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Final Hardship Regulations Revealed!

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 - Joanne Pecina 


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Your Presenters Today 

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What We'll Cover



- New safe harbor hardships
- New necessity requirements
- New distribution sources
- Amendment deadlines/process


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Safe Harbor Hardships
Can be effective 1/1/2018

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Old Law Safe Harbor Hardships



| | |
|--|---|
| <p>Participant's primary residence</p> <ul style="list-style-type: none"> • Purchase • Prevent eviction/foreclosure • Casualty  | <p>Participant, spouse, child, dependent, beneficiary</p> <ul style="list-style-type: none"> • Post-secondary education • Medical • Funeral  |
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Casualty Loss Change



- Casualty loss defined by Code §165(h)
- New law effective 2018-2025 (Code §165(h)(5))
 - Casualty loss deductible only if attributable to federally declared disaster
- Regulation provides that plan can ignore Code §165(h)(5) in determining casualty loss

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Example: Casualty loss

- Fire destroys Simon's house
 - Not part of federally declared disaster
- Insurance not enough to cover repairs
- Tax consequence
 - 2017: Simon can claim itemized deduction for casualty loss
 - 2018 – 2015: No deduction

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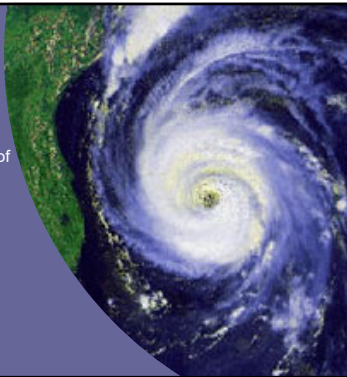
Example: Casualty Loss (cont'd)



- Simon participates in 401(k) plan that permits hardships for safe harbor needs
 - Restated for PPA
- Under PPA restatement, Simon can't get hardship distribution for 2019 because it isn't a deductible casualty loss
- Employer can amend the plan to ignore the new law limiting casualty losses to federally declared disasters
 - If it does, Simon can take the hardship

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New Hardship Need: Disaster Loss



Expenses and losses (including loss of income) incurred by the employee on account of a disaster declared by . . . FEMA . . . provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for individual assistance with respect to the disaster.

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Key Points



- Limited to disaster qualifying for FEMA individual assistance
- Only applies if **participant's** home or business is in disaster area
 - No distribution if just spouse, children, parents in disaster area
- Losses not limited to residential damage. Could include:
 - Temporary rent
 - Loss of personal property
 - Loss of earnings

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Replaces IRS Disaster Announcements



- Often, for major disasters, the IRS has authorized hardship distributions for participants and their families affected by major disaster
 - No more: Just the participant
 - Don't expect IRS special hardship disaster announcements
- "It is expected that plan administrators will be flexible in interpreting plan terms requiring documentation relating to the hardship when processing hardship distribution requests during the difficult circumstances following a disaster"

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Clarification on Safe Harbor Hardships

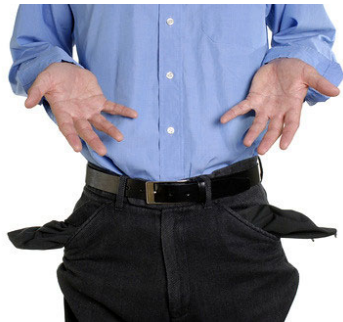


- Plan is within safe harbor if it limits hardship needs more narrowly than regulations
 - Example: Plan doesn't allow educational hardship distributions
 - Plan is still in safe harbor hardship rules
 - Example: Plan allows hardship distributions for medical expense of participant, spouse, and children
 - Does not allow distributions for expenses of other dependents or the participant's primary beneficiary
 - Plan is still in safe harbor hardship rules

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New Necessity Requirements

Can be effective first day of 2019 plan year
No suspensions after 1/1/2020



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Old Law: Necessity Rules

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|---|--|
| <p>Safe Harbor</p> <ul style="list-style-type: none"> • Doesn't exceed needed amount (including taxes) • Must take all available distributions and nontaxable loans • Can't defer/contribute for 6 months | <p>Facts and Circumstances</p> <ul style="list-style-type: none"> • Doesn't exceed needed amount (including taxes) • No alternative means available <ul style="list-style-type: none"> – Including selling property – Can rely on employee representation absent actual contrary knowledge |
|---|--|

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New Necessity Rules

- Doesn't exceed needed amount (including taxes)
- Must take all available distributions and nontaxable loans
- **Participant represents** that he or she has insufficient cash or other liquid assets reasonably available to satisfy the need
 - Must be in writing
 - Can be electronic under IRS rules
 - Plan administrator does not have actual knowledge that is contrary to the representation
 - Must apply to distributions after 12/31/2019; can apply before then
- Optional: Can leave loan requirement in place


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“Reasonably Available” Cash

- Medical bill = \$1,500
- Cash in checking account = \$2,000
- Rent due shortly = \$1,800
- Participant can represent that he/she has insufficient cash or other liquid assets reasonably available to satisfy the financial need

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Hardship Suspension Rule



- Old safe harbor necessity rule required suspension of deferrals/employee contributions from all of employer's plans for 6 months following hardship distribution
 - Old employee certification also referenced stopping deferrals
- New rule eliminates suspension requirement for:
 - 401(k) plans
 - 403(b) plans
 - Governmental 457(b) plans
- Can leave them in for
 - Tax-exempt 457(b) plans
 - Nonqualified deferred compensation plans

