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RE: Request for Guidance and Relief Regarding Qualified Birth and Adoption Distributions

Dear Ms. Weiser and Mr. Tackney:

On behalf of the SPARK Institute, we are writing to provide input on guidance needed with respect to section 113 of the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act"), which was incorporated as Division O of the Further Consolidated Appropriations Act, 2020. Section 113 addresses qualified birth or adoption distributions ("QBADs") from a retirement plan or IRA.

We sent a letter on December 31, 2019, which focused on immediate needs for guidance and relief with respect to the SECURE Act. Our previous letter included three requests with respect to section 113, which are reiterated in this letter. What has become apparent since the passage of the SECURE Act is that, of all the provisions, **section 113 is in most need of immediate substantive guidance**. SPARK members are receiving repeated inquiries from plan sponsors and participants about whether a QBAD is available. SPARK members have unfortunately been unable to program systems for QBADs because of the many unanswered questions about how the provision works. Accordingly, we recommend that guidance be released as soon as possible in the form of a Q&A Notice that provides preliminary guidance on the issues described in this letter. While we appreciate that a formal regulatory project may be necessary, we believe that guidance that can be relied upon until a regulation is issued is critical. Otherwise, participants in plans either will not have access to these distributions, as Congress intended, or plans will be forced to administer the provision without guidance.

Section 113 of the SECURE Act provides that "qualified birth or adoption distributions" from a retirement plan or IRA: (a) can be distributed regardless of whether an in-service distribution is otherwise permitted; (b) are exempt from the 10% early distribution tax penalty; (c) are exempt from the mandatory 20% withholding and 402(f) notice otherwise required when distributed from a retirement plan; and (d) may be repaid to certain retirement plans and IRAs

without regard to the usual 60-day time limit for rollovers. There is a per-taxpayer $5,000 cap per birth or adoption. This provision is effective for distributions made after December 31, 2019.

I. Confirmation of Certain Issues

SPARK members have received multiple questions about section 113 that we believe are addressed in the statute, or can be answered based on longstanding principles regarding plan design. Because these issues are so important, however, we recommend that you confirm them in guidance:

A. Optional plan provision. Section 72(t)(2)(H)(vi)(IV) allows for an in-service distribution of a QBAD because it provides that a QBAD shall be treated as meeting the requirements of sections 401(k)(2)(B)(i), 403(b)(7)(A)(ii), 403(b)(11), and 457(b)(1)(A), all of which generally restrict in-service distributions. Please confirm that a plan generally may make available QBADs even if the participant does not otherwise have a distributable event. However, like all in-service distributions, please confirm that it is optional for a plan to offer QBADs as an in-service distribution. Finally, please confirm (similar to the recent guidance on CARES Act distributions), that even if a plan does not treat a distribution as a QBAD, the individual can still treat the distribution as a QBAD on his or her tax return.

B. Reasonable restrictions on QBADs. A plan generally may impose conditions and restrictions on distributions that are more restrictive than the conditions imposed by section 72(t)(2)(H), as long as doing so does not violate another provision of the Code (or other law). Please confirm that a plan may impose administrative restrictions on QBADs to the same extent as it may do so with respect to other types of distributions. For example, a plan may impose a reasonable minimum withdrawal amount (e.g., $100) with respect to a QBAD that is made available under the plan. Similarly, a plan may, for example, provide the maximum QBAD is limited to a dollar amount lower than $5,000 (e.g. $1000) and a plan may limit the distributions that are treated as QBADs to distributions for participants who have not separated from service. Finally, some plans provide that a participant may not take an in-service distribution of employer contributions until the participant has been employed for five years, and/or restrict distribution of contributions made in the previous 24 months. We believe that all of these restrictions can be imposed on QBADs.

C. Restrictions by contribution source. Please confirm that, similar to other in-service distributions, a plan may allow QBADs from some contribution sources, but not others. For example, a plan could offer QBADs from elective deferral and matching contribution sources, but not allow QBADs from a Roth contribution source and may limit QBADs to sources that are fully vested.

