

Retirement Guidance



RETIREMENT SERVICES

NEW IRS GUIDANCE MAKES SUBSTANTIATING HARDSHIP WITHDRAWALS EASIER

One of the most misunderstood and mishandled retirement plan administration duties is how to review and document participants' hardship withdrawal requests. On February 23, 2017, an IRS memorandum provided their Employee Plan examiners with guidance on evaluating whether participants' hardship withdrawal requests sufficiently substantiate immediate and heavy financial need.

While not intended to be a statement of law, the memorandum provides IRS examiners with insight as to how to evaluate a plan's hardship withdrawal program. Most importantly, the memorandum provides plan sponsors an alternative, and much less burdensome, process to meet their hardship substantiation obligations.

A New Approach

While the memorandum details steps for IRS examiners evaluating immediate and heavy financial need, plans can still request source documents to substantiate hardships. Alternatively, under a new approach, they can provide participants with a notice and ask specific questions about the reason for the hardship withdrawal. The memorandum details all of the notice requirements and generally includes questions that would summarize the information in the source documents without obtaining the documentation itself.

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What events constitute an immediate and heavy financial need?

- ❖ Medical care expenses for the employee or spouse, children or dependents, or primary beneficiary under the plan,
- ❖ Costs directly related to the purchase of a primary residence,
- ❖ Payment of 12 months of post-secondary tuition, related educational fees, or room and board expenses for the employee or his or her spouse, children or dependents, or primary plan beneficiary,
- ❖ Payments to prevent eviction from, or foreclosure on, the employee's principal residence,
- ❖ Burial or funeral expenses for the employee's deceased parents, spouse, children or dependents, or primary beneficiary under the plan, or
- ❖ Expenses for damage repair to an employee's principal residence that would qualify for the casualty deduction under Section 165.

While plans are not required to obtain source documentation under the alternative notice and summary approach, participants must agree to keep and produce records upon request. If the IRS examiner finds inconsistent participant responses to questions, or that participants received more than two hardship withdrawals in a year without adequate explanation, the examiner can request the source documentation. In addition, where the hardship withdrawal program is being administered by a third party, the third party must provide the employer a report at least annually summarizing the hardship withdrawals made in the plan year.

Lockton's Take

While the IRS memorandum provides much-needed insight into acceptable alternatives to obtaining actual hardship documentation, some unanswered questions still leave the door open to potential blame for the plan sponsor. When a participant cannot produce requested source documentation, it is still the plan sponsor's obligation to demonstrate the hardship withdrawal program is compliant and it remains unclear how the IRS would react.

Plan sponsors wishing to use the new alternative approach should review their existing procedures, or those of third parties who administer their hardship withdrawals, to determine what, if any, changes to make. If you have questions, please contact your Lockton Retirement Services Team.

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