above that provide exceptions to the 10% penalty on early withdrawals, there are other situations that are related more to hardships, need, or a specific purpose for which tax laws have allowed exceptions to the 10% penalty on early withdrawals from qualified retirement plans. These situations include (1) payments for medical expenses, (2) costs for health insurance premiums for unemployed individuals, (3) payments for higher education expenses, (4) costs for first home purchases, (5) distributions for reservists called to active duty, and (6) distributions in the case of a birth or adoption of a child.

Medical expenses - If retirement plan distributions are made to an individual that would qualify as a medical expense deduction, these distributions are not subject to the 10% penalty. To qualify, the medical costs would have to be unreimbursed medical expenses, and since the itemized deduction for medical expenses is only the amount that exceeds 7.5% of adjusted gross income (AGI), the retirement distribution not subject to the 10% penalty would also be subject to that same limit—the exception would only apply to the amount that exceeded 7.5% of AGI (IRC, Section 72(t)(2)(B)).

Health insurance premiums for unemployed individuals - If an individual becomes unemployed, under certain conditions, the amounts paid for health insurance premiums can be withdrawn from an individual retirement plan (not an employer plan) and be exempt from the 10% penalty on early retirement withdrawals. The individual must have received unemployment compensation for at least 12 consecutive weeks because of the separation from employment. The amount distributed from the individual retirement plan must have been withdrawn during the tax year when the unemployment compensation was received or the following tax year. Also, the amount withdrawn cannot be more than the amount paid during the tax year for health insurance for the individual, the individual's spouse, and any dependents. A self-employed person may also qualify for this exception if that individual would have received unemployment compensation had she not been self-employed (IRC, Section 72(t)(2)(D)).

Higher education expenses - Amounts paid for qualified higher education expenses can also be withdrawn from an individual retirement plan (not an employer plan) without being subject to the 10% penalty as long as the withdrawals do not exceed the qualified expenses for the taxable year, reduced by the amount of any scholarships or educational assistance provided to the student. Smith (2023) discussed the current, expanded definition of qualified higher education expenses from IRC Section 529. For purposes of this exception, the qualified higher education expenses must have been for education provided to the taxpayer,

the taxpayer's spouse, or a child or grandchild of the taxpayer or taxpayer's spouse (IRC, Section 72(t)(2)(E)).

First home purchases - Another situation when withdrawals from an individual retirement plan (not an employer plan) may avoid the 10% penalty is if the distributions are first-time homebuyer distributions. Several definitions and caveats are relevant with respect to this exception. For example, a first-time homebuyer can be anyone if "such individual (and if married, such individual's spouse)" did not have an "ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence" being acquired. So, a first-time homebuyer does not necessarily mean someone who has never owned a principal residence. Also, the distribution can be made from an individual's retirement plan on behalf of any first-time homebuyer who is that individual, the individual's spouse, or a child, grandchild, or ancestor of the individual or the individual's spouse. The aggregate lifetime amount that can qualify for this first-time homebuyer exception is $10,000 for any individual, but that aggregate limit could apply to multiple first-time homebuyers over multiple years. Qualified acquisition costs are "the costs of acquiring, constructing, or reconstructing a residence;" these costs can include reasonable settlement costs. These distributions must be used to pay for qualified acquisition costs within 120 days after the retirement plan withdrawal. If there is a delay in acquisition, the amount may be contributed back into an individual retirement plan within 120 days and be treated as a rollover contribution, still avoiding the 10% extra tax (as well as the related income tax implications) (IRC, Section 72(t)(2)(F) and Section 72(t)(8)).

Reservists called to active duty - Another exception to the 10% penalty on withdrawals from a retirement plan applies to distributions to reservists who are called to active duty. The distribution can come from an individual retirement plan or from amounts due to employer contributions "made pursuant to elective deferrals." The individual, a member of a reserve component, must be ordered or called to active duty for a period exceeding 179 days or for an indefinite period, and the distribution must be made after the date of the order and before the close of the active-duty period. No maximum amount for this type of withdrawal is provided. Also, while it is assumed that the withdrawal would relate to needs due to the call to active duty, there is no specific requirement that the withdrawal be spent for specific things as is the case for the exceptions mentioned above for medical expenses, health insurance premiums for those who are unemployed, higher education expenses, or costs of purchasing a home for a first-time homebuyer.

