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Ms. Helen Morrison
Benefits Tax Counsel
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Ms. Rachel Leiser Levy
Associate Chief Counsel (EEE)
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Delivered via the Federal eRulemaking Portal at www.regulations.gov

RE: Notice 2024-55, Certain Exceptions to the 10 Percent Additional Tax Under Code Section 72(t)

Dear Ms. Morrison and Ms. Levy:

I am writing in response to the government's request for comments stated in **Notice 2024-55**.

I am a financial planner[1] and I advise clients concerning tax-advantaged retirement accounts. I wrote a book, Solo 401(k): The Solopreneur's Retirement Account, in 2022 addressing Solo 401(k)s. I blog about tax planning and financial independence at fitaxguy.com. An unsigned copy of this comment letter will be posted to fitaxguy.com on August 1, 2024.

In January 2024 I wrote a broader comment letter on SECURE 2.0.[2] Proposals 1, 3, 4, and 5 below echo that comment letter to a significant degree.

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[1] The views stated herein are solely those of the author. They are not the views of any current or former employer of the author and they are not the views of any of the clients of my financial planning firm.

[2] A PDF version of that comment letter is available at https://fitaxguy.com/secure-2-0-comment-letter/.

References to “Section” below are to the Internal Revenue Code. References to “SECURE 2.0 Section” are to the section number of the provision within the SECURE 2.0 bill text.

Proposal One: Issue a Safe Harbor List of Emergencies That Qualify as Emergencies Under SECURE 2.0 Section 115

SECURE 2.0 Section 115 authorizes penalty free distributions of up to $1,000 as an “emergency personal expense distribution” (an “EPED”). Emergency personal expense distributions can also be repaid to a retirement account within three years of the distribution.

Notice 2024-55 EPED Question and Answer 2 is a very good start when it comes to rules for EPED qualification. I recommend that regulations or other guidance keep the factors listed in Q&A 2 and add a safe harbor list of emergencies that make one eligible to take an EPED without any further inquiry. I recommend the EPED Safe Harbors include:

- The taxpayer, their spouse, or their dependent has unreimbursed expenses or a loss of $400 or more involving any of the following: injury, illness, accident, car repair, home repair, or theft.
- The death of a spouse or dependent.
- An involuntary job loss that can be reasonably expected to reduce W-2 income by at least $400 over the next 30 days.
- A reduction in self-employment or W-2 income of at least 30% from the prior taxable year.
- Any situation reasonably described as an emergency as long as it causes at least $400 of (i) a loss of income or (ii) unreimbursed expenses or losses.

For this purpose, a loss should include liabilities to third parties occurring due to the event.

Guidance should also provide that meeting the requirements of an EPED Safe Harbor allows an EPED of up to $1,000 regardless of the actual expense, income reduction, or loss involved in the safe harbor event. For example, if a taxpayer has a $450 car repair, he or she can take an EPED of any amount up to $1,000.

EPEDs are intended to be beneficial to taxpayers. This is not an area that should cause significant disputes between the IRS and taxpayers. Treasury and the IRS should write regulations under SECURE 2.0 Section 115 to reduce uncertainty and reduce potential disputes between taxpayers and the IRS. EPED Safe Harbors are a great way to do just that.

Proposal Two: Repayment Guidance to Account for Significant SECURE 2.0 Uncertainty

As a result of Judge James W. Hendrix's opinion in *Texas v. Garland*[3] on February 27, 2024, there is now significant doubt as to the validity of SECURE 2.0.

The opinion invalidated certain Omnibus bill provisions as applied to the State of Texas. Judge Hendrix determined that the Omnibus bill's purported passage in the House of Representatives occurred at a time the House did not have a sufficient quorum under the Quorum Clause to enact legislation.

The convincing reasoning of Judge Hendrix's opinion applies equally to SECURE 2.0, a component of the Omnibus. SECURE 2.0 Section 603 increases taxes on many Americans aged 50 and older by denying their catch-up contribution exclusions for contributions to workplace retirement plans such as 401(k)s.[4] Thus, there will be plenty of workers and employers with incentive to sue the federal government to invalidate SECURE 2.0. Judge Hendrix's opinion makes clear that these future litigants have a significant possibility of success in court.

This uncertainty surrounding SECURE 2.0 provides taxpayers with a significant disincentive to use the **repayment provisions**, including EPEDs. If a taxpayer uses a SECURE 2.0 repayment provision (SECURE 2.0 Sections 115, 314, 326, and 331) and SECURE 2.0 is invalidated, the repayment into a retirement account can become an excess contribution to a retirement account subject to excess contribution penalties.[5]

Regardless of the government's views, *Texas v. Garland* has now made availing oneself of the repayment provisions a risky proposition.

Assuming, for the purposes of this comment letter, that the federal government is still of the view that SECURE 2.0 is valid, **the IRS and Treasury should issue binding guidance, as soon as possible, protecting SECURE 2.0 qualified distributions and repayments.**

In that binding guidance **the government should exercise its authority under Sections 402(c)(3)(B) and 408(d)(3)(I) and waive the 60-day requirement** with respect to rollovers for

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[3] Available at https://caselaw.findlaw.com/court/us-dis-crt-n-d-tex-lub-div/115886384.html.

