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Important Details About SECURE Act Birth and Adoption Distributions

Under the SECURE Act, more flexibility has been granted to participants who want to draw on retirement savings to help offset the cost of childbirth or adoption—though care must still be taken to avoid unnecessary taxes and fees.

By John Manganaro

The IRS last week published a detailed Q&A style guidance document meant to help retirement plan industry practitioners understand and effectively implement key provisions in the Setting Every Community Up for Retirement Enhancement (SECURE) Act.

The guidance covers topics related to the legislation, such as allowing plan participation for long-term, part-time employees in 401(k) plans; the expansion of qualified birth or adoption distributions; and the timing of related plan amendments, among other areas.

In response to the Q&A document, Barry Salkin and Livia Quan Aber, both ERISA [Employee Retirement Income Security Act] specialist attorneys with the Wagner Law Group, drafted a client alert that dives into the little-discussed topic of qualified birth or adoption distributions, which are referred to as “QBOADs.” The pair explain that QBOADs have been permissible since January, but many employers have been waiting for specific IRS guidance on how these distributions would be implemented before making a decision as to whether to include them as a plan feature.

“A QBOAD is defined under the Internal Revenue Code [IRC] as any distribution of up to $5,000 from an applicable eligible retirement plan to an individual if made during the one-year period beginning on the date on which a child of the individual is born or the legal adoption of an eligible adoptee is finalized,” the attorneys say. “Each parent is entitled to receive a $5,000 distribution (not indexed for inflation) for the same child; if there are multiple births, each parent is entitled to receive a $5,000 distribution for each child.”

As is the case for other types of distributions enabled by the SECURE Act and other pieces of recent legislation, a plan administrator may rely on a “reasonable representation” from an individual that he or she is eligible for a QBOAD.

“This is the case unless the plan administrator has actual knowledge to the contrary,” the attorneys explain. “However, a plan administrator could request a copy of the birth or adoption certificate.”

According to the Wagner attorneys, an “eligible adoptee” in this context is “an individual who has not attained age 18 or is physically or mentally incapable of self-support, but excludes a child of the taxpayer’s spouse.”

“The [new IRS guidance] clarifies that the determination as to whether an individual is physically or mentally incapable of self-support is made in the same way as a determination whether an individual is disabled under Internal Revenue Code Section 72(m)(7),” the attorneys say. “Under that section, an individual is considered disabled if he or she is unable to engage in any substantial gainful activity by reason of any medically determined physical or mental impairment that can be expected to result in death or to be of long-continued and indefinite duration.”

Similar to coronavirus-related distributions (CRDs), hardship withdrawals that were established more recently in response to the pandemic, an individual receiving a QBOAD may recontribute the money to an eligible retirement plan of which the individual is a beneficiary and to which a rollover can be made. To this end, the IRS guidance further indicates that the Treasury Department will issue regulations relating to these recontribution rules, including an issue not addressed in the SECURE Act, namely, the timing of recontributions.

As the Wagner attorneys explain, a QBOAD is includible in an individual’s gross income but is not subject to the excise tax on premature distributions, and is also not treated as an eligible rollover distribution for purposes of the IRC’s direct rollover rules, the Section 402(f) notice or the mandatory 20% withholding requirement. It is, however, subject to voluntary withholding.

“An eligible plan is not required to permit QBOADS,” the attorneys add. “If it does, the plan must be amended by the last day of the 2022 plan year; if QBOADs are added after 2022, the plan must be amended by the last day of the plan year in which the QBOAD is implemented. … If an eligible retirement plan permits QBOADs, the plan must accept a recontribution from an individual if: (i) the individual received a QBOAD from that plan, and (ii) the individual is eligible to make a rollover contribution at the time he or she wishes to recontribute the QBOAD.”

According to the Wagner attorneys’ analysis, these facts suggest that an individual who has separated from service with the employer from whose plan he or she received a QBOAD will not be able to recontribute the QBOAD to that plan. However, they will presumably be able to recontribute it to an individual retirement account (IRA). Also of note, the attorneys say, is that even if an eligible plan does not include a QBOAD feature, an individual nevertheless can elect to treat a plan distribution as a QBOAD—which an individual will likely wish to do to avoid the 10% excise tax on premature distributions.

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