

Qualified Plan Consulting Alert!

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IRS Releases Guidelines for Substantiation of Safe Harbor Hardship Withdrawals

Background: The Internal Revenue Service (IRS) has released guidelines for its Employee Plans (EP) Examinations employees regarding safe harbor hardship withdrawals under a 401(k) plan. Although these are guidelines for EP examiners the guidelines provide useful information to plan sponsors for review and approval of safe harbor hardship withdrawals. Previously hardship withdrawal guidance released in 2015 provided more general guidance on the need for qualified plan sponsors to maintain documentation for all hardship withdrawals as well plan loan transactions. The new EP guidelines provide more specific guidance. (For prior guidance see QPC Alert 2015/2015-02 at <http://foremployers.voya.com/articles/401k-infocenter>)

A safe harbor hardship distribution must meet two requirements: a) the distribution must be made on account of immediate and heavy financial need and b) the distribution may not exceed the amount of the need. The new EP Examination guidelines speak specifically to documentation needed to determine whether a hardship withdrawal, that is made under the safe harbor hardship withdrawal rules, has been made on account of a deemed immediate and heavy financial need.

Overview of new guidance: Under the new EP Examination guidelines the examiner is directed to take the two steps outlined below with regard to the employer or third party administrator that is approving the distribution. Voya suggests plan sponsors review all related forms and documentation, for each hardship withdrawal request, to insure the required participant notifications have been furnished and all relevant information has been collected and retained.

Step 1: Determine whether prior to the distribution the following documentation is obtained:

- a) Source documents (such as estimates, contracts, bills and statements from third parties); OR
- b) A summary of the information contained in the source documents (in paper, electronic format, or telephone records).
- c) If a summary of the source documents is used, determine whether the employee notifications required on Attachment 1 of the guidelines (attached here) were provided.

Step 2: Review the source documents

- a) The examiner should review the source documents described in Step 1 to determine if they substantiate the hardship distribution.
- b) If the summary of documentation is used, review it to determine whether it contains the relevant items listed on Attachment 1 to the guidelines (attached here).
- c) If the employee notifications required under Step 1, Attachment 1 or the information reviewed in Step 2 is incomplete or inconsistent on its face, the examiner may ask for source documents from the employer or third-party administrator to substantiate that the hardship distribution is deemed to be on account of an immediate and heavy financial need.
- d) If the summary of information reviewed in Step 2 is complete and consistent but some employees have received more than 2 hardship distributions in a plan year, then in the absence of adequate explanation the examiner may ask for source documents to substantiate the distributions. Examples of adequate explanation include medical bills, funeral expenses or tuition on a quarterly school calendar.
- e) If a third-party administrator obtains a summary of information contained in the source documents, as described under Step 1, the examiner should determine whether the third-party administrator provides that data to the employer, as least annually, describing the hardship distributions made during the plan year.

If the examiner determines all the requirements of Step 1 and Step 2 are met the plan should be treated as satisfying the substantiation requirement for making hardship distributions deemed to be on account of an immediate and heavy financial need.

Effective date: This guidance is effective on February 23, 2017 and should be applied to examinations open on that date.

Voya position: These guidelines for EP examiners offer plan sponsors some additional insight into the types of documentation the IRS expects a plan sponsor to review and retain when deciding whether to approve a safe harbor hardship withdrawal.

IRS Circular 230 Disclosure

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Attachment I

HARDSHIP SUBSTANTIATION INFORMATION AND NOTIFICATIONS FOR SUMMARY OF SOURCE DOCUMENTS

I. Notifications that the Employer/Administrator Must Provide to the Employee

- The hardship distribution is taxable and additional taxes could apply.
- The amount of the distribution cannot exceed the immediate and heavy financial need.
- Hardship distributions cannot be made from earnings on elective contributions or from QNEC or QMAC accounts, if applicable.
- The recipient agrees to preserve source documents and to make them available at any time, upon request, to the employer or administrator.

II. General Information for All Hardship Requests

- Participant's name
- Total cost of the event causing hardship (for example, total cost of medical care, total cost of funeral/burial expenses, payment needed to avoid foreclosure or eviction)
- Amount of distribution requested
- Certification by the participant that the information provided is true and accurate

III. Specific Information on Deemed Hardships

A. Medical Care

- Who incurred the medical expenses (name)?
- What is the relationship to the participant (self, spouse, dependent, or primary beneficiary under the plan)?
- What was the purpose of the medical care (not the actual condition but the general category of expense, for example, diagnosis, treatment, prevention, associated transportation, long-term care)?
- Name and address of the service provider (hospital, doctor/dentist/chiropractor/other, pharmacy)
- Amount of medical expenses not covered by insurance

B. Purchase of Principal Residence

- Will this be the participant's principal residence?
- Address of the residence
- Purchase price of the principal residence
- Types of costs and expenses covered (down-payment, closing costs and/or title fees)
- Name and address of the lender
- Date of the purchase/sale agreement
- Expected date of closing

C. Educational Payments

- Who are the educational payments for (name)?
- What is the relationship to the participant (self, spouse, child, dependent, or primary beneficiary under the plan)?
- Name and address of the educational institution
- Categories of educational payments involved (post-high school tuition, related fees, room and board)
- Period covered by the educational payments (beginning/end dates of up to 12 months)

D. Foreclosure/Eviction from Your Principal Residence

- Is this the participant's principal residence?
- Address of the residence
- Type of event (foreclosure or eviction)
- Name and address of the party that issued the foreclosure or eviction notice
- Date of the notice of foreclosure or eviction
- Due date of the payment to avoid foreclosure or eviction

E. Funeral and Burial Expenses

- Name of the deceased
- Relationship to the participant (parent, spouse, child, dependent, or primary beneficiary under the plan)
- Date of death
- Name and address of the service provider (cemetery, funeral home, etc.)

F. Repairs for Damage to Principal Residence

- Is this the participant's principal residence?
- Address of the residence that sustained damage
- Briefly describe the cause of the casualty loss (fire, flooding, type of weather-related damage, etc.), including the date of the casualty loss
- Briefly describe the repairs, including the date(s) of repair (in process or completed)