D. Per child. Section 72(t)(2)(H)(ii) provides that the aggregate amount that may be treated as a QBAD "with respect to any birth or adoption shall not exceed $5,000." Section 72(t)(2)(H)(iv)(I) provides that a plan is not treated as failing to meet any requirement

under the Code "merely because the plan treats the distribution as a qualified birth or adoption distribution, unless the aggregate amount of such distributions from all plans maintained by the employer (and any member of any controlled group which includes the employer) to such individual exceeds $5,000." Please confirm that the $5,000 amount applies per child in the case of multiple births (e.g., the birth of twins) or in the case of a multiple adoptions.

E. Per parent. Similarly, because the $5,000 limit is tied to the child of an individual, please confirm that the $5,000 amount applies separately to each parent (other than in the case of an individual that adopts the child of his or her spouse).

F. Grandparents, etc. excluded. Section 72(t)(2)(H)(iii)(I) defines a QBAD by reference to a "child of the individual." Please confirm that QBADs apply only to the parent of the child, not to other relatives such as grandparents, unless the other person legally adopts the child. In addition, please confirm whether or not an individual with temporary or permanent legal custody of a child may qualify for a QBAD.[1]

G. Total across plans and IRAs. Please confirm that the $5,000 amount is the maximum for a parent per child, across all the plans and IRAs of the parent. Per section 72(t)(2)(H)(iv)(I), quoted above, please confirm that a plan is not required to inquire about QBADs distributed from other plans or IRAs, except with respect to other plans in the same controlled group and that an IRA trustee or custodian is not required to confirm or monitor the $5,000 limit across more than one IRA of the parent. If a participant exceeds the $5,000 limit across multiple accounts, then any excess is treated as not being a QBAD and thus subject to the 10% penalty (unless another exception applies). Finally, please confirm that if the participant withdraws more than $5,000 across the plans of two unrelated employers, neither plan is disqualified and neither plan needs to take any further action as long as each plan, individually, complies with the $5,000 limit.[2] Please also confirm if any special rules apply, or are available, to multiple-employer plans.

H. Amount of distribution. We read the provision to provide that the $5,000 distribution is the maximum amount. Please confirm that a participant may not distribute an additional amount above $5,000 to pay the income tax that may be due.

I. Distribution after birth or adoption. Section 72(t)(2)(H)(iii)(I) provides that a QBAD is a distribution made "during the 1-year period beginning on the date on which a child of the individual is born or on which the legal adoption by the individual of an eligible adoptee is finalized." Please confirm that, in order to qualify, the distribution must occur *after* the birth or adoption.

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[1] For example, it is not unusual for a relative of a child to have temporary custody or guardianship of the child after his or her birth, because the parents are unable or unwilling to care for the child.

[2] In addition, plan administrators have no responsibility for "failed" QBADs (that is, distributions intended to qualify as a QBAD when made but subsequently determined to not qualify as a QBAD due to fraud or otherwise), if such distribution was made without knowledge of fraud by the plan administrator.

J. Money purchase plan. Section 72(t)(2)(H)(vi)(I) defines applicable eligible retirement plan as "an eligible retirement plan (as defined in section 402(c)(8)(B)) other than a defined benefit plan." Please confirm that distributions from a money purchase plan may qualify as QBADs (but see below regarding in-service distributions prior to the earlier of normal retirement age or 59 ½).

K. Rollover eligible. Section 72(t)(2)(H)(vi) states that for "purposes of sections 401(a)(31), 402(f), and 3405, a qualified birth or adoption distribution shall not be treated as an eligible rollover distribution." Notably absent from this list is a reference to section 402(c), which provides for tax-free rollovers from plans to IRAs or other plans. Accordingly, it appears that a QBAD is *eligible* for an indirect rollover, even though the plan is not required to offer a direct rollover under section 401(a)(31). Note that the issue to be confirmed here is solely related to ordinary rollovers, not the repayment rules addressed in the next section.

