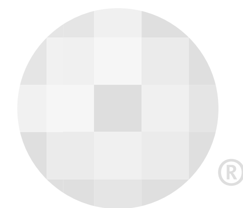
# Employee Benefits Corner

*By Elizabeth Thomas Dold and David N. Levine*

## An Update on Hurricane Sandy and a Look Forward to 2013



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With the 2012 Presidential election behind us, speculation has begun as to what 2013 holds for the retirement plans world. In this month's column, we look at one hot topic—Hurricane Sandy relief—and also look forward to 2013.

## I. Hurricane Sandy Relief

### A. Forms of Relief

Subsequent Hurricane Sandy, the IRS issued a number of pieces of guidance designed to help retirement plan sponsors and participants cope with the significant damages inflicted along the coast in the eastern United States. This guidance includes the following:

- *Announcement 2012-44.* In Announcement 2012-44, the IRS provided liberal rules for loans and hardship distributions from tax-favored employer plans to taxpayers affected by Hurricane Sandy. This guidance generally follows the contours of the IRS's Hurricane Katrina relief.
- *Extension of Various Tax Deadlines.* In addition to the Announcement, the IRS has issued news releases which extend the deadlines for filing certain tax returns and submitting certain tax payments that would otherwise be required on or after October 26, 2012, for taxpayers located in the areas struck by Hurricane Sandy (*see* IRS News Release 2012-82 (Oct. 31, 2012) and IRS News Release 2012-83 (Nov. 2, 2012)). The latter extends certain tax filing deadlines until February 1, 2013, including individual income tax, excise and employment tax returns, and filing

of the Form 990 for tax-exempt organizations. Moreover, under section 8 of Rev. Proc. 2007-56, the declaration of a federal disaster area extends a host of other benefits-related deadlines listed therein, including for filing the Form 5500.

### B. Announcement 2012-44

***1. General Explanation of the Relief.*** Announcement 2012-44 permits certain hardship or emergency withdrawals and loans from tax-favored retirement plans to employees or former employees whose principal residence or place of employment on October 26, 2012, was located in one of the counties that have been or are later designated as federal disaster areas by the President.

A loan or hardship distribution made in accordance with this guidance will only qualify for relief if it is made on or after October 26, 2012, and no later than February 1, 2013. Further, any distributions paid under this relief are limited to amounts that could otherwise be distributed as a loan or hardship (or emergency) distribution under the Code and regulations. This guidance covers Code Sec. 401(k) and 403(b) plans as well as governmental eligible deferred compensation plans described in Code Sec. 457(b). Defined benefit and money purchase plans may only permit such in-service hardship distributions if the amounts are withdrawn from a separate account in the plan, if any, containing employee contributions or from rollover contributions that are separately accounted for under Rev. Rul. 2004-12. The Announcement also states that plans are not required to suspend contributions for up to six months for participants receiving a hardship distribution. Lastly, we note that the Announcement is broadly worded in a manner that would permit a plan participant who has certain relatives in affected areas to take advantage of the plan loan or hardship withdrawal under the guidance to assist that relative.

***2. Plan Amendments.*** Like the Hurricane Katrina guidance, plan sponsors are not required to adopt the relief and do not have to adopt all features of the relief. However, under the Announcement, plans may make loans to affected employees or former employees whether or not the plan documents currently allow for such loans to be made, so long as the requirements of Code Sec. 72(p) are met. Similarly, the plan does not currently need to provide for hardship distributions for affected employees or former employees to receive a hardship distribution. However, if participants are permitted to take loans or hardship distributions in accordance with this guidance, plans that do not currently provide for loans or hardship distributions must be amended to do so by the end of the 2013 plan year.

***3. Administrative Flexibility.*** To ease administrative burdens, the Announcement allows plan administrators to rely on representations from affected employees or former employees as to the need for and amount of a hardship distribution, unless the plan administrator has actual knowledge to the contrary. Although plan administrators may suspend their normal procedural requirements (*e.g.,* supporting documentation) during this relief period, they must make a good-faith effort to comply with those requirements. Further, if required documentation is not obtained at the time of the distribution, the plan administrator must make a reasonable attempt to obtain such documentation as soon as practicable thereafter.

## II. Looking Forward to 2013

Although the second term of any President often brings changes in senior political appointees, of which in the employee benefits area there is a very limited number, the underlying regulatory priorities of the Obama administration are unlikely to change. Further, given the continued divided state of Congress, with the Democrats in control of the Senate and the Republicans in control of the House of Representatives, there is no guaranty as to what type of legislation will emerge from the next Congress. Given this maintenance of much of the status quo, below we discuss guidance and legislation likely to be under consideration in 2013.

