

The Drought Is Over: Recent Legislation Affecting Retirement Plans

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New legislation provides several significant modifications affecting retirement plans, effectively eliminating the legislative drought experienced in recent years.

Bipartisan Budget Act of 2018 (the "Act")

Hardship Withdrawals

Effective for plan years beginning after December 31, 2018, the Act liberalizes the hardship withdrawals provisions for plans that include "cash or deferred arrangements."

- ***Elimination of the six-month prohibition on contributions.*** The Act removes the six-month suspension period on elective deferrals (and employee contributions) following receipt of a hardship withdrawal. Because the Act modified Treas. Reg. 1.401(k)-1(d)(3)(iv)(E), this change affects only the determination of whether a hardship distribution satisfies a deemed "immediate and heavy financial need" under the safe harbor test. Code section 403(b) plans are also affected by this change with respect to hardship withdrawals because the Treas. Regs. under Code section 403(b) incorporate the 401(k) regulations by reference. The Code section 401(k) regulations will be updated to reflect this modification no later than one year after enactment of the Act (on February 9, 2019). Presumably, plans will need to be amended to reflect this modification by December 31, 2020. But stay tuned for additional guidance in upcoming newsletters regarding updated deadlines.
- ***Elimination of Requirement to Obtain Any Available Loans.*** Participants requesting a hardship withdrawal will no longer be required to take any available loan under the plan in order to be eligible to receive a hardship withdrawal. Because the Act added a new section (14) to Code section 401(k) to address this change, the modification presumably affects the determination of whether a hardship distribution satisfies a financial need under both the facts



and circumstances and the safe harbor tests. Under the facts and circumstances test, the requirement that participants must exhaust all commercially available loans appears to be continuing.

- **Amount Available for Withdrawal (Inclusion of QNECs/ QMACs and earnings).** The Act now permits qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs) to be withdrawn in the event of a hardship. In addition, earnings on these contributions (including elective deferrals) will also be permitted to be withdrawn.

Comments on the Modifications Made to Hardship Withdrawals

- **Elimination of Suspension Period.** For those employers who endorsed the suspension period, we believe it is unlikely that 401(k) suspensions could be maintained following the effective date of the new legislation without violating either the nondiscriminatory coverage or nondiscriminatory benefit requirement, or both. Furthermore, even though the six-month suspension of deferrals has been eliminated from the safe-harbor standard for determining whether withdrawals are necessary to satisfy a deemed "immediate and heavy financial need," a participant's voluntary cessation of deferrals would be a favorable factor in satisfying the financial need requirement under the facts and circumstances test.
- **Inclusion of QNECs and QMACs and Earnings.** We believe these sources are available for all hardship withdrawals, regardless of when these amounts were contributed or earned. Nonetheless, we anticipate that guidance by the Internal Revenue Service (IRS) will confirm this position.
- **Documentation Demonstrating Compliance.** With the relaxation of the hardship withdrawals requirements and the inclusion of additional sources to fund hardship withdrawals, it is conceivable that plan sponsors may need to administer a higher volume of hardship withdrawals. Accordingly, it becomes even more important to ensure procedures are in place for verifying a participant's eligibility for a hardship withdrawal. As a reminder, while a plan sponsor may rely on a third-party administrator for assistance in administering hardship withdrawals, the plan sponsor is ultimately responsible for the verification of hardship requests and for determining whether such withdrawals are made only in accordance with the terms of the plan and current law. As a result, it is vital that a plan sponsor retain sufficient records (including participant summaries, where applicable) verifying eligibility for hardship withdrawals. In the event of an audit, an IRS examiner will still require documentation demonstrating compliance in this regard. Failure to maintain these records is treated as a qualification failure by the IRS. Therefore, diligent procedures for compliance remain essential, especially due to the increased availability of such withdrawals for plan participants.

