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LAW ALERT
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IRS Issues Guidance on Qualified Birth or Adoption Distributions

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In 2020, most of the IRS guidance with respect to employee benefit plans has addressed issues arising under the CARES Act, but in recently issued guidance - Notice 2020-68 (Notice) - the IRS addressed several issues under the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), including participation of long-term, part-time employees in 401(k) plans, qualified birth or adoption distributions (QBOADs), and the timing of related plan amendments. The Notice also addresses a provision of the Bipartisan American Miners Act of 2019, which reduced the age for in-service distributions under tax-qualified defined benefit and money purchase pension plans from age 62 to age 59½. This Alert will focus on the QBOAD provisions of the Notice.

While QBOADs have been permissible since January 2020, many employers have been waiting for some IRS guidance on how these distributions would be implemented before making a decision as to whether to include a QBOAD as a plan feature. A QBOAD is defined under the Internal Revenue Code 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. 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. A plan administrator may rely on a reasonable representation from an individual that he or she is eligible for a QBOAD, unless the plan administrator has actual knowledge to the contrary, although a plan administrator could request a copy of the birth or adoption certificate.

An "eligible adoptee" 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 Notice 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). 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.

A tax-qualified defined contribution plan (but not a defined benefit plan), a 403(b) plan, a governmental 457(b) plan, and an IRA are types of plans eligible to permit a QBOAD.

An individual receiving a QBOAD may recontribute the QBOAD (but not more than the aggregate amount of the QBOAD) to an eligible retirement plan of which the individual is a beneficiary and to which a rollover can be made. The Notice indicates that the Treasury Department will issue regulations relating to the recontribution rules, including an issue not addressed in the SECURE Act, namely, the timing of recontributions. 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 Code's direct rollover rules, the Code 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. 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. A plan authorizing QBOADs may expand its distribution options to permit distributions of elective deferrals, qualified matching contributions, and qualified nonelective contributions prior to the date when they would otherwise have been allowed to be distributed. 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. Therefore, 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, but presumably will be able to do so to an IRA. Even if an eligible plan does not include a QBOAD feature, an individual can elect to treat a plan distribution as a QBOAD, which he or she might wish to do to avoid the 10% excise tax on premature distributions.

The guidance in Notice 2020-68 is not intended to be comprehensive, and issues not addressed include whether a plan sponsor can limit QBOADs to expenses related to the birth or adoption, and whether it can impose a lesser dollar limit than $5,000.

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