Interestingly, the amount of the distribution can, at the option of the individual, be repaid into an individual retirement plan for that individual in one or more contributions any time during the 2-year period following the end of the active-duty period. While no deduction is allowed for these recontributions, the dollar limits otherwise applicable to individual retirement plan contributions do not apply (IRC, Section 72(t)(2)(G)). While some of the other distributions to be discussed later allow repayments to be treated as rollover contributions, nothing is stated specifically about rollover treatment with respect to a distribution to a qualified reservist. While the distribution will not be subject to the 10% penalty, it will be subject to income taxes, and nothing is stated implying that a repayment would be treated as a rollover, so it appears that the reservist cannot reverse the taxability of the original distribution.

Birth or adoption of a child - A further exception for the 10% penalty on early retirement plan distributions was added by the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE), part of the Further Consolidations Act, 2020 (P.L. 116-94). This exception is for a qualified birth or adoption distribution. These can come from either employer plans or from individual retirement plans. The maximum amount of a distribution for any single birth or adoption is $5,000, but multiples of this

amount could apply for multiple births or adoptions. Additionally, if both spouses have retirement account, each could potentially withdraw $5,000 for each child born or adopted. The $5,000 amount is not indexed, so it will not increase unless done through further legislation. As with the withdrawals for reservists called to active duty, there is no specific requirement that the amounts withdrawn be used for costs of the birth or adoption; they could be used for other purposes.

The distribution needs to be made within one year from when the child is born or the legal adoption of the child is finalized. To qualify for this exception, the adoptee cannot be a child of the taxpayer's spouse. The adopted child must either be a minor or be physically or mentally incapable of self-support. In addition, the taxpayer must include the name, age, and taxpayer identification number (TIN) for the child born or adopted on the taxpayer's tax return for the taxable year.

A qualified birth or adoption distribution can be repaid in one or more contributions. The recontributions to an employer plan cannot exceed the eligible distributions from that plan. The repayments can only be made to a retirement plan of which the individual is a beneficiary and to which the individual can make rollover contributions. For retirement plans other than IRAs, the individual must also be eligible to make other contributions to the plan at the time of repayment. If these repayment rules are met, the recontributions are treated as rollover contributions through a direct trustee to trustee transfer within 60 days of the distribution. This seemingly implies that, although the original distribution was taxable, the repayment could reverse the taxability and allow the individual to file an amended return for the year of the distribution and remove that income from the return. However, with the 3-year rule for amending returns, the repayment would need to come within that time frame, or an amended return for the year of the distribution could not be filed.

EXCEPTIONS ADDED BY SECURE 2.0

The SECURE 2.0 Act added several more exceptions, but they do not all become effective at the same time. Some adjustments to existing exceptions were also legislated.

New Exceptions Effective Upon Enactment

Exceptions for the 10% penalty on early withdrawals were enacted by SECURE 2.0 for individuals with terminal illnesses or who take early withdrawals for costs of recovering from qualified disasters. These exceptions became effective at the time of enactment of SECURE 2.0.

Terminal illness - A new exemption from the 10% penalty for early retirement distribution was added for those who have a terminal illness. In this case, to qualify, an individual would need medical certification that the illness will be reasonably expected to result in death in 84 months or less, and the individual would need to provide sufficient documentation to the plan administrator. While repayment is perhaps less likely in this case, the law does allow repayment with rules similar to those discussed for qualified birth and adoption distributions (P.L. 117-328, Division T, Section 326). This provision became effective at the date of enactment of SECURE 2.0, December 29, 2022.

Qualified disaster recovery distributions - Qualified disaster recovery distributions are also exempt from the 10% penalty for disasters for which the incident period begins on or after 30 days after the enactment of the Taxpayer Certainty and Disaster Tax Relief Act of 2020, which was part of the Consolidated Appropriations Act, 2021 (P.L. 116-260, Division EE). The enactment date for that act was December 27,

2020. The incident period is the period specified by the Federal Emergency Management Agency as the period when the disaster occurred.