### A. IRS Landscape

***1. Leadership.*** It appears unlikely that the day-to-day employee plans leadership on the tax side of the employee plans arena will change in connection with the start of the second Obama administration. The Deputy Assistant Secretary for Retirement and Health Policy, J. Mark Iwry, the Benefits Tax Counsel, George Bostick, and the Director, Employee Plans, Robert S. Choi, at the IRS all are unlikely to change positions any time soon. Further, the leadership of the Employee Plans area of the Office of Chief Counsel has shifted over the past 12 to 18 months, making significant change unlikely in coming months.

***2. 2013 Activities.*** Over the past several years, the federal budgets for the IRS have been relatively stagnant and have even declined in some years. Further, during this time, a significant number of

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long-tenured employees have retired from the IRS and related agencies. Based on this backdrop, likely IRS activities in 2013 include the following:

- Determination Letter Program.
  - *Recent Years*. In 2005, as part of its efforts to improve the efficiency of its determination letter program, the IRS introduced its "staggered" remedial amendment process.[1] Despite this effort to smooth out the process of receiving and processing new filings, for many years, the IRS continued to face a backlog of unaddressed determination letter filing cases. Notably, in 2012, this backlog has appeared to decline, although certain cases still continue to have long delays before they are reviewed. Further, in late 2011, after extended study, the IRS made significant changes to its determination letter program under which numerous filing for pre-approved plans and optional demonstrations on Schedule Q were eliminated.[2] These changes effectively eliminate the need to review determination letter requests that had few if any issues of concern, thus also decreasing the time burden of reviewing determination letter cases as a whole. In addition, effective for filings on and after February 1, 2012, the IRS also implemented a new determination letter Form 5300 that appears to be designed to obtain more information for IRS agents that will allow them to more efficiently process cases.[3]
  - *Looking Forward*. The IRS has already released a draft of an updated Form 5300 with even more detailed requirements for filings prepared and submitted on or after February 1, 2013.[4] This additional information may further enhance the IRS's ability to process applications more quickly. Further, although long-pending, in 2013, the IRS may also update its interim and required amendment process in a manner simplifying the amendments required, thus reducing the compliance steps that might need to be reviewed as part of each determination letter application.
- IRS Guidance.
  - *Recent Years.* Since the enactment of the Patient Protection and Affordable Care Act, the IRS has been dedicating significant resources to issuing the guidance that is needed prior to certain key effective dates in 2014. Significant resources in the Office of Chief Counsel, and Office of Benefits Tax Counsel have also been devoted to these projects.
  - *Looking Forward*. It is likely that Affordable Care Act implementation resource demands will continue into 2013. Further, if employee benefits-related legislation is enacted in 2013, IRS resources could be further directed to implementing any legislation. However, regardless of these potential priorities, it is likely that certain guidance, such as the long-awaited final cash balance regulations, will be issued. Further, as the Employee Plans Newsletter has evolved, it has regularly been used to provide "soft" guidance that, while not issued through the formal rulemaking process, provides insight and clarification regarding issues of concern to the employee benefits community. We expect that the Employee Plans Newsletter will continue in this role for 2013.
- Examinations.
  - *Recent Years*. In recent years, there has been a rise of "soft touch" examination activities. Most commonly, these "soft touches" have come through the Employee Plans' Employee Plans Compliance Units ("EPCUs").[5] Notably, EPCU projects are not formal examinations, but rather are designed to encourage compliance without a full-blown audit. Further, in pilot activities, the IRS has been focusing certain large plan examinations on "internal controls" processes rather than searching for random errors in administration.
  - *Looking Forward*. The IRS will continue to encourage plan sponsors and administrators to focus on internal controls as part of their compliance processes. Formal examinations are likely to continue down this road as well. Although, as noted above, IRS budgets have been limited in recent years, examinations remain relatively well staffed which is likely to result in a continued increase level of contact from the IRS's examinations function.
- Customer Education and Outreach.
  - *Recent Years*. In recent years, the IRS, the Office of Chief Counsel, and Office of Benefits Tax Counsel have been very active in their outreach efforts. In 2012, many have noted that the number of attendees from these agencies at industry conferences has declined, most likely as a consequence of budgetary issues. In addition, the IRS has significantly

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grown its outreach efforts conducted through phone forums and web-based seminars.

- *Looking Forward*. It is unlikely that the IRS will have the budget flexibility to increase the number of attendees at industry conferences and telephonic and web-based activities will continue to grow as a cost-effective form of outreach. While this outreach is very helpful, given less face-to-face contact, there remains the risk that phone or web-based outreached efforts may be interpreted by practitioners in a manner that the IRS may not intend. For example, in 2012, significant concerns were raised after a speaker at an IRS phone forum indicated concern about the appropriate interest rate for plan loans.

## B. Legislative Landscape

***1. Leadership.*** As noted above, the elections did not result in a change in the control of either the House or the Senate. Further, the election is unlikely to result in a change in the leadership of the Senate Finance Committee, Senate Health, Education, Labor, and Pensions Committee, the House Committee on Education and the Workforce, and the House Committee on Ways and Means during the 113th Congress.

