GMS Flash Alert

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United States - Hurricane Victims May Access Funds in Certain Retirement Plans

In two recent Announcements[1], the U.S. Internal Revenue Service (IRS) provided that qualified retirement plans may permit more expansive hardship distributions to plan participants affected by Hurricanes Harvey and Irma. The Announcements also allow employers to offer affected plan participants plan loans even if the plan does not currently provide for plan loans.

When there is a major federally declared disaster, the IRS generally announces special relief from various filing deadlines and procedural requirements for taxpayers affected by the disaster. Most recently, the IRS has announced several types of relief for taxpayers affected by Hurricanes Harvey and Irma.[2] Among the types of relief provided are special rules that may allow taxpayers, in certain circumstances, easier access to funds held in certain qualified employer retirement plans (such as section 401(k) plans).

WHY THIS MATTERS

Normally, there are limitations as to what circumstances will qualify a plan participant for a hardship distribution without causing plan failure. There are also procedural requirements that must be met in order to receive a distribution or loan from the plan. The relaxation of these requirements for individuals affected by Hurricanes Harvey and Irma may provide some relief while employees or former employees seek to rebuild after the hurricanes.

How the Relief Works

The above-mentioned IRS Announcement has indicated that a plan failure will not occur if a hardship distribution or loan is made to an employee or former employee whose principal residence or place of employment was within a county identified by FEMA for federal assistance at the time Hurricane Harvey or Hurricane Irma hit that area.[3] The relief also applies in the case of the employee's lineal ascendant or descendant, dependent, or spouse whose principal residence or place of employment was within the affected areas.

Hardship Distributions and Distributions in Case of an Unforeseeable Emergency

Plans making hardship distributions must already have language providing for hardship distributions (or for distributions in case of an unforeseeable emergency in the case of Internal Revenue Code ("the Code") section 457(b) plans). The amount of the distribution is still limited by the maximum amount allowable under the Code and any plan provisions, but it is not limited to just those events listed in the applicable Treasury Regulations. Unlike hardship distributions not associated with federally declared disasters, the special rules for hardship distributions because of disaster do not require the employer to turn off employee elective contributions for the rest of the year (though most employees do so anyway).

Also unlike "regular" hardship distributions, the plan administrator does not have to wait until all of the procedural requirements are satisfied before making a hardship distribution. The plan administrator just has to make a good faith attempt to comply with the hardship requirements. As soon as practicable, however, the plan administrator should make a reasonable attempt to collect the requisite paper-work. This grace period for disaster hardship withdrawals applies from the date the area was identified by FEMA (August 23, 2017 for Hurricane Harvey and September 4, 2017 for Hurricane Irma) to January 31, 2018.

In the case of plan loans, if an employee asks for a loan but the plan terms do not provide for plan loans, the employer can decide to provide plan loans before the plan is amended, so long as the plan is then amended to provide for plan loans by the end of the first plan year beginning after December 31, 2017.

General Tax Treatment

The special relief above does not change the taxation of hardship distributions. A participant taking a hardship distribution is almost always fully taxable on the distribution. In addition, if the plan participant taking the hardship distribution is under age 59 1/2, the distribution is subject to the 10 percent additional income tax penalty under Code section 72(t) unless the participant can meet one of the limited exceptions.

Plan loans are generally for no more than five years. The amounts must generally must be amortized and repaid over the five-year period. If a participant fails to pay back the loan in time, the defaulted amount is treated as taxable income in the year of default.

KPMG NOTE

For further information regarding disaster-related relief, see:

- KPMG's *Tax News Flash* (September 12, 2017), "Retirement plan loans, hardship distributions relating to Hurricane Irma".
- KPMG's *Tax News Flash* (August 30, 2017), "IRS announces retirement plan loans, hardship distributions to hurricane victims".
- K. Field and K. Cacciotti, Washington National Tax, KPMG LLP, Washington, D.C., "Employers Helping Employees - Disaster Relief" in KPMG's *What's News in Tax* (published September 5, 2017). For a copy of this article, please contact your local KPMG professional.

FOOTNOTES:

1 See IRS Announcement 2017-13 and Announcement 2017-11.

2 For related coverage in GMS *Flash Alert*, see the following issues: 2017-131 (September 1, 2017), 2017-136 (September 15, 2017) and 2017-137 (September 15, 2017).

3 For a list of areas identified by FEMA, click here.

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