AMERICAN BENEFITS COUNCIL

January 11, 2019

Submitted via www.regulations.gov

Internal Revenue Service
CC:PA:LPD:PR (REG–107813–18)
Room 5203
Ben Franklin Station
Washington, DC 20044

Re: Hardship Distributions of Elective Contributions, QMACs, QNECs, and Earnings, RIN–1545–BO82

Dear Sir/Madam:

The American Benefits Council (the "Council") welcomes the opportunity to submit comments on the proposed regulation published by the Department of the Treasury and the Internal Revenue Service ("IRS") regarding hardship distributions of elective contributions, qualified matching contributions ("QMACs"), qualified nonelective contributions ("QNECs"), and earnings.[1]

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either directly sponsor or provide services to retirement and health plans that cover more than 100 million Americans.

The Council and its members appreciate the flexible and administrable approach that the Treasury Department and IRS set forth in the proposal with respect to the manner in which plans may implement both the required and permissive changes to the hardship distribution rules. We further appreciate the very reasonable approach that the regulation would take in addressing certain questions that recent amendments to the Internal Revenue Code ("Code") have raised. As such, the majority of our comments below describe additional items for which the Council and its members would appreciate further clarification from the IRS.

[1] 83 Fed. Reg. 56,763 (Nov. 14, 2018).

1. Reliance on Proposed Regulation

The most critical issue raised by the proposed regulation that we ask the IRS to address as soon as possible is the need for confirmation that taxpayers may rely on the proposed regulation until a final regulation is published, and that any changes made in the final regulations that are more restrictive than the proposal will be applied prospectively only.

Notwithstanding the section header in the preamble to the proposed regulation labeled "Applicability Dates and Reliance," the preamble only states when the changes may be "applied," and explicit statements regarding reliance are absent from the proposal. Many plan sponsors are already in the position of needing to rely on the proposal for guidance with respect to certain aspects of the proposed regulation. In this regard, section 1.401(k)-1(d)(3)(v)(B) of the proposed regulation would provide plan sponsors with the option of applying the revised list of safe harbor expenses (i.e., the amended safe harbor expense related to casualty losses and the new safe harbor expense related to FEMA-designated disaster areas) to distributions made on or after January 1, 2018. Clarifying that plan sponsors may rely on the proposed regulation is especially important for those plan sponsors who would like to apply the revised list of safe harbor expenses as early as January 1, 2018.

2. Support for Administrative Flexibility and Other Improvements

As noted above, we are pleased that the Treasury Department and IRS incorporated helpful flexibility within the proposed regulation to account for the various ways in which plan sponsors have approached the legislative changes to the hardship distribution rules before additional guidance was available. Those features and other aspects of the proposal that we support include the following:

- Postponing the application of the prohibition on suspensions of an employee's elective deferrals or after-tax contributions as a condition of receiving a hardship distribution to distributions made on or after January 1, 2020;
- Providing plan sponsors with the option of eliminating the suspension of contributions as a condition of receiving a hardship distribution as of the first day of the first plan year beginning after December 31, 2018, and providing additional flexibility in ending the suspension with respect to hardship distributions that were received in the second half of the 2018 plan year;
- Amending the safe harbor event related to casualty losses so that it is applied without regard to the amendments made to Code section 165(h)(5) by the Tax Cuts and Jobs Act, yet providing flexibility in how such provision may be

administered from January 1, 2018 through the first day of the plan year beginning after December 31, 2018; and

- Taking steps to begin automating and streamlining disaster relief guidance, which has to date generally been issued on an ad hoc basis.[2]

3. Safe Harbor Plan Assets Available for Hardship Distribution

Prior to the Bipartisan Budget Act of 2018 ("BBA"), the Code imposed restrictions on the distribution of certain amounts under 401(k) and 403(b) plans. Section 41114 of the BBA amended Code section 401(k) for plan years beginning after December 31, 2018, to provide that the amounts that may be withdrawn upon hardship of the employee include not only elective deferrals, but also QNECs, QMACs, and earnings on elective deferrals, QNECs, and QMACs.[3]