[4] SECURE 2.0 Section 603 disqualifies many taxpayers from contributing catch-up contributions to traditional workplace retirement plans. Denying taxpayers the exclusion from income they are otherwise entitled to increases their taxes. Notice 2023-62 delays enforcement of SECURE 2.0 Section 603 for two years until January 1, 2026.

[5] For example, Section 4973 imposes a 6 percent annual penalty on excess contributions to traditional IRAs and Roth IRAs.

any SECURE 2.0 qualified distributions followed by three year repayments until further notice or there is a final judgment with respect to SECURE 2.0.[6] Doing so would guarantee rollover treatment (avoiding excess contribution penalties) to SECURE 2.0 repayments into retirement accounts regardless of future litigation results.

This guidance from the IRS and Treasury would clearly further the sound administration of the tax laws. First, if one assumes SECURE 2.0 and the repayment provisions are valid, their use should not be discouraged by uncertainty caused by litigation in federal courts. Second, if SECURE 2.0 is not valid, its invalidity should not be an occasion for taxpayers to incur excess contribution penalties for what are simply repayments of amounts that originated in retirement accounts.

Proposal Three: Regulations Providing that No Amended Tax Return is Required if the Qualified Distribution is From a Roth Account and Would Be Tax and Penalty Free if it Were a Nonqualifed Distribution

Many households have Roth IRAs.[7] When one takes a distribution from a Roth IRA[8] prior to turning age 59 ½, it is tax and penalty free to the extent of any previous annual contributions and Roth conversions at least five years old. Further, those who are age 59 ½ and have owned a Roth IRA for at least five years can take any amount from their Roth IRA tax and penalty free.

[6] Federal litigation regarding how the Quorum Clause impacts SECURE 2.0 is clearly an event “beyond the reasonable control of the individual subject to” the 60-day requirement. See both Section 402(c)(3)(B) and Section 408(d)(3)(I). Thus, the IRS and Treasury are authorized to waive the 60-day rule for what would otherwise be failed rollovers if SECURE 2.0 is struck down.

[7] According to the Investment Company Institute, 31.9 million American households owned Roth IRAs in 2023. See The Role of IRAs in US Households’ Saving for Retirement, 2023, page 4, available at https://www.ici.org/system/files/2024-02/per30-01.pdf.

[8] A qualified birth or adoption distribution can be taken from an “applicable eligible retirement plan” as defined by Section 72(t)(2)(H)(vi)(I). It provides “[t]he term “applicable eligible retirement plan” means an eligible retirement plan (as defined in section 402(c)(8)(B)) other than a defined benefit plan.”

Section 402(c)(8)(B) defines an “eligible retirement plan” to include “an individual retirement account (within the meaning of section 408(a)).”

A Roth IRA is an individual retirement account within the meaning of Section 408(a). That is demonstrated by Section 408A(b), which provides that a Roth IRA is an “individual retirement plan” as defined by Section 7701(a)(37). Section 7701(a)(37) provides that an individual retirement plan is an individual retirement account within the meaning of Section 408(a). Thus, a Roth IRA is an IRA and is an “applicable eligible retirement plan” under Section 72(t)(2)(H)(vi)(I). See also Treas. Reg. Sec. 1.408A-1 Q&A 1(b).

Thus, many of the distributions qualifying for the repayment provisions[9] would have simply been tax and penalty free distributions from a Roth IRA.

Treasury and the IRS should issue regulations clarifying that no amended tax return is required, including no amended Form 8606 Part III, to report a repayment to a Roth IRA if the entire distribution would have been fully tax and penalty free regardless of the repayment rules.[10]

The Form 5498 filed by the financial institution can adequately report the repayment to both the IRS and the taxpayer.

The regulations should extend this treatment to designated Roth account distributions that would be fully and penalty free regardless of repayment provision qualification, such as those occurring when the taxpayer has a loss in their designated Roth account or those occurring after the taxpayer has turned age 59 ½ and has owned the designated Roth account for at least five years.

Proposal Four: Verify That a Person Older Than Age 59 ½ Qualifies for a Three Year Repayment

EPEDs, qualified birth or adoption distributions, and the other repayment provisions provide two specific tax benefits. First is the forgiveness of the 10 percent early withdrawal penalty on the qualified distribution. The second benefit is the ability to repay the qualified distribution to a retirement account in order to obtain a tax refund and keep the amounts invested for retirement.

Attaining the age of 59 ½ ends the need for the first benefit. However, those age 59 ½ and older still need retirement savings and should still receive the benefit of a potential tax refund. Regulations or other guidance should verify that those over the age of 59 ½ can receive the benefit of the repayment provisions and repay qualified distributions to a retirement account.

Some may question this considering that the repayment provisions are found in Section 72(t)(2), which generally provides exceptions to the 10 percent early withdrawal penalty. That placement reflects a common-sense decision to keep the exceptions to the 10 percent early withdrawal penalty consolidated together and does not reflect any intention to deny the benefits of the repayment provisions to those over the age of 59 ½.

