NEW SECURE 2.0 10% PENALTY EXCEPTIONS: DOMESTIC ABUSE & FINANCIAL EMERGENCIES

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SECURE 2.0 includes a number of new ways a person under the age of 59 ½ can access retirement account dollars while avoiding the 10% penalty. Historically, there have been more than a dozen ways to sidestep the extra charge. Things like first-time homebuyer costs, higher education costs and disability are all legitimate exceptions to the early distribution penalty. While taxes could still apply, the 10% penalty is off the table for eligible distributions. Here are two of the new "penalty-free access points" to both IRA and company plan retirement accounts made available in SECURE 2.0:

Domestic Abuse. Sadly, domestic abuse is a common enough occurrence that it was included as a 10% penalty exception. Effective in 2024, a new exception is created for victims of domestic abuse that occurred within the previous 12 months by a spouse or domestic partner. Those in need of leveraging this exception can self-certify that they experienced domestic abuse and withdraw the lesser of $10,000, indexed for inflation, or 50 percent of the balance of the account.

This new exception is applicable to plans - like a 401(k) - and IRAs. "Domestic abuse" 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. Distributions taken under the domestic abuse exception can be repaid to the same or another like account over 3 years, and income taxes on repaid dollars will be refunded.

Financial Emergencies. In court case after court case, defendants pleaded for mercy when it came to waiving the 10% penalty after they withdrew their retirement dollars early. Consistently the same tune is played: “It was a true emergency,” or, “I was in dire straits and needed emergency money.” While I no doubt believe many of these defendants, the tax courts have consistently avoided setting any precedent for early access. Time after time the courts have declined any sort of one-off waiver. SECURE 2.0 cracks the door, albeit slightly, to those in need of emergency funds.

Effective in 2024, the new legislation includes a 10% penalty waiver for financial emergencies. However, this exception is extremely limited. Yes, if a person faces unforeseeable personal expenses or immediate financial needs relating to a personal or family emergency, they may dip into savings. Yes, the account owner can self-certify that the emergency is real. (No need for an independent financial analysis.) But the dollar amount is limited.

Distributions using the financial emergency exception are limited to one per calendar year and a maximum amount of $1,000. Additionally, no other emergency distributions may be taken in the following three years, or until the original distribution is repaid, or future salary deferrals (for plans) or contributions (for IRAs) meet or exceed the amount of the emergency personal expense distribution. This means that the retirement account must be made whole before any future emergency distributions using the exception can be taken.

$1,000 is no windfall, but it could help a person keep their head above water.