Flashpoint: Budget Act Contains Retirement Plan Changes

Note to self: do not turn the light out for the night if Congress just passed a budget act and you haven't gone looking for benefits provisions.

Yes, the new Bipartisan Budget Act of 2018 (the "Budget Act"), passed by Congress on Thursday, February 8, and signed on the morning of February 9 by President Trump, includes some retirement plan provisions, all of which are good news.

401(k) Hardship Changes

Several of the hardship simplification provisions that were proposed during the tax law debate found their way to the Budget Act. In particular, the Budget Act:

- Instructs the IRS to modify the 401(k) regulations to remove the requirement that participants who receive hardship distributions must suspend deferrals for six months.
- Amends the rules to permit hardship distributions to be taken from QNECs, QMACs, safe harbor contributions, and earnings. Under current rules, hardship withdrawals could be taken only from deferrals themselves (i.e., not earnings, except for those that were pre-1989), and profit sharing and matching accounts (including earnings). The current rules have the dual effect of reducing the amount available to a participant who has suffered a hardship, as well as complicating recordkeeping by requiring that a plan keep track of the "principal" deferrals made by participants. The new rules resolve both issues.
- Eliminates the current hardship rule that requires that participants take all available loans from all plans of the employer before taking a hardship distribution. Again, this simplifies the hardship distribution process. On the other hand, it also increases the pre-retirement "leakage" of benefits from the plan. Loans must be repaid, thereby increasing the likelihood that the removed funds will be returned to the plan. There is no means to directly repay a hardship distribution.

There is no rush to change plans and procedures: all of these provisions go into effect for plan years beginning January 1, 2019, and later.

Disaster Relief for California Wildfire Victims

The Budget Act also extends the now standard disaster-related provisions to those in California who were victims of the massive wildfires. These provisions include:

- Increasing participant loan availability from the normal 50% of the vested account up to a maximum of $50,000 to the liberalized 100% of the vested account up to $100,000;
- Permitting otherwise unavailable distributions of up to $100,000 to people who live in the disaster area without imposing the 10% premature distribution penalty or requiring 20% mandatory withholding. In addition, the tax on the distribution may be spread over a three-year period, or may be avoided entirely if the participant repays the distribution within the same three-year period.

The loan or withdrawal must occur before January 1, 2019.

- Any hardship distribution taken between April 1, 2017, and January 15, 2018, that was intended to be for the purchase or construction of a house in the wildfire disaster area that ended up not being bought or built due to the wildfires can be redeposited to the plan (or to any other plan that can accept rollovers) by June 30, 2018, and avoid being considered to be taxable income. Instead, it will be treated as a rollover.
- The due date for any repayment on a loan that was outstanding to a wildfire victim on or after October 8, 2017, is extended by one year (and the payments after such payment are similarly adjusted), and the five-year maximum repayment period for the loan is determined disregarding the one-year extension period.

To qualify for this relief, the affected participant must have his or her principal place of abode in the Federally-declared California wildfire disaster area during the period from October 8, 2017, to December 31, 2018, and must have suffered an economic loss due to the fires. Note that the loss suffered need not relate to the participant's home – it could be a loss related to the participant's business, too. Any amendment required to conform the plan to these rules must be adopted not later than the end of the plan year beginning in 2019, effective retroactively to when the provisions applied, and the plan must be operated according to the terms of that amendment during the interim period.

If you have questions regarding the Budget Act, contact Ilene or Alison.

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