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LEGAL DEVELOPMENTS

Qualified Plan Changes within the Bipartisan Budget Act

A roundup of changes, including those related to hardship withdrawals, California wildfire relief, federal tax levies, and multiemployer plans.

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It is not often that you think of qualified plan changes when you think about the federal budget, but you need to, because the Bipartisan Budget Act of 2018 (the Act) contains a number of important qualified plan changes that will require the attention of plan sponsors and recordkeepers alike in short order. These changes include the following:

1. *Hardship withdrawals.* The Act expands hardship withdrawal rules for 401(k) and 403(b) plans that offer in-service hardship withdrawals, effective for the 2019 plan year.
2. *California wildfire relief*. The Act provides similar relief that Congress has provided in the past for certain hurricane victims. This guidance, which applies to victims of the 2017 California wildfires, tracks the relief provided to victims of Hurricanes Harvey, Irma, and Maria, and is effective immediately (February 9, 2018).

3. *Federal tax levies*. The Act permits improper federal tax levies to be rolled back to the qualified plan or to an individual retirement account (IRA), effective immediately (January 1, 2018).
4. *Congressional committee for multiemployer plans*. The Act establishes a Congressional bipartisan committee to address the funding dilemma affecting multiemployer plans and the Pension Benefit Guaranty Corporation (PBGC).

Expanded Hardship Withdrawals

Historically, there have been a number of restrictions on hardship withdrawals from 401(k) and 403(b) plans (which incorporate the 401(k) regulations by reference) that have added to the complexities of these distributions and have made it rather difficult for a participant in need to gain access to his or her account. These restrictions include:

- *Available Funds*. Hardship withdrawals are not available from all contribution sources. For example, these withdrawals are not available to safe harbor plan employer contributions, nor to qualified nonelective contributions (QNECs), nor to qualified matching contributions (QMACs), nor to post-12/31/1988 investment earnings (including such earnings on pre-tax contributions).
- *Other Distributions First*. To have a bona fide hardship distribution, the participant must demonstrate that he or she has sustained a heavy and immediate financial need and that the hardship distribution is necessary to satisfy the need. Treasury regulations outline simplified rules for deeming that each of these requirements are met, generally referred to as the "safe harbor hardship" rules, which are common plan features. For a requested hardship withdrawal to fall within the safe harbor requirements to be deemed necessary to satisfy an immediate and heavy financial need, the participant must take all other available plan distributions first before taking a hardship withdrawal. Under this rule, the participant generally is required to obtain all other currently available distributions, including Employee Stock Ownership Plan (ESOP) dividends, and plan loans available under the plan and all other plans maintained by the employer. For this purpose, other plans include all qualified and nonqualified plans of deferred compensation by the employer.
- *Six-Month Suspension on Employee Contributions*. Again, for a hardship withdrawal to meet the safe harbor requirements to be deemed necessary to satisfy an immediate and heavy financial need, the plan sponsor must suspend the withdrawing employee's contributions (including 401(k) and Roth deferrals and after-tax contributions) to the plan and all other plans maintained by the employer for at least six months after he or she receives a hardship withdrawal. For this purpose, other plans include a stock option, stock purchase, or similar plan maintained by the employer (including nonqualified plans).

So, it gives me great pleasure to say that the Act largely eliminates these restrictions for plan years beginning after 2018 (*e.g.*, January 1, 2019, for calendar year plans). Specifically:

- *Available Funds Expanded*. Hardship withdrawals may then be made available from all contribution sources and earnings thereon under a 401(k) and 403(b) plan. Specifically, hardship withdrawals will be available from QNECs, QMACs, safe harbor plan contributions, and all earnings from available contribution sources (including 401(k) deferrals and, presumably, 403(b) deferrals, but Internal Revenue Service (IRS) guidance would be welcomed). This should eliminate the need to track post-12/31/1988 earnings, as well as historic hardship withdrawals, in order to properly determine the amount available for a needed distribution.
- *Other Distributions First (But Can Ignore Loans)*. The Act provides that a hardship withdrawal will not fail to be a hardship distribution solely because the employee does not take any available loan under the plan (which presumably will extend to other plans with the same employer). As a result, the loan process can be skipped when considering a hardship request. Unfortunately, we still need to make sure no other plan distributions are available for a safe harbor hardship, as this provision described above was not removed.
- *No More Six-Month Suspension*. The Act instructed Treasury to eliminate the six-month deferral and other employee contribution suspension requirement in the regulations.