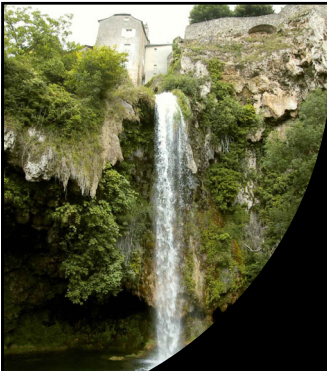
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Effective Date Hardship Suspension



- Can eliminate hardship suspension rules for
 - Hardship distributions on or after first day of 2019 plan year
- Must eliminate hardship suspension rules for
 - Hardship distributions after 12/31/2019
- Can apply:
 - Just to distributions after effective date, or
 - To deferrals after effective date
 - Example:
 - Calendar year plan eliminates suspensions for distributions after 1/1/2019
 - Can allow participants to defer 1/1/2019 even though hardship distributed in last half of 2018

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Sources of Hardship Distributions

Expanded as early as first day of 2019 plan year

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Old Law: Possible 401(k) Sources


401(k) plans could make hardship distributions from:

- Amount of elective deferrals (disregarding earnings)
- Ordinary matching contributions
- Ordinary nonelective contributions

No hardship distributions available from:

- Earnings on deferrals
- QNECs, QMACs
- ADP safe harbor contributions; QACA ADP safe harbor contrib.


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Change Effective as of First Day of 2019 Plan Year


- All 401(k) funds can be available for hardship distributions, including:
 - Earnings on deferrals
 - QNECs, QMACs
 - Plus earnings
 - ADP safe harbor contributions; QACA ADP safe harbor contrib.
 - Plus earnings
- Includes old money and new money

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2 Major Differences for 403(b) Plans

Earnings on deferrals still not available for hardship distribution



No employer contributions available for hardship distributions from mutual fund custodial account

- Including QNECs, safe harbor, etc.


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Optional

- Each of these expansions of hardship sources is optional
 - You don't have to expand sources
 - You can pick and choose sources
- Expansion can be effective as early as first day of 2019 plan year




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**Amendments:
Deadlines
and Process**

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Pre-approved Plan Deadline



- Must Amend Plan effective 1/1/2020
 - Eliminate deferral suspension
 - **Document failure** if not adopted by due date (plus extensions) of tax return that includes 1/1/2000
 - So, for calendar year taxpayer, document failure if not adopted by extended due date of 2020 tax return

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What If You Apply New Rules Earlier?



- If you apply the changes in the 2019 plan year, the deadline to adopt the amendment is the extended due date of the tax return for the tax year that includes the date the provisions went into effect
 - Don't worry about 2018 changes
- Example:
 - Calendar year tax and plan year
 - Amendment effective 1/1/2019
 - Amendment deadline is extended deadline of 2019 return

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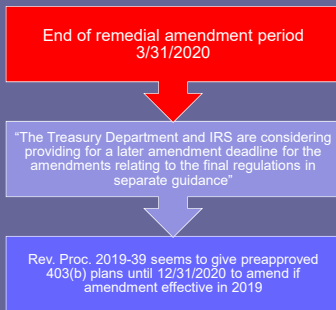
Nongovernmental Individually Designed 401(k) Plans



- Assume issue on 2019 Required Amendments List
- Deadline to adopt the amendment will be December 31, 2021

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403(b) Deadline



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Who Adopts the Amendment?

- Plan sponsor?
- Preapproved plan sponsor?
 - A lot of options in amendment

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Midyear Amendment to Safe Harbor Plan

- Notice 2016-16 requires that, if safe harbor 401(k) or 403(b) plan is amended midyear, it must issue an updated safe harbor notice and give employees the option to change deferral elections
 - If amendment affects issue required to be in safe harbor notice
 - Distribution provisions are in safe harbor notices
 - Must be provided ASAP, but not later than 30 days after amendment adoption

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What If?

- What if safe harbor notice cross-references SPD for distribution provisions?
 - Don't think you can wait for SMM distribution to inform participants
- Recommendation:
 - Generate SMM when you do amendment
 - Be sure to include effective date(s)
 - Distribute as both updated safe harbor notice and SMM


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**So, Put It Together
and What Have You
Got?**



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Hardship Requirements



- There are still two requirements for getting a hardship distribution:
 1. Immediate and Heavy Financial Need
 - Same "deemed" reasons **plus new federal disaster area relief**
 - Can still use facts and circumstances if prefer
 - Participant must still demonstrate existence of and amount of need:
 - Provide proof to Plan Administrator; or
 - Substantiation guidelines from IRS audit director

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Hardship Requirements



- There are still two requirements for getting a hardship distribution:
 2. Distribution is Necessary to Satisfy the Need
 - Plan Administrator may still judge by looking at participant's financial situation
 - Deemed "necessary" rules:
 - Employee has obtained all other currently available distributions (except hardships)
 - Employee has provided written representation that he or she has insufficient cash or other liquid assets to satisfy the need
 - Employer has no actual knowledge to the contrary
 - Amount of distribution does not exceed lesser of need or vested account (**401(k) includes employer contributions, deferrals, earnings**)

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Hardship Requirements



- Suspension of deferrals is impermissible as of 1/1/2020
 - May make effective earlier
 - With regard to new hardship distributions only or all suspension in effect
 - Amendment to reflect must be adopted by:
 - Tax return due date (including extensions) for the year in which the amendment is effective for preapproved qualified plans
 - As determined by appearance on Required Amendments List for individually designed plans

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Hardship Requirements



- Special 403(b) rules:
 - No distribution of earnings on deferrals
 - No distribution of employer contributions for custodial account/mutual fund 403(b) programs
 - Amendment due by 12/31/20 for 2019 changes

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Questions?



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Contact Information

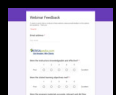
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Quick intro & demo by Joanne Pecina

(personal/private demo available)

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