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For your information

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IRS announces plan loan and hardship withdrawal relief for Hurricane Sandy

Plan sponsors looking for ways to help employees gain access to plan funds that will help them recover from the Hurricane Sandy disaster received good news late Friday, November 16, 2012 when IRS Announcement 2012-44 was released. The announcement expands the options available for 401(k), 403(b) and eligible governmental 457(b) plans. The key modifications offered include:

- A wider range of situations qualifying as safe harbor hardship distributions
- Relaxed verification procedures
- A suspension of the applicable 6-month ban on participation in 401(k) and 403(b) plans normally applicable to safe harbor hardship withdrawals
- Delayed amendment deadlines for updating plan documents to reflect operational changes

The announcement does not waive the 10 percent premature distribution penalty or increase the maximum loan limit. As noted in our November 15, 2012 *For Your Information* on Hurricane Sandy, Congressional action would be needed to modify those barriers to accessing plan funds.

Background

As the primary aim of qualified retirement plans such as 401(k), 403(b) and eligible governmental 457(b) plans is to serve as a way to accumulate funds for retirement, the tax rules generally discourage tapping into these funds for other reasons. However, plans are permitted to allow participant loans on a limited basis and withdrawals for narrowly framed emergency situations. For example, plan loans are limited to the lesser of one-half of the participant's account balance or $50,000, with adjustments for outstanding loans. In-service distributions from elective deferral accounts prior to age 59½ are limited to hardship situations. Profit sharing plans may also contain withdrawal rules based on service or timing conditions.

An employer seeking to meet the hardship criteria may use safe harbors defined in IRS regulations. One safe harbor provides a list of the situations that are deemed to meet the "immediate and heavy financial need" criteria; another addresses the requirement that the distribution is necessary to satisfy that need. The requirements for eligible governmental 457(b) plans limit hardship withdrawals to "unforeseen emergencies". With or without the safe harbors, participants are limited to withdrawing just their elective contributions (minus previous withdrawals). They may not withdraw earnings, qualified nonelective contributions (QNECs) or qualified matching contributions (QMACs).

Plan documents must state the rules that are used for administering the hardship withdrawal and participant loan features of the plan. If the plan sponsor chooses to make a change, the plan must be amended by the end of the plan year; later if there is a legal requirement to make a change.

To discourage early distributions, the Internal Revenue Code (Code) generally imposes a 10 percent early distribution penalty when participants tap into their retirement nest egg prior to age 59½. Over time, exceptions to the penalty have been added to the Code for medical expenses, qualified reservist distributions, first time home purchases, and higher education expenses – depending on whether the source is an employer plan or an individual retirement account (IRA).

Expedited processing enabled by IRS announcement

In Announcement 2012-44, the IRS (with DOL's agreement to steer clear of pressing any ERISA violation claim) offers relief from a number of the usual distribution restrictions to allow plan sponsors to focus on quickly distributing plan funds to address Hurricane Sandy needs.

Affected individuals: The relief applies for participants whose principal residence or place of employment on October 26, 2012 was located in one of the counties or Tribal Nations that have been identified as covered disaster areas because of Hurricane Sandy. It also applies to any of the following classes of a participant's relatives who had a principal residence or place of employment in one of these areas: lineal ascendant, lineal descendant, dependent or spouse.

Affected plans: The relief is targeted at the types of plans and accounts that are permitted to make loans and hardship withdrawals. This includes profit sharing plans, stock bonus plans, 401(k), 403(a), 403(b) and eligible governmental 457(b) plans. It generally does not include money purchase plans or defined benefit plans unless there is a separate account for employee contributions or rollover amounts. It does not allow for withdrawals from QNEC and QMAC accounts or from earnings on elective contributions.

Hardship withdrawals: The announcement allows withdrawals to be made for any hardship arising from Hurricane Sandy, not just those enumerated in the Code and regulations. For purposes of a governmental 457(b) plan, a distribution for any hardship arising from Hurricane Sandy is considered to be made on account of an "unforeseeable emergency." In addition, the announcement permits the withdrawal without the need for a post-distribution contribution restriction such as the 6-month restriction in the 401(k) regulatory safe harbor.

Plan loans: Plan loans are required to meet the tax limitations in Code Section 72(p) such as the 5-year repayment requirement (unless eligible for the home loan exception) and the maximum loan limit.

Procedural requirements: The announcement allows the plan to disregard procedural requirements normally followed by the plan for processing plan loans and hardship withdrawals as long as the plan administrator makes a good-faith diligent effort under the circumstances to comply. Plan administrators may rely upon representations from the participant about the need for and amount of a hardship withdrawal, unless the plan administrator has actual knowledge to the contrary. As soon as practicable, the plan administrator must make a reasonable attempt to assemble any foregone documentation such as spousal consent.

Plan amendments: Plans that do not currently offer loans or withdrawals must be amended to memorialize the allowances made for Hurricane Sandy distributions. The amendment should be made by the end of the first plan year beginning after December 31, 2012.

> **Buck comment:** Although the announcement does not appear to require plan amendments to refine eligibility or suspension details in situations where the plan currently contains a loan or hardship provision, it is advisable to amend the plan in any situation where the plan is operating differently than in accordance with its specific terms.

Timeframe for distributions: Announcement 2012-44 applies to loans and/or distributions made no later than February 1, 2013.

In closing

Plan sponsors can use the relaxed rules announced by the IRS to offer some immediate relief to affected employees. While select budget legislation has been introduced to finance the response to the disaster, it does not presently include proposals to exempt Hurricane Sandy distributions from the 10% premature distribution penalty or to increase the maximum loan limit. Whether changes comparable to those allowed for Katrina and certain other disasters will materialize remains to be seen.