The distribution must be made on or after the first day of the incident period but before 180 days after the applicable date of the disaster. The applicable date is defined as the latest of (1) the enactment date of this exception, (2) the first day of the incident period, or (3) the date of the disaster declaration. In addition, the individual receiving the distribution must have had a principal place of abode located in the qualified disaster area during the incident period of the qualified disaster and must have suffered an economic loss because of the disaster. A qualified disaster is one that has been declared a major disaster by the President under Section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act after December 27, 2020, and the qualified disaster area is the area defined by the disaster declaration. The maximum aggregate amount an individual can claim as a qualified disaster recovery distribution for a disaster is $22,000. (The Taxpayer Certainty and Disaster Tax Relief Act of 2020 (P.L. 116-260, Division EE) had a temporary provision for early distributions from retirement plans for qualified disasters that was very similar to the now-legislated qualified disaster recovery distribution, but the aggregate limit under that provision was $100,000.)

A qualified disaster recovery distribution can be repaid within 3 years using provisions similar to those mentioned earlier for a qualified birth or adoption distribution. Perhaps because of the larger limit for this exception to the 10% penalty, the income that has to be recognized can be recognized equally over three tax years rather than all being recognized in one tax year. However, a taxpayer can elect not to use the three-year proration (P.L. 117-328, Division T, Section 331).

New Exceptions Effective Later

Three new exceptions are effective for distributions made after December 31, 2023—certain emergency expenses, pension-linked emergency savings accounts, and distributions made in case of domestic abuse. A fourth new exception is effective for distributions made at least three years after December 29, 2022, the date of enactment: qualified long-term care distributions.

Emergency expenses - Distributions for emergency personal expenses can also be exempt from the 10% penalty. These are defined as a “distribution 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.” Plan administrators are able to rely on the individual’s written certification that the distribution meets this definition.

Several rules apply to these distributions. The amount is limited to $1,000, but the distribution also cannot deplete the plan balance below $1,000. No more than one distribution can qualify in any calendar year. In addition, once a qualifying distribution is taken, no additional distribution can qualify as an emergency expense distribution in the following three calendar years unless either (1) the previous distribution has been repaid to the plan, or (2) the total amount contributed to the plan by the individual subsequent to the previous distribution is at least as large as the previous distribution that has not been repaid (P.L. 117-328, Division T, Section 115).

Emergency savings accounts - P.L. 117-328, Division T, Section 127 provides that distributions from pension-linked emergency savings accounts (PLESAs) after December 31, 2023, can also be exempt from

the 10% penalty. However, while the exception is added to IRC Section 72(t)(2)(J), the details are included in IRC Section 402A(e) along with significant amendments to multiple sections of U.S. Code, Title 29.

As with many other exceptions discussed in this paper, PLESAs have many detailed rules for eligibility, contributions, and withdrawals. Many of these details are discussed in a report from Mercer (Calloway, et. al., 2023), along with an admission that "agency guidance is needed to address a variety of key implementation issues." Some of the most significant details discussed in that report will be summarized here, but other details are beyond the scope of this paper.

Participants must meet eligibility requirements to participate in the plan to additionally enroll in a PLESA, but highly compensated employees are not allowed to participate. If someone with a PLESA becomes a highly compensated employee, no additional contributions can be made to the PLESA, but existing amounts can be withdrawn. PLESA contributions can only come from the employee, not the employer. If the employer has a match for the PLESA contributions, the match must go into the pension account, not the PLESA. Employee contributions cannot come through a transfer from the pension account.

The contributions must be made on a Roth basis, not a pre-tax basis; this coincides with all withdrawals being exempt from taxes as well as avoiding the 10% penalty for early withdrawals. PLESA balances from contributions cannot exceed $2,500 (indexed after 2024) unless the plan sponsor sets a lower limit. However, if PLESA withdrawals reduce the balance from contributions below that limit, the employee might again be able to make contributions up to the point that contributions again reach the limit. The plan cannot impose minimum contribution or account balance restrictions. PLESA contributions apparently count toward the annual maximum deferral limits; excess contributions would first be distributed from the PLESA before corrective distributions are made from the retirement plan.