In response to the changes made by the BBA, the proposed regulation would eliminate the current rule specifying that hardship distributions "[do] not include earnings, QNECs or QMACs" (unless grandfathered).[4] In addition, the preamble to the proposed regulation states that safe harbor contributions made to a plan described in Code section 401(k)(13) (i.e., a qualified automatic contribution arrangement or "QACA") "may also be distributed on account of an employee's hardship (because these contributions are subject to the same distribution limitations applicable to QNECs and QMACs)."[5]

Clarification regarding safe harbor contributions under Code section 401(k)(12): Although we believe it is clear that safe harbor contributions made under the safe harbor described in Code section 401(k)(12) may also be distributed on account of an employee's hardship, we ask that the IRS explicitly confirm this point in the final regulation in order to preclude any uncertainty that could otherwise develop as a result of the preamble only discussing safe harbor contributions under QACAs in this regard.

As noted above, the BBA permits QNECs and QMACs to be distributed on account of an employee's hardship. The regulation for safe harbor contributions described under Code section 401(k)(12) describes the safe harbor contribution requirements as

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[2] This change is consistent with recommendations the Council made to the Treasury Department, Department of Labor, and the Pension Benefit Guaranty Corporation to encourage the agencies to proactively standardize and coordinate their disaster relief procedures in advance of future disasters. *See* Council letter to David Kautter, IRS Acting Commissioner (January 22, 2018).

[3] Not all changes made by the BBA to the assets available for hardship distribution apply to 403(b) plans.

[4] Treas. Reg. § 1.401(k)-1(d)(3)(ii).

[5] 83 Fed. Reg. 56,766.

requiring the employer to make a "qualified nonelective contribution" and "qualified matching contributions" (i.e., QNECs and QMACs) on behalf of eligible non-highly compensated employees.[6] As such, we believe it is clear that a plan may also make such contributions eligible for distribution on account of hardship as provided under the BBA.[7] Nevertheless, in order to avoid the possibility of doubt, we request that this be confirmed for the safe harbor described under Code section 401(k)(12) in the final regulation.

4. NEW RULES FOR SHOWING NECESSITY OF DISTRIBUTION TO SATISFY NEED

Under the current hardship distribution rules, a distribution is only treated as having been made on account of a hardship if the distribution is necessary to satisfy an immediate and heavy financial need of the employee.[8] Whether the distribution is necessary to satisfy such need is determined using either a general rule or a safe harbor rule. In effect, the proposed regulations would blend the general rule and safe harbor rule approaches into one test by eliminating certain aspects of the current rule (e.g., the safe harbor rule requirement that plans restrict employees from making contributions for at least six months following a hardship distribution), and modifying other aspects.

Clarification regarding "actual knowledge": Under the proposed regulation, a distribution would be treated as necessary to satisfy an immediate and heavy financial need of an employee (1) only to the extent that the amount of the distribution is not in excess of the amount required to satisfy the need, (2) if the employee has obtained all other currently available distributions under all qualified or nonqualified deferred compensation plans of the employer, and (3) the employee represents in writing or by an electronic medium that he or she has insufficient cash or other liquid assets to satisfy the need.[9] For purposes of the third requirement, the proposal states that the plan administrator "may rely on the employee's representation unless the plan administrator has *actual knowledge* to the contrary" (emphasis added).

Although the general rule under the current regulation includes an "actual knowledge" component, the vast majority of plans currently utilize the safe harbor approach and are therefore unfamiliar with what the IRS intends for "actual knowledge" to entail. We therefore request that the final regulation provide additional

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[6] Treas. Reg. § 1.401(k)-3(b)(1) and (c)(1).

[7] Although the BBA defines QNEC and QMAC by cross reference to Code §§ 401(m)(4)(C) and 401(k)(3)(D)(ii)(I), respectively, and the terms "qualified nonelective contribution" and "qualified matching contributions" as used in Treas. Reg. § 1.401(k)-3(b)(1) and (c)(1) are defined in Treas. Reg. § 1.401(k)-6, the definitions are functionally the same.