We await IRS guidance on the proper implementation of these provisions (which is anticipated even though the IRS has a lot on its plate), including guidance on:

- Whether changes to the plan document are needed to maintain the safe harbor withdrawal status;
- Whether changes to the plan document are needed to maintain a plan's safe harbor 401(k)/401(m) status;
- What, if any, transition relief will be available in relation to hardships taken during 2018 for which the six-month suspension period extends past the first day of the 2019 plan year;
- What conforming changes will be made to the definitions of QNEC and QMACs (on which we already have proposed regulations pending as a result of the change in position regarding the use of forfeitures) and whether plan amendments will be needed as a result;
- What happens if the plan sponsor does not want to make any of these changes to the operation of the hardship rules within its plan; and
- The timing and scope of any required or desired plan amendments.

But, while we wait, plan sponsors and recordkeepers should be ready to dust off their hardship procedures (again) and see what changes may be needed or desired, and be prepared for plan amendments (and related summary plan description). These changes, coupled with the recent guidance on streamlined hardship documentation, are a move in the right direction to facilitate making funds available when a participant needs it the most.

Relief for Improper Federal Tax Levies

We all know that one big exception to the anti-alienation protections for qualified plans is federal tax levies. But even the IRS makes mistakes sometimes in assessing levies, and has a specific procedure under the Internal Revenue Code to refund any improper amounts to the taxpayer. Unfortunately, this typically results in a taxable distribution to the participant with no way to get the funds back into the qualified plan. To the extent this is your situation, we have good news! Effective January 1, 2018, plan distributions (including 401(a), 401(k), 403(b), governmental 457(b), and IRAs) made to comply with a federal tax levy that was wrongful can be restored to the plan (with interest) if the plan sponsor so allows, or can be rolled to an IRA by the tax filing deadline (excluding extensions) for the year of the refund. This returns the funds to their tax-deferred position without adverse tax consequences.

Again, we will await guidance regarding the timing and need for plan amendments (and Summary Plan Description (SPD) modifications) for this optional provision, but if this situation arises (which may well be rare), there is relief.

Relief for California Wildfire Victims

For qualified plans (including 401(a), 403(b), IRA or governmental 457(b) plans) that cover Californians, this additional congressional relief that tracks the relief available for Hurricanes Harvey, Irma, and Maria should be considered. Note that these provisions supplement, and do not replace, the existing hardship and loan guidance set forth in Announcement 2017-15.

In short, plan distributions of up to $100,000 made between October 8, 2017, through December 31, 2018, to participants whose principal place of abode between October 8, 2017, and December 31, 2017, was in the California wildfire disaster area and who sustained an economic loss by reason of the wildfires are entitled to favorable tax treatment, including:

1. Taxation over a three-year period;
2. The ability to return the distributed amount back to an eligible retirement plan within three years and avoid taxation;
3. No 10 percent early withdrawal tax;
4. No mandatory 20 percent federal income tax withholding, as they are not treated as eligible rollover distributions; and
5. The ability to take an in-service distribution from the 401(k)/403(b) plan, even if the participant is not yet age 59½.

Moreover, a participant who took out plan money (between April 2017 and January 14, 2018) to purchase a California home, but for whom the purchase was forestalled due to the wildfires is permitted to return the unused funds to the plan. There is also loan relief that increases the loan limit to $100,000 and 100 percent of the vested account balance and provides a one-year delay for certain loan repayments.

The Act provides that a plan amendment to implement these changes by the end of the 2019 plan year (with governmental plans getting an additional two years) is required to the extent the plan sponsor provides the relief. Hopefully, the IRS also has this on its list for guidance (or otherwise provides guidance on Hurricanes Harvey, Irma, and Maria and these wildfires, which would be better than looking back at the Katrina guidance that was issued in 2005 (Notice 2005-92) to help with the interpretation of these provisions.)

Therefore, plan sponsors and recordkeepers should review their current provisions to consider if this additional relief is appropriate, and if it is, update their distribution procedures accordingly (and put this amendment on the to-do list).

Committee on Solvency of Multiemployer Pension Plans

Lastly, the Act includes a call to action for Congress to focus on the pension funding situation faced by the PBGC's multiemployer insurance program and multi-employer plans. As the first step, the Act provides for an establishment of a bipartisan committee charged with improving the solvency of multiemployer pension plans and the PBGC, which is no easy task. This committee, known as the House and Senate Joint Select Committee on Solvency of Multiemployer Pension Plans, is to issue a report by November 30 of this year to make recommendations and legislative language to address these solvency concerns. The Act also provides procedural avenues to fast-track resulting legislative guidance.

Conclusion

Plan sponsors and third-party recordkeepers should review these law changes and consider the necessary implementation action to take advantage of the relief and stay tuned for IRS guidance on these changes. ■