***2. Key Legislative Items.***

*a. Fiscal Cliff and Tax Reform.* The key challenge facing Congress into 2013 is the "fiscal cliff" that will occur as of January 1, 2013. Although the Internal Revenue Code's retirement plan limits and provisions are not directly affected by the fiscal cliff, retirement plans (as well as employer provided health insurance) are at the crosshairs of the fiscal cliff. Retirement plans are currently estimated to "cost" the U.S. Treasury over $100 billion per year. However, as many in the retirement plans industry have noted, amounts contributed to retirement plans are, except for Roth contributions which are taxed on contribution, eventually subject to taxation, so the impact of the tax expenditure for retirement plans is arguably overstated although given the focus on current revenue, it is not clear whether this analysis will be adopted by members of Congress. Fiscal cliff options that would potentially affect retirement plans include the following:

- *National Commission on Fiscal Responsibility and Reform (Bowles-Simpson)*. In late 2010, a joint commission, National Commission on Fiscal Responsibility and Reform, appointed by President Obama issued its report on the federal government's fiscal challenges.[6] One item in this report proposed capping contributions to "tax-qualified" retirement plans at the lesser of $20,000 or 20 percent of eligible compensation, collapsing the types of tax-favored retirement programs, and increasing the Savers Credit. This provision has commonly been referred to as the 20/20 proposal. Given the shift of many employers to defined contribution plans with enhanced matching and/or employer contributions, this proposal immediately raised a number of concerns. Fiscal cliff legislation could contain a modified version of this proposal.
- *Reduction in Maximum Contribution Limits*. In 1994, the maximum contribution that can be taken into account under a tax-qualified plan was reduced $235,840 to $150,000. Similarly, fiscal cliff legislation could result in rollbacks in the maximum defined benefit and defined contribution plan limits under Code Sec. 415 and/or reductions in the Code Sec. 401(a)(17) compensation limit.
- *Limits on Tax Deductibility for Higher Income Taxpayers*. In its fiscal year 2013 budget proposal, the Obama Administration proposed capping deductions for employee contributions to defined contribution plans at 28 percent of the tax value. The effect of this proposal would have been to limit the tax-advantage of pre-tax contributions made by highly compensated employees. Fiscal cliff legislation could also pick-up this type of proposal.
- *Elimination of Pre-Tax Deductions for Employee Contributions*. Similar to the Obama Administration fiscal year 2013 proposal, Congress could act to make all employee contributions to defined contribution plans "after-tax," thus increasing current revenue.

Of course, the actual viability of any of these proposals is uncertain depending on the outcome of fiscal cliff negotiations.

*b. Other Retirement Plans Designs.* In addition to fiscal cliff negotiations, a number of retirement proposals could move forward in 2013, especially as part of a larger tax reform agreement. Ideas that might come under consideration include:

- *Obama Administration Proposals*. In addition to the limit on the deductibility of employee contributions to defined contribution plans described above, the Obama Administration has previously encouraged an expansion of the Savers Credit and the implementation of automatic IRAs to increase participation in tax-favored retirement savings vehicles.

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- *Bush Administration Proposals*. During the Bush Administration, the Administration proposed consolidating the various types of retirement plans—from 401(k) plans to 403(b) plans to 457(b) plans into a single type of retirement vehicle.
- *Harkin Proposal*. During summer 2012, Senator Harkin (D-Iowa) and Chairman of the Senate Committee on Health, Education, Labor and Pensions unveiled a proposal for the Universal, Secure, and Adaptable Retirement Funds a privately run pension fund with minimal involvement.
- *Secure Choice Pensions*. The National Conference on Public Employee Retirement Systems has proposed that state governments and public plans be allowed to maintain pension plans for employers in their states. California has already passed preliminary enabling legislation.
- *Open Multiple Employer Plans*. There has been significant interest in "open" multiple employer plans designed and administered by private sector sponsors.

## ENDNOTES

1. Rev. Proc. 2005-66.
2. Announcement 2011-82. Also, in fall 2012, the IRS eliminated its letter forwarding program because of the ongoing availability of the Social Security locator program. Rev. Proc. 2012-35.
3. *www.irs.gov/Retirement-Plans/Retirement-News-for-Employers---Fall-2011---Revised-Form-5300*.
4. *www.irs.gov/pub/irs-dft/f5300--dft.pdf*.
5. *www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-%28EPCU%29*.
6. *www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/TheMomentofTruth12_1_2010.pdf*.

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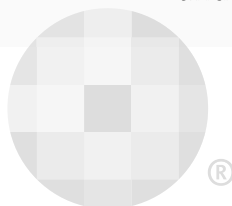

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