[8] Treas. Reg. § 1.401(k)-1(d)(3)(i); *see also* Treas. Reg. § 1.401(k)-1(d)(3)(iv).

[9] The proposed regulation specifies that the employee's written representation would be required for distributions made on or after January 1, 2020. Proposed Treas. Reg. § 1.401(k)-1(d)(3)(iii)(B).

guidance in this regard, including what standard a plan administrator should apply in determining whether it possesses "actual knowledge," and how any such knowledge should be considered in light of an employee's representation that no other resources are reasonably available. As an alternative, we encourage the IRS to consider eliminating the "actual knowledge" exception in the final regulation due to these concerns over administrability as well as privacy concerns.

Clarification regarding employee representation: As noted above, one of the requirements for determining that a distribution would be treated as necessary to satisfy an immediate and heavy financial need is obtaining a representation by the employee that he or she has insufficient cash or other liquid assets to satisfy the need. We ask the IRS to clarify that such employee representation would not violate the 403(b) prohibition on an employee's self-certification with respect to hardship withdrawals.

Determining the necessity of a hardship distribution in 2019: Because two components of the proposed regulation with respect to determining the necessity of a hardship distribution do not take effect until January 1, 2020,[10] the Council asks that the IRS confirm that the determination of a hardship distribution's necessity for distributions made in 2019 is limited to (1) limiting the hardship distribution to the amount necessary to satisfy the need based on the information and/or documentation provided by the employee, and (2) requiring the employee to obtain all other currently available distributions under all qualified or nonqualified deferred compensation plans of the employer. Further, we request confirmation that, for 2019, alternatively, a plan may, but is not required to, follow the current "general rule" in the regulation for determining whether a distribution is no more than necessary to satisfy an immediate and heavy financial need.[11]

5. NEW SAFE HARBOR EXPENSE FOR FEMA-DESIGNATED DISASTER AREAS

Under the current hardship distribution rules, a distribution is only treated as having been made on account of a hardship if it is made on account of an "immediate and heavy financial need." Although the rules provide a general rule for determining whether an employee has an immediate and heavy financial need, the regulation also sets forth six deemed safe harbor events. The proposed regulation would add a seventh event for

[10] The two components are: (1) removal of the six-month suspension on contributions following a hardship distribution; and (2) the written representation requirement, which is currently only required under the general test of necessity.

[11] In other words, a plan may follow the rules in Treas. Reg. § 1.401(k)-1(d)(3)(iv)(A)-(D) in 2019 instead of the streamlined rules in the proposed regulation.

> Expenses and losses (including loss of income) incurred by the employee on account of a disaster declared by the Federal Emergency Management Agency (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.

Substantiation of new safe harbor expense: The Council and its members request that the IRS provide guidance as soon as possible with respect to what information the IRS would expect employers and plan administrators to obtain in order to substantiate the new safe harbor expense, especially with respect to an employee's "loss of income." We would find it helpful to better understand what types of situations the IRS had in mind, such as with respect to both salaried and hourly employees, as well as situations involving reductions in or loss of overtime pay. Because the loss of income due to a job loss would, under most plans, mean that the employee could take a plan distribution on account of severance from employment, we assume that "loss of income" was intended to cover scenarios other than job loss, but clarification on this point would be appreciated. It would further be helpful for the IRS to clarify that an employer's certification of the employee's "loss of income" would be sufficient documentation.

In addition, we ask the IRS to update its February 23, 2017, and March 7, 2017 memoranda for Employee Plans Examinations Employees (and the Internal Revenue Manual) regarding the substantiation of hardship distributions to account for the new safe harbor expense. The update should include clarifying that the examination procedures described in the February 23rd memorandum cover the new safe harbor, and updating Section III of the attachment to the February 23rd memorandum to reflect the new safe harbor.