Although PLESAs are designated as emergency savings accounts, participants do not need to "demonstrate any immediate financial need or provide substantiation for a withdrawal" (Calloway, et. al., 2023). Participants must be allowed to make withdrawals at least monthly, and plans cannot charge for the first four withdrawals in a plan year. However, plans can charge reasonable administrative fees for the account and can charge a reasonable amount for additional withdrawals in a plan year. A retirement plan can give participants an option to enroll in a PLESA or can have an automatic enrollment provision at a rate of up to 3% of compensation. However, with automatic enrollment, participants can opt out or select a lower contribution rate.

Domestic abuse - Distributions in case of domestic abuse made after December 31, 2023, can also be exempt from the 10% penalty. The limit for such a distribution is $10,000, but the distribution is also limited to the amount of 50 percent of the present value of the accrued benefit under the plan. The $10,000 amount will be indexed starting in 2024. The distribution must be made during the 1-year period from the date the individual is a victim of domestic abuse by a spouse or domestic partner. Domestic abuse for this purpose is defined as "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" (IRC, Sec. 72(t)(K)(iii)(II). The plan administrator can rely on the individual's self-certification of being a domestic abuse victim. As with several of the other qualifying distributions, a distribution to a domestic abuse victim can be repaid into the plan following rules similar to those cited above (P.L. 117-328, Division T, Section 314).

Long-term care - P.L. 117-328, Division T, Section 334 adds another item to the list of distributions that can be exempt from the 10% penalty—qualified long-term care distributions. However, similar to the pension-linked emergency savings accounts exception mentioned earlier, the details of long-term care distribution are not provided in Section 72(t)(2) but are instead added in Section 401(a)(39). In addition, the exemption for the 10% penalty for these distributions does not apply to distributions unless they are made more than 3 years after the enactment of P.L. 117-328, which was on December 29, 2022, so the effective date for these distributions to be exempt is later than for the other exceptions, even for the newly added exceptions that did not become effective at the date of enactment.

Paragraph 39 of Section 401(a) was added by P.L. 117-328, Division T, Section 334. It limits the amount of a qualified long-term care distribution for any taxable year, in aggregate, to the smallest of the following: (1) the amount paid for (or assessed to) the employee for certified long-term care insurance for the employee or the employee's spouse (with possible other exceptions for family members of the employee if allowed by the Secretary of the Treasury), (2) 10% of the present value of the nonforfeitable accrued benefit of the employee in the plan, or (3) $2,500. However, the $2,500 amount will be indexed after 2024, so by the time the exception for the 10% penalty becomes effective, the $2,500 amount may have increased. A long-term care premium statement needs to be filed to verify the long-term care premium costs.

Adjustments to Existing Exceptions

Returned IRA contributions, if withdrawn by the extended due date of the tax return, have been exempt from the 10% penalty, but previously, earnings on those returned contributions were not. SECURE 2.0 added an exemption for the earnings on returned IRA contributions (P.L. 117-328, Division T, Section 333).

The repayment of qualified birth or adoption distributions legislated by the SECURE Act did not have any deadline, but SECURE Act 2.0 added a three-year deadline for repayment. This repayment is still not required, but those who take these distributions can repay them but now only within the three-year period following the distribution (P.L. 117-328, Division T, Section 311). This would make sense, as reversing the taxability through repayment could only be accomplished if done in a timely manner for an amended return—three years.

An earlier discussion indicated that employees who receive retirement benefits upon separating from service after age 55 will not be subject to the 10% penalty. But qualified public safety employees who separate from service as early as age 50 can also qualify for the exemption from this 10% penalty. SECURE Act 2.0 made some adjustments to these provisions. The definition of qualified public safety employees was expanded to include corrections officers or forensic security employees (P.L. 117-328, Division T, Section 330). In addition, private sector firefighters were added as exempt from the 10% penalty if they meet the qualifications (P.L. 117-328, Division T, Section 308), which were amended to include those who are at least age 50 or who have at least 25 years of service in the plan (P.L. 117-328, Division T, Section 329).

Public Law 117-328, Division T, Section 331 discussed earlier added a qualified disaster recovery distribution exception. However, it also provided an amendment for the first-time homebuyer distribution exception. If an individual took a distribution as a first-time homebuyer but did not end up using the money for a home acquisition because the intended purchase or construction ended up being in a qualified disaster

area, the amount may be repaid with rules similar to those mentioned previously. Specific timing rules for the disaster and the recontribution apply.