L. Roth. Please confirm that a QBAD may be taken from a designated Roth account and a Roth IRA, and that the relief from the 10% penalty will apply to the extent the distribution is not a qualified distribution and the 10% penalty would otherwise apply.

M. 457(b) Plans. Please confirm that a QBAD may be taken from a governmental 457(b) plan, but may not be taken from a non-profit 457(b) plan.

II. Issues Regarding Repayments

Many of the issues for which there is considerable uncertainty involve the provisions of new section 72(t)(2)(H)(v) that relate to the "repayment" of a QBAD.

A. Optional or required. Is a plan required to accept repayment of QBADs? Does the answer change if the plan has been specifically amended to adopt in-service QBADs? Does the answer change if the original QBAD did not come from the same plan?

> **Recommendation:** No repayments are required to be accepted if a plan does not allow rollovers generally. Further, no repayments are required to be accepted even where the plan would accept a rollover contribution from the participant.[3] Further, pursuant to section 72(t)(2)(H)(v)(II), a plan may not accept repayment of QBADs from another plan. Note that, if a plan changes recordkeepers, the documentation for QBADs made in prior years may not be preserved; a plan should not be expected to keep this information forever.

[3] We appreciate that the Joint Committee description states: "If an employer adds the ability for plan participants to receive qualified birth or adoption distributions from a plan, the plan must permit an employee who has received qualified birth or adoption distributions from that plan to recontribute only up to the amount that was distributed from that plan to that employee, provided the employee otherwise is eligible to make contributions (other than recontributions of qualified birth or adoption distributions) to that plan." However, the statute itself does not explicitly state that any plan must accept repayments.

B. Repayments from IRA: Can a plan accept repayments of a QBAD made from an IRA?

> **Recommendation:** No. Pursuant to section 72(t)(2)(H)(v)(II), a plan cannot accept repayments from an IRA.

C. Repayment documentation. Is any documentation required to accept a QBAD repayment?

> **Recommendation:** Per our prior comments, we do not believe any documentation is required for QBADs from other plans or IRAs because a repayment is not allowed in that case. With respect to repayments from the same plan, the plan administrator can rely on a participant's certification.

D. Time limit. Because the statute does not appear to impose a time limit on repayments, difficult issues could arise if a QBAD repayment is accepted many years after the original distribution. Can a plan impose a time limit on QBAD repayments, such as only allowing repayments within the same taxable year or within three years?

> **Recommendation:** A plan can impose time limits on QBAD repayments. In addition, we recommend the IRS consider whether it has the authority to impose a time limit (*e.g.* six years) that applies in all cases.

E. Basis (non-Roth). Section 72(t)(2)(H)(v)(III) provides that in the case of a repayment of a QBAD, "the taxpayer shall, to the extent of the amount of the contribution, be treated as having received such distribution in an eligible rollover distribution (as defined in section 402(c)(4)) and as having transferred the amount to the applicable eligible retirement plan in a direct trustee to trustee transfer within 60 days of the distribution." This section is very confusing, for a number of reasons. First, it refers to a "direct trustee to trustee transfer," that is, a direct rollover, but also refers to the 60-day rule, which is an indirect rollover. In addition, the point of an indirect rollover is that the distribution is transferred tax-free. This is only possible if it occurs quickly, because then the taxable income is not reported on the tax return for the year of the distribution.

From the plan's perspective, how must a repayment of a QBAD be tracked for purposes of basis? SPARK's members are very concerned about the possibility of needing to determine what portion of a QBAD repayment is considered after-tax and what portion should be tracked as pre-tax (similar to a rollover of pre-tax amounts), especially because the receiving plan would have no information about how the distribution was reported on the participant's tax return in the year of distribution or the year of repayment. It will be very difficult for a plan administrator to know the original character of a QBAD repayment in many (and probably most) cases. This will also be an issue if the participant had multiple QBADs in prior years.

