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IRS Relaxes Retirement Plan Rules for Louisiana Flood Victims

The IRS has announced relaxed rules for tapping into retirement funds in response to the Louisiana floods that began on August 11, 2016. This relief goes beyond the normal disaster relief extensions and mimics the extra relief announced in 2012 for Hurricane Sandy victims. The relief provides relaxed standards for processing hardship withdrawals and plan loans and allows more time to adopt plan amendments, if appropriate. It does not open the door to loans or withdrawals from amounts that are inaccessible for hardship withdrawal such as QNEC and QMAC accounts and income accumulated on elective deferrals. It also does not provide relief from the 10% penalty on premature distributions prior to age 59½.

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Background

Because 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, current 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 and recent loans. In-service distributions from elective deferral accounts prior to age 59½ are limited to hardship situations.

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 "unforeseeable 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).

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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 changes may be permitted 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, limited 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 2016-30, 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 disaster needs.

> **Comment.** The current guidance mimics the relief IRS issued for Hurricane Sandy in 2012. After the Hurricane Sandy guidance was issued, additional informal guidance was provided and is collected in this Fall 2012 Edition of *Retirement News for Employers*. Presumably, similar responses would apply to the current situation. For example, FAQ #3 explains that a plan loan would still need to be obtained in advance of a hardship distribution if the plan offers loans and it is not impractical to do so.

Affected Individuals. The relief applies for participants whose principal residence or place of employment on August 11, 2016 was located in one of the parishes that have been identified in the general disaster IRS news release as covered areas because of the Louisiana storms. It also applies to a participant with a lineal ascendant, lineal descendant, dependent or spouse who had a principal residence or place of employment in one of these areas. For example, a participant in New York would be able to take a hardship distribution to help a child rebuild her home in the disaster area.

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.

Hardship Withdrawals. The announcement allows withdrawals to be made for any hardship arising from the Louisiana storms, not just those enumerated in the Code and regulations. For purposes of a governmental 457(b) plan, a distribution for any hardship arising from the Louisiana storms 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. It does not allow for withdrawals from QNEC and QMAC accounts or from earnings on elective contributions.

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 the Louisiana storms distributions. The amendment should be made by the end of the first plan year beginning after December 31, 2016.

> **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 2016-30 applies to loans and/or distributions made on or after August 11, 2016 and no later than January 17, 2017.

Other Disaster Relief

The relief described above supplements the array of relief the agencies generally provide for disaster situations. IRS disaster relief is provided under Code section 7805A and was announced for this region on August 15. That guidance generally allows these storm victims until January 17, 2017 to file certain individual and business tax returns and to make certain tax payments. The relief includes the filing of Form 5500.

PBGC also announced disaster relief for victims of the Louisiana floods. Designated persons responsible for meeting PBGC deadlines that are located in the disaster area are provided additional time based on the January 17, 2017 deadline established by IRS. For example, this includes premium due dates, post-event reportable event notices, and plan termination filing deadlines. For late premium payments, the PBGC waives the applicable penalty, but not the applicable interest charge. Additional relief will be considered on a case-by-case basis.

> **Comment.** The DOL responded to Hurricane Sandy with an announcement focusing on delays in processing participant contributions, loan repayments, blackout notices and health plan benefit claims and COBRA elections (see our November 26, 2012 *For Your Information*) but has not followed suit for this or other specific disasters.

What More Can an Employer Do?

Employers with significant populations in the affected areas may wish to take additional steps to make things easier for affected employees. Here are some actions an employer can take.

Make qualified disaster relief payments to employees. Qualified disaster relief payments made by an employer to employees affected by the disaster are not included in the employees' income. Qualified disaster relief payments include amounts necessary to cover the following types of expenses, to the extent not covered by insurance: necessary personal, family, living, or funeral expenses and expenses for repairing or rehabilitating personal residences or repairing or replacing their contents.

Offer leave-sharing plans. Employees may be permitted to contribute vacation, sick, or personal leave to an employer-sponsored leave bank for use by other employees who are absent from work as a result of a federally declared major disaster. If the conditions set out in IRS Notice 2006-59 are satisfied, the value of the donated leave will be included in the leave recipient's income and not in the income of the leave donor.

Extend the annual enrollment period for health and other welfare plans. Affected employees may be given additional time to complete their annual enrollment. The only requirement is that their elections be made before the first day of the plan year to which they relate.

Arrange exceptions to in-network provider and other health plan limitations. This could include treating all providers caring for affected employees as "in-network" and waiving prior authorization, precertification, or referral requirements. Limitations on prescription drug refills or replacement of eyeglasses could also be waived.

Extend the time limits for employee notices or payments. Employees whose lives have been disrupted may be unable to provide timely notice of change-in-status or COBRA qualifying events or to make timely COBRA elections. They may also have missed COBRA premium payment deadlines. Employers may want to provide these employees with a limited grace period for completing these actions so that they are not adversely affected.

Remind employees of Family and Medical Leave Act (FMLA) options. Employees are entitled to leave under the FMLA for a serious health condition caused by the disaster. Employees who must care for a child, spouse, or parent with a serious health condition may also be entitled to leave because of the flooding. For example, an employee might need to care for a family member who requires refrigerated medicine or medical equipment that is inoperable because of a power outage.

Remind employees about employee assistance programs. Employee assistance programs can provide employees with important information about available resources. They can also provide employees and their family members with counseling, if necessary.

Establish lines of communication. Employees need a source of reliable information from their employer. Because many employees may be dislocated or may still not have power, the employer should set up a hotline or other centralized information source that employees can access by phone.

In Closing

Plan sponsors can use the relaxed distribution rules announced by the IRS to offer some immediate relief to affected employees. No congressional proposals have been introduced to date to exempt distributions to address the Louisiana storms from the 10% premature distribution penalty or to increase the maximum loan limit. Whether such changes, comparable to those allowed for Katrina and certain other disasters, will materialize remains to be seen.

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