DISCUSSION

The SECURE 2.0 Act increased the number of exceptions to the 10% penalty for early retirement plan withdrawals and modified some existing ones. Of course, individuals will not need to worry if they are already over 59½ at the time they make withdrawals from their retirement accounts, as retirement plan distributions after that age are not considered early withdrawals. They would therefore not be subject to the 10% penalty, with the possible exception of Roth IRA withdrawals of earnings if the individual has not had a Roth account open for at least five years.

It seems quite clear that these additional exceptions to the 10% early distribution penalty will increase flexibility for those with retirement savings plans. This flexibility may encourage individuals to start retirement savings earlier and add more to their retirement accounts than they otherwise would have because of the possibility of early withdrawals without penalty for various types of emergencies or other situations.

One question that arises is whether tax laws are making early withdrawals too easy, potentially jeopardizing long-term savings for retirement. This may be true especially if people make withdrawals that can be repaid but which are not repaid. For those distributions that can be paid back into the account(s), it may be difficult to do so, especially when repayment is not required. Time limits may help some to get a repayment made, but those same time limits may discourage others from repaying. If repayments are not made when allowed, this will reduce long-term retirement savings, which also includes the earnings that can compound over time, possibly many years.

Plans are not required to be amended to allow all of the distributions that can qualify for exceptions to the 10% penalty. Individuals may be frustrated if their plan does not allow a distribution they had expected to qualify for.

If a participant uses an early distribution for an exception where the entire distribution must be used for a specific purpose (medical expenses, health insurance premiums for those who are unemployed, first-time homebuyer, qualified higher education expenses, etc.) the distribution is still taxable, even if it is not subject to the additional 10% penalty. Where will the individual get the money to pay the taxes?

If repayments are made in a timely manner, thus qualifying for rollover status, making the original distribution nontaxable, amended tax returns would need to be filed to reclaim taxes previously paid. If the amount is repaid partially in each of the three years allowed, would amended returns have to be filed three different times for the same original tax year? What about amounts that are includable in income over three years such as for a qualified disaster recovery distribution? What if these amounts were repaid partially in each of the three years allowed? Might amended returns need to be filed for at least each of the first two years when income from the distribution was claimed?

The addition of so many exceptions to the 10% penalty adds immense complexity and complication to tax laws and implementation. In fact, more details exist for some of these exceptions than were listed above, so the complexity may be even greater than implied in the above descriptions. This is true for individuals, employers with plans, and plan administrators. One example of the complexity is for distributions from

pension-linked emergency savings accounts. With no minimum contributions or account balance, it may be hard to justify the costs of maintaining the accounts in some cases. The plan will also need to keep a lot more records, verify that distributions meet plan requirements, and make sure repayments are handled by the plan appropriately. Individuals will need to know what distributions they qualify for, and they may not understand the ramifications of taking early withdrawal distributions, including the tax consequences and repayment eligibility.

Is the increased complexity worth the increased flexibility? Will the increased flexibility really lead to more and earlier retirement contributions? Will individuals who end up taking early distributions that qualify for penalty exemption end up paying at least the value of the penalty saved in personal time and effort or in getting appropriate advice from professionals on the requirements, ramifications, and tax implications? Will they be any better off?

CONCLUSION

Withdrawals from tax-deferred retirement accounts prior to age 59½ are considered early withdrawals and are subject to an additional 10% penalty. However, exceptions to this penalty are allowed in certain circumstances. This paper has reviewed the exceptions that existed prior to the SECURE 2.0 Act and provided a description of the new exceptions legislated by the SECURE 2.0 Act, along with some adjustments to existing exceptions that were made by that act. While these exceptions certainly increase the flexibility individuals may have in withdrawing money from these accounts for specific purposes or under specific conditions, it may also result in smaller retirement savings because of the increased flexibility for early withdrawals. Even though these exceptions may provide great benefits to some individuals, they also greatly increase the complexity of the tax law for employers, retirement plan administrators, and individuals. Future empirical evidence may help us evaluate the short-term and long-term success of these legislative changes.

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