Recommendation: Some SPARK members recommend that all QBAD repayments should be treated as after-tax contributions[4] and, to the extent a QBAD was made from a Roth contribution source or Roth IRA, any repayment of such QBAD is disregarded for purposes of determining the tax basis of any other Roth contributions under the plan or Roth IRA. Other SPARK members felt that all QBAD repayments should treated as pre-tax (unless from a Roth or after-tax source) and thus should be taxable when later distributed, even if the participant cannot take a deduction or exclusion for the original taxable income generated when the QBAD occurred. This is what the statute appears to be driving at, although certainly not clearly. Another alternative that SPARK members suggested is that if a distribution is (a) repaid within the same year, then the distribution would be treated as non-taxable and the repayment would be treated as pre-tax or (b) if repaid in a year after the year of distribution, the distribution would be treated as taxable and the repayment as after-tax.

As we have discussed this provision among the SPARK membership, one thing becomes clear. There does not appear to be any approach that is (a) consistent with the natural reading of the statute, (b) prevents double taxation in all cases, and (c) is practical to administer from the plan's perspective in a way that the plan always knows that it tracked the repayment correctly.

F. Roth amounts. Can a plan accept repayment of a QBAD that was originally distributed from a designated Roth account? If yes, how should this be tracked?

Recommendation: If permitted, the amount should be tracked as if it were a direct rollover from another plan's designated Roth account. A plan administrator may rely on the plan records, if available, to determine the amount of basis, should the employee later take a nonqualified distribution.

G. Distribution restrictions. If a participant makes a repayment of a QBAD to a plan, is the amount subject to the distribution restrictions that applied to the amount previously?

[4] The thinking behind this approach might proceed as follows. Typically, we think of "direct rollovers," which include "direct trustee to trustee transfers" for purposes of Code section 401(a)(31), separately from eligible rollover distributions that are rolled over by the recipient within 60 days. Direct rollovers are reported on Form 1099-R with a taxable amount of zero and no withholding. Eligible rollover distributions are reported as a taxable distribution with 20% withholding (regardless of whether or not they are rolled over within 60 days). Given the ambiguity, the best (or, at least, preferred) interpretation from the plan's perspective would be to treat the "taxpayer as having received such distribution as an eligible rollover distribution," which would result in the distribution being reported as taxable but not subject to 20% withholding by reason of the exemption under Code section 72(t)(2)(H)(vi)(II) and the statutory provision. The remaining language – "and as having transferred the amount to the applicable eligible retirement plan in a direct trustee to trustee transfer within 60 days of the distribution" – should be read from the plan's perspective as describing an "indirect rollover." Under this theory, the funds go into the plan's rollover source, perhaps as an after-tax amount, rather than undoing the previous tax treatment of the distribution. Otherwise, unless this all occurs in the same year, the individual must amend a prior return, which is not possible after three years, to avoid double taxation.

Recommendation: No. The amount should be treated like a rollover contribution and distributable under the plan's rules for rollover contributions.

H. Participant income tax return. The IRS will need to provide instructions regarding the reporting of a QBAD repayment on an individual's tax return. We assume that a form similar to Form 8915 will need to be created. If all repayments are treated as after-tax as recommended per the comments above, special instructions/reporting on the individual's tax return would not appear to be necessary. In any event, a plan administrator will have no way of knowing whether a participant will properly report a QBAD, or a QBAD repayment, on his or her tax return at the time the QBAD repayment is processed.

Recommendation: A plan administrator has no responsibility (and the plan cannot be disqualified) with respect to participant tax reporting or lack thereof, or the plan administrator can rely on a representation that proper tax reporting will be made by the participant.

I. Form 5498 reporting. How should a QBAD repayment to an IRA be reported on Form 5498?

Recommendation: The 2020 Form 5498 instructions provide that the amount of a QBAD repayment is reported in Box 14a with the Code BA in Box 14b. This is an acceptable answer, so long as the IRA trustee, custodian, or issuer can rely on a representation from the IRA owner that the amount is a valid QBAD repayment.

