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Agencies Relax Rules for Victims of Hurricane Maria and California Wildfires

Natural disasters continue to wreak havoc in various parts of the United States and U.S. territories. In mid-September 2017, Hurricane Maria devastated the U.S. Virgin Islands and Puerto Rico. Beginning on October 8, 2017, wildfires destroyed large swaths of California. On the heels of similar guidance for victims of Hurricanes Harvey and Irma, IRS will allow retirement plan sponsors to temporarily relax standards for processing hardship withdrawals and loans for participants who lived or worked in the affected counties. For victims of Hurricane Maria, the guidance supplements the 10% penalty and withholding relief previously announced for individuals living in the affected areas.

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 emergencies. 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 by the IRS. One safe harbor provides a list of situations 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).

Plan documents must state the rules used for administering the hardship withdrawal and participant loan features of the plan. If the 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% early distribution penalty when participants tap into their retirement nest eggs before 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).

Puerto Rico and the U.S. Virgin Islands each are U.S. possessions that have their own tax system – administered by the local equivalent of the IRS. The income tax system of the U.S. Virgin Islands is identical to that of the U.S. (except that tax is paid to the local taxing authority). Puerto Rico's tax code is similar to, but not exactly the same as, the U.S. Internal Revenue Code. Some employers cover residents of these possessions in their U.S. qualified plan, and need to meet the requirements of both the U.S. Code and the tax code of the possession(s) to avoid negative tax consequences for participants and beneficiaries who are residents of these territories; other employers that have employees in these possessions maintain separate plans for them that are only qualified under the local tax code.

IRS Allows Expedited Processing

In Announcement 2017-15, the IRS offers relief from a number of the usual distribution restrictions to allow plan sponsors to quickly offer access to retirement plan funds for disaster needs. The relief is almost identical to that announced for Hurricanes Harvey and Irma, which mirrored relief provided in 2016 for victims of Hurricane Matthew and the Louisiana flooding. (See our September 19, 2017, September 6, 2017, November 2, 2016 and September 2, 2016 *For Your Information* publications.)

> **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 practical to do so.

Affected individuals. The relief applies to participants whose principal residence or place of employment was affected by either Hurricane Maria or the California Wildfires in an area identified by FEMA as eligible for individual assistance. 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.

Who's eligible?

The relief is available not only to participants who lived or worked in the affected areas, but also to participants with lineal ascendants or descendants, spouses or dependents who lived or worked in an area impacted by the disaster.

> **Comment.** The relief also extends to individuals in additional counties (or county equivalents such as islands in the U.S. Virgin Islands) that are added to FEMA's list of those eligible for individual assistance

related to Hurricane Maria and the California wildfires. The individual would have to live or work in the affected area on the date that FEMA specifies as the beginning of the incident period.

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 Hurricane Maria or the California wildfires, 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 hurricane is considered to be made due to an "unforeseeable emergency." In addition, the announcement permits the withdrawal without the need for a post-distribution contribution restriction such as the six-month restriction in the 401(k) regulatory safe harbor. However, the types of money accessible is still limited: the relief 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 five-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 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 Hurricane Maria and California wildfires distributions. The amendment should be made by the end of the first plan year beginning after December 31, 2017.

> **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 it's operating differently than in accordance with its specific terms.

Timeframe for distributions. Announcement 2017-15 applies to loans and/or distributions made on or after the incident date (which means September 16, 2017 for the U.S. Virgin Islands, September 17, 2017 for Puerto Rico, and October 8, 2017 for California) and no later than March 15, 2018.

Uncertainty for Puerto Rico. Although the rules for administering hardships and loans for qualified plans in Puerto Rico

The Disaster Tax Relief and Airport and Airway Extension Act of 2017

By way of this act, Congress provided the victims of Hurricanes Harvey, Irma, and Maria the ability to stretch taxation over multiple years, allowed for larger loans and offered extra time for repayments. At that time, the agencies had previously issued guidance relaxing distribution and loan rules for Harvey and Irma – but not for Maria. See our **October 6, 2017** *FYI*. However, this congressional relief does not extend to victims of the California wildfires.

are nearly identical to those that apply to U.S. qualified plans, their tax system is not administered by IRS. It appears that for retirement plans subject to local qualification rules in Puerto Rico (including plans that are also qualified in the U.S.), the plan's local qualification could be jeopardized if the plan applies the IRS relief without confirming that the local taxing authority has provided similar relief. In an effort to provide clarification, on November 8, 2017, the Governor of Puerto Rico authorized in OE-2017-067 the establishment of tax rules for distributions from qualified retirement plans and retirement accounts following Hurricane Maria and other natural disasters. In response to that announcement, in Administrative Determination 17-29, the Puerto Rico Treasury issued guidance. However, questions remain about how to coordinate that guidance with the U.S. relief for dual qualified plans.

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 these areas. That guidance generally allows these storm victims until January 31, 2018 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 Hurricane Maria and the California wildfires similar to that issued for Hurricanes Harvey and Irma. Designated persons responsible for meeting PBGC deadlines who are located in the disaster area have additional time based on the January 31, 2018 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.

While DOL previously announced relief for victims of Hurricanes Harvey and Irma, similar relief has not yet been announced for victims of the most recent 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 to employees affected by the disaster are not included in their 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 or leave donation 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 because of a federally declared 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.

IRS has extended this relief to victims of Hurricane Maria in Notice 2017-62 and the California wildfires in Notice 2017-70. Both notices provide that until December 31, 2018, employers can let employees donate their vacation, sick or personal leave in exchange for the employer donating the cash compensation associated with their leave to certain charitable organizations providing relief to victims of the hurricane *or* tropical storm. When employees donate their leave, the value of amounts donated would be excluded from their gross income and wages (for income, Social Security and Medicare tax purposes), but would still be deductible to the employer as a trade or business expense (as would be the case if the employer had paid those amounts to the employees). Such amounts would not be deductible as a charitable contribution by either the employee or the employer, although the tax treatment provided above is generally more favorable.

Extend 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.

Remind employees of FMLA options. Employees are entitled to leave under the Family and Medical Leave Act (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 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 to offer some immediate relief to affected employees. This type of relief has been made available for individuals affected by several different weather-related disasters, and seems to be the new standard for handling such events. It remains possible that further relief could be forthcoming from DOL, similar to that provided for other recent disasters.

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