Individuals Held Harmless on Wrongful Levy on Retirement Plans

Effective for tax years beginning after December 31, 2017, if plan benefits are returned to an individual by the IRS because they were wrongfully levied, the individual may re-contribute such amounts (with interest) to the plan, thereby restoring the benefits' tax-deferred status. For this purpose, the term "plan" refers to a qualified retirement plan, 403(b) plan, governmental 457(b) plan or an individual retirement account (IRA). The contribution must be made no later than the due date (without extension) for filing the individual's tax return for the year in which the IRS re-

turns the wrongfully levied monies. Additionally, the terms of the plan must provide for the return of the monies.

California Wildfires

For individuals who sustained an economic loss as a result of the 2017 California wildfires, the Act modifies plan provisions to assist in their recovery.

1. Qualified Wildfire Distributions. Distributions made to affected individuals from retirement plans (i.e., a qualified retirement plan, 403(b) plan, governmental 457(b) plan or an IRA) may be eligible for special tax treatment if they satisfy the conditions applicable to “qualified wildfire distributions.” “Qualified wildfire distributions” are amounts eligible to be withdrawn for the period beginning October 8, 2017, through December 31, 2018, that are paid to individuals: (i) whose principal residence was located in the California wildfire disaster area at any time during the period from October 8, 2017, through December 31, 2017; and (ii) who sustained an economic loss due to the wildfires. Such distributions made during this period are limited to \$100,000, including all plans in which the individual participates that are maintained by the same employer.

For participants who take such distributions, tax relief includes the following provisions:

- The elimination of the 10% early withdrawal penalty and the mandatory withholding requirement (20%) otherwise applicable for eligible rollover distributions;
- The ability to repay the distribution at any time during the three-year period, beginning with the year of distribution, to any plan that accepts rollover contributions. Because the repayment will be treated as a rollover contribution, the distribution will not be includable as income; and
- If the individual does not repay the distribution, the includable income from the distribution will be spread over a three-year period beginning with the year of the distribution, unless the individual elects otherwise.

These distributions will not be subject to the direct rollover and special tax notice requirements otherwise applicable to eligible rollover distributions, or the distribution restrictions applicable under Code section 401(k)(2)(B)(i), including the related restrictions under Code sections 403(b)(7)(A)(ii) and 403(b)(11), (i.e., where amounts may not be distributable to participants earlier than (i) severance from employment, death or disability, (ii) the attainment of age 59 1/2, (iii) after incurring a financial hardship, (iv) when individuals who have been called to active duty may receive qualified reservist distributions, or (v) with respect to 401(k) plans, the termination of the plan without the establishment or maintenance of another defined contribution plan, other than an employee stock ownership plan (ESOP)). In addition, these distributions will also not be subject to those distribution restrictions applicable under Code section 457(d)(1)(A).

Plan amendments to incorporate these California “qualified wildfire distributions” provisions must be made on or before the last day of the first plan year beginning after December 31, 2018 (or, for governmental plans, the last day of the first plan year beginning after December 31, 2020).

A number of questions still remain as to how some of these provisions will function in actual operation (i.e., how participants will verify their eligibility concerning the location of their principal residence, as well as proof of their economic loss, and under what circumstances amended tax returns may be necessary to report the income on these distributions). Hopefully, future guidance will help resolve these issues.

2. Participant Loans. The Act grants special tax treatment on participant loans made to certain individuals who were affected by the wildfires. These individuals are those (i) whose principal residence was located in the California wildfire disaster area at any time during the period from October 8, 2017, to December 31, 2017, and (ii) who suffered an economic loss as a result of the wildfires.

- **Increased Limit.** For a limited period, such affected individuals may borrow funds from their retirement plans in excess of current limits: the lesser of 100% of the vested plan benefit or \$100,000 (increased from 50% and \$50,000, respectively). The adjusted loan threshold is available during the period beginning February 9, 2018, through December 31, 2018.
- **Participant Loan Repayments.** The Act includes a one-year grace period on the repayment of participant loans for these affected individuals. If such individuals had any participant loan outstanding at any time on or after October 8, 2017, any repayments due on that loan during the period beginning October 8, 2017, through December 31, 2018, can be delayed for one year. For those individuals who take advantage of this delay, their remaining loan repayments can be re-amortized. For repayments made during this period, the five-year maximum loan repayment period under Code section 72(p)(2)(B) is disregarded.

