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SECURE 2.0 Adds New Early Withdrawal Exceptions

Withdrawals covered by these new exceptions can be repaid within three years.

The SECURE 2.0 Act, passed as part of an omnibus spending bill in December 2022, added new exceptions to the 10% federal income tax penalty for early withdrawals from tax-advantaged retirement accounts. The Act also expanded an existing exception that applies specifically to employer plans. These exceptions are often called 72(t) exceptions, because they are listed in Section 72(t) of the Internal Revenue Code.

The 10% penalty tax generally applies to withdrawals prior to age 59½ from IRAs, employer-sponsored plans [such as 401(k) and 403(b) plans], and traditional pension plans, unless an exception applies. The penalty is assessed on top of ordinary income taxes.

New exceptions

Here are the new exceptions with their effective dates. Withdrawals covered by these exceptions can be repaid within three years to an eligible retirement plan. If repayment is made after the year of the distribution, an amended return would have to be filed to obtain a refund of any taxes paid.

- **Disaster relief** — up to $22,000 for expenses related to a federally declared disaster if the distribution is made within 180 days of the disaster occurring; included in gross income equally over three years, beginning with the year of distribution, unless the taxpayer elects to report the full amount in the year of distribution (effective for disasters on or after January 26, 2021)
- **Terminal illness** — defined as a condition that will cause death within seven years as certified by a physician (effective 2023)
- **Emergency expenses** — one distribution per calendar year of up to $1,000 for personal or family emergency expenses to meet unforeseeable or immediate financial needs; no further emergency distributions are allowed during the three-year repayment period unless the funds are repaid or new contributions are at least equal to the withdrawal (effective 2024)
- **Domestic abuse** — the lesser of $10,000 (indexed for inflation in future years) or 50% of the account value for an account holder who certifies that he or she has been the victim of domestic abuse (physical, psychological, sexual, emotional, or economic abuse) during the preceding one-year period (effective 2024)

Expanded exception for employer accounts

The 10% penalty does not apply for distributions from an employer plan to an employee who leaves a job after age 55, or age 50 for qualified public safety employees. SECURE 2.0 extended the exception to public safety officers with at least 25 years of service with the employer sponsoring the plan, regardless of age, as well as to state and local corrections officers and private-sector firefighters.

Previously established exceptions

These exceptions to the 10% early withdrawal penalty were in effect prior to the SECURE 2.0 Act. They cannot be repaid unless indicated. Exceptions apply to distributions relating to:

- Death or permanent disability of the account owner
- A series of substantially equal periodic payments for the life of the account holder or the joint lives of the account holder and designated beneficiary

- Unreimbursed medical expenses that exceed 7.5% of adjusted gross income
- Up to $5,000 for each spouse (from individual accounts) for expenses related to the birth or adoption of a child; can be repaid within three years to an eligible retirement plan
- Distributions taken by an account holder on active military reserve duty; can be repaid up to two years after end of active duty to an individual retirement plan
- Distributions due to an IRS levy on the account
- (IRA only) Up to $10,000 lifetime for a first-time homebuyer to buy, build, or improve a home
- (IRA only) Health insurance premiums if unemployed
- (IRA only) Qualified higher education expenses

These exceptions could be helpful if you are forced to tap your retirement account prior to age 59½. However, keep in mind that the greatest penalty for early withdrawal from retirement savings may be the loss of future earnings on those savings. Some employer plans allow loans that might be a better solution than an early withdrawal.

Retirement account withdrawals can have complex tax consequences. Consult your tax professional before taking specific action.
