Select Limits, Hardship Withdrawal Changes and a Rollover Automation Option

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Updated Limits Impacting Participant Contribution Elections for 2019

While we have been waiting on guidance regarding whether retirement plans must be amended for the Tax Cuts and Jobs Act and the Bipartisan Budget Act with respect to hardship distributions and certain rollover issues, there are more regular changes to discuss first and then we will turn to the significant proposed regulations on hardship distributions. The annual adjustments to contribution and deduction limits for retirement plans was updated. This alert will only touch on a few of those changes that are most important as people elect their contributions for 2019.

- Employees may contribute out of their pay on either a pre-tax or post-tax (Roth) basis to their 401(k) accounts $19,000 in 2019 if they are under the age of 50 and do not turn age 50 in 2019. For employees who turn age 50 in 2019 or who are past age 50 they may contribute the $19,000 plus an additional catch-up contribution of $6,000 in 2019.
- Employers may only consider compensation earned by each employee of up to $280,000 when calculating the employer's contributions such as matching or profit sharing. The taxable wage base for 2019 is $132,900 and FICA taxes are paid on compensation up to such amount.
- The maximum amount that can be added to an employee's account in a defined contribution retirement plan for 2019 is $56,600, plus, if the employee is eligible the catch-up contribution (please remember there are requirements that apply to be able to offer the catch-up contribution.
- ESOPs have some special limits such as maximum account balances which were also indexed, but ESOPs and defined benefit pension plans are special and so their limits for 2019 are not discussed in this alert to keep it to the most relevant items.

Hardship Withdrawal Changes

Late in 2017 and in February of 2018, two laws were enacted requiring changes in the hardship withdrawal distributions and the operation of 401(k) plans that included a direction to the Internal Revenue Service and Treasury Department (collectively the "Service") to issue regulations to implement Congress's intent. Proposed regulations were released late last week. Some of these changes can be effective as of January 1, 2019 and others will be effective as of January 1, 2020- it is never easy or simple.

Hardship withdrawals are typically available for specified reasons and when the individual has an immediate and heavy financial need. In order to qualify a hardship withdrawal must be necessary to satisfy an immediate and heavy financial need, and under the current rules, this required the individual had to stop contributing for 6 months and had to have taken all other available distributions or loans. The proposed rules change this after January 1, 2020 by no longer requiring employees to stop making employee contributions and no longer requiring the employee to take loans first. The proposed rules still require the employee to have obtained all other available distributions from the employer's other plans and the employee must represent that he has insufficient cash or other liquid assets to satisfy the financial need, but it does not require the employee to stop contributing towards his retirement. If you have a nonqualified deferred compensation plan subject to Code section 409A whose benefit is tied to 401(k) plan benefit, you should evaluate how this impacts such nonqualified plan under the linked plan rules under 409A.

The proposed regulations also add as a reason justifying a hardship withdrawal a federally declared disaster impacting the employee's principal residence or principal place of employment, provided such location(s) are in the area designated by FEMA for individual assistance for the declared disaster. For persons whose principal residence or principal place of employment were in areas declared by FEMA to be eligible for individual assistance, such as areas impacted by hurricanes Florence or Michael, or other disasters declared by FEMA as eligible for individual relief in 2018, this means that they may qualify for a hardship withdrawal in 2018. (See http://www.disasterassistance.gov/get-assistance/ to identify

which areas are approved for individual disaster assistance by FEMA). If the plan in which the individual participates is updated for the new reasons for a hardship distribution, a hardship distribution for a qualified FEMA declared eligible disaster in 2018 can be requested by March 15, 2019. The expanded list of reasons for a hardship can be used for a hardship distribution that was made on or after January 1, 2018, but a plan amendment will need to reflect the new reasons and the effective date, and the systems or work arounds will need to be instituted as procedures to facilitate distributions not currently contemplated as hardships in the system based on the hardship withdrawal rules as they existed prior to the TCJA and BBA changes. While there may be amendment delays under the proposed regulations, early adoption of the new reasons will likely trigger an amendment required by your plan's record keeper at an earlier date to guide its implementation of the early adoption of the new reasons.

The proposed rules also expanded the hardship distributions to cover the funeral expenses, educational expenses or medical expenses of the designated primary beneficiary of the participant. The Tax Cuts and Jobs Act ("TCJA") (among other changes) restricted the deduction of casualty losses from 2018 through 2025 to only losses for federally declared disaster areas, the proposed regulations indicate that the new TCJA limits on what constitutes a casualty loss for deduction purposes, do not apply for determining whether a distribution qualifies as a hardship distribution. Historically a casualty loss was not tied to a federally declared disaster area so the TCJA would have significantly limited the availability of hardship withdrawals for other traditional casualty losses. The proposed regulations restore the prior law definition of a casualty loss to be one of the events potentially allowing a hardship withdrawal. (For example, a casualty loss could be the damage caused by a large tree falling on your principal residence or car.)