J. One rollover per year rule. Is a QBAD repayment treated as a rollover for purposes of the one rollover per year rule that applies to IRAs under Code section 408(d)(3)(B)?

Recommendation: No, a QBAD repayment is not treated as a rollover for purposes of the one rollover per year rule.

III. Other Issues and Questions

A. Form 1099-R reporting. How should a QBAD be reported on Form 1099-R? Does the answer change if the plan has been amended to allow for in-service QBADs?

Recommendation. No special reporting is required. As provided in the 2020 Form 1099-R instructions, the distribution should be reported using Code 1 (Early distribution, no known exception) in Box 7 to report any distribution to a participant who is younger than age 59½.[5] The answer does not change if the plan allows for in-service QBADs.

[5] The 2020 Form 1099-R instructions could be read to imply that Code 1 should always be used for any QBAD. However, we believe that if another code applies it should be used, such as Code 2 (because the individual has reached age 59 ½ or if the distribution is after separation from service after reaching age 55).

B. Sources for Distribution. What contribution sources are eligible for an in-service QBAD?

> **Recommendation:** With one exception, a plan may allow an in-service QBAD from any contribution sources, including elective deferrals, designated Roth contributions, after-tax contributions, rollover contributions, employer matching and profit-sharing contributions, safe harbor employer contributions, QNECs and QMACs, all amounts held in a 403(b) annuities and custodial accounts, and governmental 457(b) plans. The only exception is that a money purchase plan may not distribute QBADs prior to the earlier of: (a) the plan's normal retirement age; or (b) the date specified in the plan's provision implementing Code section 401(a)(36) (that is, age 59½). As noted earlier, we believe it is clear that a plan could allow QBADs from only a subset of eligible contribution sources.

C. Anti-cutback relief. If a plan adds a feature allowing QBADs as in-service distributions, is that feature protected by the anti-cutback rule or can the plan later be amended to remove the in-service distribution?

> **Recommendation**: Similar to hardship distributions,[6] a plan should be able to remove this in-service distribution without violating the anti-cutback rule.

D. Deadline for distribution. Section 72(t)(2)(H)(iii)(I) provides that the distribution must be made "during the 1-year period beginning on the date" of birth or finalization of legal adoption. How is this deadline applied?

> **Recommendation:** The one-year period ends on the date that is the one-year anniversary of the birth or finalization of legal adoption. For example, if a birth occurs on September 21, 2020, the distribution must occur no later than September 21, 2021. Further, the distribution is deemed to occur on the date that the plan's records shows that the distribution request was made pursuant to the plan's policies and procedures. In addition, we recommend the IRS consider providing guidance on the date that an adoption is "finalized."

E. Birth or adoption before effective date. If the birth or adoption occurred before the effective date (January 1, 2020), but the distribution from the plan or IRA occurs after the effective date within one year of the birth or adoption, is the distribution eligible to be treated as a QBAD?

> **Recommendation:** Because the effective date applies to distributions on or after January 1, 2020, the distribution need only occur within one year of the birth or adoption as long as the distribution occurs on or after January 1, 2020. One

[6] Treas. Reg. section 1.411(d)-4, Q&A-2(b)(2)(x). An amendment to the regulations under section 411(d)(6) may be required to ensure this relief also applies under ERISA's anti-cutback rule.

SPARK member pointed out that in light of the lack of guidance and the need to deal with the CARES Act, plans and their providers have been unable to implement or support QBADs in early 2020. Accordingly, the IRS might consider providing a special extension of the one-year deadline for births or adoptions occurring in 2019, especially in light of COVID-19 complications.

F. Documentation. In the case of a plan that allows for in-service QBADs, what documentation should be collected by the plan administrator?

