REGULATORY Update

QUARTERLY UPDATE, APRIL 2017

IRS Publishes New Guidelines for Substantiating Hardship Distributions

On February 23, 2017, the Internal Revenue Service (IRS) issued new guidelines that affect how retirement plan sponsors document safe harbor hardship distributions. In general, most 401(k) and other defined contribution plans offer a hardship distribution provision, which allows plan participants to withdraw retirement funds provided that the withdrawal is (i) made on account of an immediate and heavy financial need, and (ii) necessary to satisfy the financial need. The participant must provide documented proof of the financial need, with plan sponsors bearing responsibility for verifying the validity of the hardship claim, as well as the retention of all substantiating documents.

The main change under the new guidelines pertains to the source of the supporting hardship documentation. Previously, the participant needed to provide the actual documents that proved a financial hardship—for example, an eviction notice or a bill for uninsured medical expenses. Under the new guidance, *summary* documents are also considered permissible documentation.

HOW TO APPLY THE NEW GUIDELINES

Here is an overview of the steps plan sponsors should take prior to making a safe harbor hardship distribution, based on the IRS's latest guidance:

- Obtain source documents (such as estimates, contracts, bills, and statements from third parties) or a summary of the information contained in source documents (in paper or electronic format, or in the form of telephone records) from the plan participant.
- Review the documents to determine if they meet the hardship distribution guidelines, including one of the six criteria that qualify a hardship as heavy and immediate:
  - Uninsured medical expenses
  - Purchase of a primary residence
  - Post-high-school educational tuition
  - Prevention of eviction/foreclosure
  - Funeral expenses
  - Repairs to damage of primary residence
- If using summary documents, provide the required employee notifications prior to making a hardship distribution. The notice to the employee should indicate that:
  - The hardship distribution is taxable and additional taxes could apply.
  - The amount of the hardship distribution cannot exceed the immediate and heavy financial need.
  - Hardship distributions cannot be made from earnings on elective contributions or from qualified nonelective contributions (QNECs) or qualified matching contributions (QMACs), if applicable.
  - The recipient agrees to preserve source documents and to make them available at any time, upon request, to the employer or administrator.
- Finally, don't forget to maintain copies of all documentation for your files!

Retirement plan governance, including proper execution of hardship distributions, is a core responsibility of plan sponsors. If you need assistance with this procedure, leverage the expertise of your plan service providers.

Forfeitures Can Fund Safe Harbor Contributions, QNECs, and QMACs, IRS Says

In a January 2017 proposed regulation, the IRS offered a minor, yet welcome, administrative enhancement that will allow forfeiture assets to be used to fund 401(k) safe harbor contributions, QNECs, and QMACs. Previously, forfeited assets (the unvested portion of employer money forfeited from the accounts of employees who separated from service) could not be used to fund or offset safe harbor contributions, QNECs, or QMACs. Why? Because such contributions require 100-percent vesting, and forfeiture assets are, by definition, less than fully vested. The proposed regulation relaxes that stance and allows for a more practical approach.

Why is this good news for retirement plan sponsors? Prior to the change, safe harbor contributions, QNECs, and QMACs needed to be funded completely by the employer, even if there were assets in the forfeiture account that otherwise could have been used to offset the full or partial amount of such a contribution. Going forward, the ability to use forfeiture assets for these contributions could reduce the size of the check that employers have to write.

Although the proposed regulation will apply to tax years beginning on or after final publication, the IRS has stated that taxpayers (in this case, plan sponsors) may rely on the proposed changes immediately. Be sure to review the terms of your plan document (or check with your third-party administrator) to confirm that using forfeiture assets to fund employer contributions is permissible.

We Can Help

Our firm is ready to provide you with the ideas, guidance, and foresight to prepare your firm and your employees for a successful 2017. If you would like to review the new hardship substantiation procedures, approved use of forfeiture assets, or any aspect of your retirement plan, we're here to assist you.

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