The Bipartisan Budget Act of 2018 ("BBA") directed the Service to issue regulations that would eliminate the requirement that an employee not be allowed to contribute to their 401(k) plan for 6 months after they take a hardship withdrawal and also permitted hardship withdrawals to be taken from not only the employee salary reduction or Roth contributions, but also from employer contributions in the form of qualified matching contributions, qualified non-elective contributions and profit sharing contributions and from earnings on the individual's account. Previously the 6 month suspension was part of proof of the "immediate and heavy financial need" requirement to qualify for a hardship withdrawal. For hardship withdrawals occurring in 2018, the employer/plan sponsor may elect to either let the 6 month suspension of employee salary deferrals and contributions to run its full period (even if it extends into 2019, e.g., a hardship requested on November 1, 2018 would have the six month period for stopping employee contributions continue until May 1, 2019, without any plan amendment), or the employer/plan sponsor may elect to amend the plan to end such 6 month suspension as of December 31, 2018, if that is earlier. If your plan is not individually designed, you will need to amend your plan or your adoption agreement to change the duration of the contribution stoppage and contact your record keeper and payroll processer to determine if their systems will permit the option to end the cessation of employee contributions on December 31, 2018, or if only the full 6 month stoppage period will be available under their respective systems.

For 403(b) plans, the BBA changes did not include permitting earnings to be distributed in a hardship withdrawal from a 403(b) account, but the BBA changes did include the other expansions of hardship withdrawal relief. Plan sponsors offering 403(b) plans will need to amend their plan documents for these changes as well particularly if early implementation is elected. 403(b) plan sponsors will need to determine if all of the 403(b) annuity or custodial account vendors at their institution will be ready to implement these changes and the effective date of such implementation to be able to update the plan document.

The BBA changes were to be effective for plan years after December 31, 2018. The proposed regulations have a proposed effective date for plan years beginning on and after January 1, 2020. The effective dates in the preamble and in the proposed regulation itself for these various provisions and the options available to plan sponsors requires careful review and analysis. If an election under one of the options to adopt early is considered, employers or plan sponsors should first determine if and when the plan record keeper, the administrative procedures and the payroll procedures are updated for the early adoption of the new rule.

Before an employer makes any decision regarding these proposed regulation changes to the plan document and operations with respect to hardship withdrawals, the employer should first review the plan document or prototype adoption agreement and base plan document to determine what its current rules are with respect to hardship withdrawals to ascertain what plan document amendment and employee communications may be necessary. Next, the employer or plan

sponsor needs to contact its plan's record keeper to determine when their system might be updated to accommodate the new options under the proposed regulations. Some of the provisions in the proposed regulations can be effective earlier than Plan years beginning on or after January 1, 2020, but the systems need to be ready to support the plan changes and record keepers may wait for final regulations before commencing the programming changes.

The BBA's change stopping the cessation of employee contributions for 6 months did not address the consequences of such changes on nonqualified deferred compensation plans under Code section 409A; however, such changes are addressed under the 409A regulations regarding linked plans and deferral elections.

Changes to Rollover Rules- Still Waiting

There were also rollover changes in both the TCJA and the BBA, but no guidance regarding those changes has been issued and no word has been provided on such amendments. One of the changes has been in effect since April 1, 2018 and presumably the amendment deadline for adopting such change into the plan document will be delayed as a change that is integrally related to a qualification requirement.

A Proposed Approach Toward Facilitating Keeping Retirement Plan Money with the Individual

Late last week the U.S. Department of Labor (the "Department") issued two separate items related to one proposal which attempts to help participants keep their retirement plan assets together. The Department issued an advisory opinion and a proposed prohibited transaction exemption with respect to the proposal by Retirement Clearinghouse, LLC ("RCH"). RCH proposes to contract with a variety of plan sponsors to take the participant account balances that would have been subject to being automatically rolled over to an IRA because they exceeded $1,000 and transfer those to an individual retirement account for the individual and then to try to match those accounts to accounts in other employer retirement plans for that individual in subsequent employment so that the funds in the conduit IRA could be transferred to the individual's new employer plan. There are fees for these services that would be deducted from the IRA. The plan sponsor must tell the employees about this new feature (amend the plan and summary plan description) and the employee must receive and not respond to two notices before this automatic rollover starts into motion. The Department has asked for comments on the proposed prohibited transaction exemption. The related advisory opinion on the arrangement discussed which entities were fiduciaries with respect to the retirement money as it moved through this process to keep the funds with the employee as the employee's career moves to different employers.

Employers may expect to hear more about this proposed arrangement through service proposals. Employers must enter into contracts with the vendor to start the process, if they elect to do so and this may raise issues related to various protections for personal information and data security for the information used in this process. This is likely a new tool that you will be hearing about as a way to help employees facilitate keeping track of their retirement plan savings if they do not respond to their former employer's notices regarding such benefits available for distribution or rollover. Employers will need to consider the requirements and the fees for the services as the fees will need to be understood and evaluated as implementing this is a fiduciary act per the Advisory Opinion as it relates to whether this is a reasonable arrangement and if the services are appropriate and helpful to carry out the purposes of the plan and if the fees are reasonable in light of the services provided and if the employee's personal data will be adequately protected. Employers will need to communicate the rules and the fees related to the services to the participants, if adopted.

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