3. Repayment of Hardship Withdrawals Made for Home Purchases. Participants who received hardship withdrawals for the purchase or the construction of their principal residence during the period beginning April 1, 2017, through January 14, 2018, may elect to contribute those funds back into a retirement plan. To qualify, the home must have been located within the California wildfire disaster area and its purchase (or construction) must have been discontinued due to the wildfires. First-time homebuyers who made withdrawals from their IRAs during the same period are also able to take advantage of this relief if they satisfy the same requirements applicable for the repayment of hardship withdrawals. Such repayments may be made through June 30, 2018.

Solvency of Multiemployer Pension Plans and Pension Benefit Guaranty Corporation

The Act also provides for the formation of a committee to improve the solvency of multiemployer pension plans and the Pension Benefit Guaranty Corporation (PBGC). Composed of 16 members (8 members from the House of Representatives and 8 members from the Senate), the committee was required to be bipartisan and was required to hold its first meeting no later than March 11, 2018. At that time, the committee was required to begin preparing a report listing their findings and recommendations on how to increase the stability of both multiemployer pension plans and the PBGC. By November 30, 2018, the committee must vote on the proposed legislative language they have drafted in connection with their findings. The text of the committee's

report and the proposed legislative language will be made available to the public (in electronic form) at least 24 hours prior to its consideration before the committee. If at least five Republican and five Democratic committee members approve the legislative language, it will be presented to the Senate for consideration on an expedited basis.

Tax Cuts and Jobs Act (the “Tax Cut Act”)

Other retirement plan changes were made in connection with the Tax Cuts Act:

Personal Casualty Losses and Hardship Withdrawals

The Tax Cuts Act modified Code section 165(h) to permit personal casualty deductions to be taken only for losses attributable to federally declared disaster areas for tax years 2018 through 2025. For 401(k) plan sponsors relying on the safe harbor to determine whether an event satisfies a deemed “immediate and financial need,” the Treas. Regs. incorporate Code section 165 by reference with respect to “expenses for the repair of damages to the employee’s principal residence.” As a result, the Tax Cuts Act indirectly limits such hardship withdrawals by making them available only for casualty losses occurring within a federally declared disaster area after December 31, 2017. Until further guidance is issued by the IRS, plan sponsors relying on the safe harbor now need to determine how to handle hardship withdrawal requests related to casualty damage affecting principal residences outside of federally declared disaster areas.

Rollovers of Participant Loan Offset Amounts

The deadline for rolling over plan loan offset amounts is now the filing due date (including extensions) for a participant’s tax return, based on the year in which the offset is treated as distributed from a “qualified employer plan.” For this purpose, a “qualified employer plan” is a qualified plan under Code sections 401(a), 403(b) or governmental 457(b) plans. Prior to the Tax Cuts Act, the deadline to roll over the offset amount under Code section 402(c) was the 60th day after the loan offset occurred. This modification applies only for plan loan offset amounts treated as distributed by reason of a participant’s severance from employment or the termination of the employer’s plan. This provision is applicable for plan loan offset amounts treated as distributed in taxable years beginning after December 31, 2017. Because the offset amount is treated as a distribution, the liberalization of the rollover period gives participants more time to find funds equal to the amount of the offset to roll over into another qualifying plan or IRA, thereby deferring the taxation on the amount.

As a result of the recent legislative modifications, it is advisable to review your plans to determine whether amendments or procedural modifications are necessary to maintain compliance. Given the nature of some of the changes, we anticipate announcements to be issued by the IRS for further clarification. Stay tuned for more developments as guidance unfolds.

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