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[9] The regulations contemplated by proposals 3, 4, and 5 should be issued regardless of the future outcome of potential SECURE 2.0 Quorum Clause litigation since qualified birth or adoption distributions, enacted in the 2019 SECURE Act, have a repayment provision. Thus, regardless of the outcome of future litigation there will be at least one repayment provision in Section 72(t).

[10] Such as a distribution of previously made Roth IRA annual contributions. See Treas. Reg. Sec. 1.408A-6 Q&A 1(b) and 8(a).

Proposal Five: Excuse the Excess Contribution Penalty if the IRS Disagrees With Repayment Qualification

The 3 year repayment rules inadvertently created a significant risk for taxpayers: excess contribution penalties if the IRS disagrees with the taxpayer and determines the taxpayer did not qualify for the relevant provision. The repayment into the retirement account often becomes an excess contribution if the IRS prevails in its view that a distribution did not qualify.

The 3 year repayment rules are intended to help, not hurt, taxpayers. Further, the tax law is complicated, even for professionals. American taxpayers should not be subject to penalties when they attempt to interpret laws Congress intended to help them.

I recommend that the Treasury and IRS issue regulations that, at least initially, waive any excess contribution penalties taxpayers might be subject to if they repay amounts to a retirement account erroneously believing they qualify for one of the repayment provisions.

For purposes of applying any retirement account excess contribution penalty, the repayment to the retirement account (if it creates an excess contribution) should be deemed to have been made on the date of the final determination (i.e., an IRS determination the taxpayer agrees to or a final determination made by a court). If the regulations provide this rule, the taxpayer would have the ability to withdraw the excess contribution[11] penalty free under the normal remedial procedures, and would only owe ordinary income tax on the growth attributable to the excess contribution.[12]

Proposal Six: Regulations Clarifying that Schedule C Solopreneurs Can Qualify for the Rule of 55 Exception to the Section 72(t) Ten Percent Early Withdrawal Penalty for Distributions From Their Solo 401(k)s

There has been considerable confusion when it comes to whether a sole proprietor can qualify for the Rule of 55 exception with respect to distributions from his or her Solo 401(k). It seems counterintuitive to claim they could, considering that a Solo 401(k) requires an employer to sponsor it and the Rule of 55 in Section 72(t)(2)(A)(v) requires a “separation from service” from the employer (in this case, self-employment).

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[11] If the excess contribution was made into a qualified plan, regulations should treat it as an excess deferral subject to penalty free remediation under Treas. Reg. Sec. 1.402(g)-1(e)(2), (3), and (8)(i).

[12] With respect to corrective distributions from traditional IRAs, the 10 percent early withdrawal penalty under Section 72(t) would apply to the net income attributable (NIA) to the excess contribution in the event SECURE 2.0 is invalidated. SECURE 2.0 Section 333 repealed the early withdrawal penalty as applied to traditional IRA NIA corrective distributions.

Corrective distributions of NIA from Roth IRAs should not be subject to the Section 72(t) early withdrawal penalty under existing regulations regardless of the outcome of potential SECURE 2.0 Quorum Clause litigation. See Treas. Reg. Sec. 1.408A-6 Q&A 9(e).

However, Section 401(c)(1) and (c)(3), in a somewhat cryptic fashion, make it possible for a retired sole proprietor to continue to qualify as an “employer” for qualified plan purposes. This would allow a retired solopreneur to avail him or herself of the Rule of 55 and avoid the Section 72(t) early withdrawal penalty on Solo 401(k) distributions. The proper broad scope and scale of Section 401(c)(1) and (c)(3) is informed by the fact that from the Self-Employed Individuals Tax Retirement Act of 1962[13] until the Tax and Equity and Fiscal Responsibility Act of 1982,[14] retired sole proprietors were required to remain “employers” for qualified plan purposes, as they were not allowed to fully withdraw amounts from self-employed qualified plans until turning age 59 ½.[15]

As self-employment and Solo 401(k)s grow in popularity, I believe it is important for the IRS and Treasury to issue clarifying guidance providing that retired sole proprietors can avail themselves of the Rule of 55 exception to the Section 72(t) early withdrawal penalty.

I would be happy to discuss the proposals made and issues raised in this letter at your convenience. Please email me at sean@mullaneyfinancial.com to arrange for such a discussion.

Sincerely,

Sean W. Mullaney

[13] Public Law 87-792, 76 Stat. 809, available at https://uscode.house.gov/statviewer.htm?volume=76&page=809# and available at https://www.finance.senate.gov/imo/media/doc/ConfRpt87-2411.pdf.

[14] Public Law 97-248, 96 Stat. 324, available at https://www.govinfo.gov/content/pkg/STATUTE-96/pdf/STATUTE-96-Pg324.pdf.

[15] See then-effective Section 401(d)(4)(B). I wrote an article, *Solo 401(k)s and the Rule of 55: Does the Answer Lie in 1962?*, extensively detailing these rules and why Schedule C solopreneurs qualify for the Rule of 55. The article is available at https://fitaxguy.com/revisiting-solo-401ks-and-the-rule-of-55/.