Recommendation: In general, we believe that no documentation should be required because the SECURE Act already requires a participant or IRA owner to provide certain information on his or her tax return; had Congress wanted plans to collect this information or other documentation, it could have said so. In addition, plans generally do not require documentation for similar "family information," such as proof that a spouse is truly a spouse or that an individual is a dependent for tax purposes. If, however, the IRS decides to require documentation of some kind, the IRS should follow its new procedures for substantiating that a hardship distribution is deemed to be on account of an immediate and heavy financial need. These new rules, incorporated into the Internal Revenue Manual,[7] allow the plan to collect certain information, make certain disclosures, and have the participant agree to keep source documents. We suggest similar procedures might apply here if documentation is required. For example, the plan administrator might collect, in the case of a birth, the name of the child and the date of birth. (A TIN should not be required and might delay distribution.) The plan administrator would then have the participant agree that he/she will maintain the child's birth certificate to be produced upon request.

G. Source of support. The term "eligible adoptee" includes an individual over age 18 who is "physically or mentally incapable of self-support." How is this determined?

Recommendation: As noted above, we believe that plans should not be required to obtain proof that an adoptee meets the standard to be an eligible adoptee. However, for purposes of the participant determining his or her eligibility, guidance may be helpful. For example, it may be helpful to confirm that this is determined similar to the definition in Code section 23(d)(2)(B) (relating to deductions for adoption expenses) or Code section 21(b)(1)(B) (relating to deductions for dependent care).

H. Withholding. Assume that a plan does not allow an in-service QBAD, but a participant is eligible for a distribution for another reason (e.g., termination of employment). Under what circumstances must the plan treat the distribution as a QBAD for purposes of withholding, the requirement to offer a direct rollover, and the requirement to provide a 402(f) notice?

[7] I.R.M. 4.72.2.7.4.1.

Recommendation: A plan that contains no special provisions for QBADs is not required to determine whether a distribution is a QBAD and may impose normal withholding. In addition, a plan permitting QBADs is not required to treat a distribution as a QBAD unless it is designated as such pursuant to the plan's policies and procedures.[8]

I. Interaction with hardship rules. Under current regulations, an individual must take all other available distributions before a hardship distribution can be made. Does this include QBADs, if allowed by the plan?

Recommendation. A participant is not required to take a QBAD before requesting a hardship distribution and a plan administrator need not verify that a participant is not eligible for a QBAD before processing a hardship distribution request. (However, to the extent that the distribution does qualify as a QBAD, the participant is eligible for relief from the 10% penalty.)

J. Safe harbor plans. What impact does adding a QBAD have on safe harbor plans? Can it be added mid-year?

Recommendation. A QBAD can be added mid-year even though the distribution right was not described in the safe harbor notice (which applies only to plans using matching contributions because of the SECURE Act). In addition, adding a QBAD mid-year should not require redistribution of the safe-harbor notice. Even though the safe harbor notice did not describe the distribution, participants are not *harmed* with respect to the contribution decisions they would have made based on the safe harbor notice.

K. Deadline for adoption of plan amendment. Because the offering of an in-service QBAD distribution is optional, what is the deadline for adopting plan amendments?

Recommendation: Section 601 of the SECURE Act applies, because this is an amendment made pursuant to an amendment made by the SECURE Act. The rules regarding "discretionary" amendments for individually designed plans, and "interim" amendments for pre-approved plans, do not apply. Thus, the amendment deadline in the case of non-governmental, non-collectively bargained plans is no earlier than the last day of the first plan year beginning on or after January 1, 2022.

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[8] If the IRS disagrees and determines that 20% withholding can be waived even when a plan does not contain a QBAD provision, then as noted in our December 31, 2019 letter, relief will be needed because of the immediate effective date of the provision.

The SPARK Institute appreciates your efforts to provide guidance as quickly as possible on section 113 of the SECURE Act. Please contact the SPARK Institute's outside counsel, Michael Hadley, Davis & Harman LLP (mlhadley@davis-harman.com or 202-347-2230) with any questions.

Sincerely,

Tim Rouse
Executive Director