Scope of new safe harbor expense: As stated in the text of the proposed regulation as provided above, the new safe harbor expense would be available with respect to expenses and losses incurred by the employee as long as the *employee's* principal residence or principal place of employment at the time of the disaster was located in a FEMA-designated disaster area. The preamble to the proposed regulation notes that this new safe harbor expense is similar to relief given by the IRS following certain other federally declared disasters, such as the relief provided in Announcement 2017-15. Our members have noted that Announcement 2017-15 and other similar disaster relief has been made available not only in the case of when an employee's principal residence or place of employment at the time of the disaster was located in a FEMA-designated disaster area, but also in cases where the employee's lineal ascendant or descendant, dependent, or spouse had a principal residence or place of employment in such area at such time.

While the Council does not have a strong view on whether the new safe harbor expense should be expanded to employees whose family members had a principal residence or principal place of employment at the time of the disaster in a FEMA-designated disaster area, we wanted to raise this difference between the proposed regulation and Announcement 2017-15 and ask that the IRS clarify whether the scope of the new safe harbor expense was intended to be narrower than other recent disaster relief guidance. Similarly, we ask the IRS to consider and clarify whether the new safe harbor expense should only apply when such expenses are "incurred by the employee," as the proposed text currently provides, or whether it would also apply to such expenses incurred by the employee's spouse or other immediate family members.

6. AMENDMENT DEADLINES

The Council's members request that the IRS issue guidance with respect to when pre-approved plan documents for 401(k) plans must be amended to account for any changes made under the new hardship distribution rules.

We similarly request guidance with respect to when 403(b) plans must be amended to account for any changes made under the new hardship distribution rules. Although the provision of more general guidance on the timing of 403(b) plan amendments is included on the Treasury Department's 2018-2019 Priority Guidance Plan, it is unclear whether such guidance will be issued prior to the time when amendments reflecting revised hardship distribution rules should be made.

7. SUSPENSION OF NON-HARDSHIP WITHDRAWALS OF AFTER-TAX CONTRIBUTIONS

As noted above, the proposed regulation would prohibit the suspension of an employee's elective deferrals or after-tax contributions as a condition of receiving a hardship distribution for distributions made on or after January 1, 2020. Although it is clear that this prohibition would apply with respect to hardship distributions, it is less clear whether the proposed regulation would have any implications on the suspension of after-tax contributions in connection with a distribution of after-tax employee contributions that was not made on account of hardship. Many employers impose restrictions on contributions after a distribution of after-tax contributions, based on longstanding revenue rulings.[12] As such, the Council requests guidance on whether plan sponsors may continue to apply a six-month suspension based on in-service non-hardship after-tax withdrawals of employee contributions,[13] and/or whether plan

[12] *See* Rev. Rul. 74-56 (concluding that a plan would not be disqualified if the in-service withdrawal of employee contributions that were the basis of employer matching contributions triggered a six-month suspension for making future contributions to the trust).

[13] We recommend the IRS review Revenue Rulings 68-24, 71-295, 73-553, 72-275, 74-55, and 74-56 to determine if any clarifications or modifications are necessary in light of this issue.

sponsors may choose to remove any such suspension, such as for the purpose of maintaining more consistent rules vis-à-vis hardship distributions.[14]

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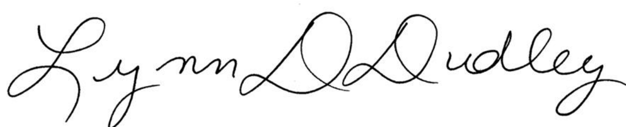
Thank you for your consideration of our comments. Should you have any questions or wish to discuss our comments further, please contact me at (202) 289-6700 or by email us ldudley@abcstaff.org and jjacobson@abcstaff.org.

Sincerely,



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[14] For example, some plans impose a six-month suspension on contributions after either a hardship distribution or a withdrawal of after-tax contributions. Generally, the plan will require the employee to receive all distributions on after-tax contributions before receiving a hardship distribution. Suppose an employee takes a non-hardship distribution of after-tax contributions (which triggers a six-month suspension of contributions) and later takes a hardship distribution of elective deferrals (for which, beginning in 2020, the plan may *not* impose a suspension of contributions). May the suspension continue because it is being imposed for a non-hardship distribution?