

December 2, 2016

Mr. Kyle Brown  
Division Counsel  
Tax Exempt & Government Entities  
CC:TEGEDC  
999 North Capitol St., NE  
Washington, DC 20002

## **RE: Recommendations for Suggested Hardship Distribution Substantiation and Participant Loan Documentation Guidance**

Dear Mr. Brown:

The American Retirement Association (“ARA”) is writing to provide recommendations to the Internal Revenue Service (“Service”) with regard to the need for guidance relating to the substantiation and documentation of hardship distributions and participant loans. The ARA appreciates the opportunity to address matters which serve to strengthen and protect the private retirement system.

The ARA is a national organization of more than 20,000 members who provide consulting and administrative services to American workers, savers and sponsors of retirement plans and IRAs. The ARA members are a diverse group of retirement plan professionals of all disciplines including financial advisers, consultants, administrators, actuaries, accountants, and attorneys. The ARA is the coordinating entity for its four underlying affiliate organizations, the American Society of Pension Professionals and Actuaries (“ASPPA”), the National Association of Plan Advisors (“NAPA”), the National Tax-deferred Savings Association (“NTSA”) and the ASPPA College of Pension Actuaries (“ACOPA”). ARA members are diverse but united in a common dedication to America’s private retirement system.

### **Summary**

ARA recognizes that the Service has not issued formal guidance regarding the necessary substantiation and documentation required to make a hardship distribution or participant loan from an employer-sponsored retirement plan.<sup>1</sup> The Service has, however, provided sub-regulatory and informal guidance on this issue.<sup>2</sup> The absence of formal guidance has created uncertainty with regard to industry practices and procedures that have arisen with respect to processing hardship distributions and participant loans. We appreciate the opportunity to work with the Service on clarification of best practices in this area so as to ensure plans are being operated in accordance with the qualification requirements under the Internal Revenue Code.

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<sup>1</sup>TD-9169, 69 FR 78148, preamble to final Code Section 401(k) regulations and TD 9340, 72 FR 41, preamble to final Code Section 403(b) regulations.

<sup>2</sup>See <https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-hardship-distributions>; <https://www.irs.gov/retirement-plans/dos-and-donts-of-hardship-distributions>; <https://www.irs.gov/retirement-plans/hardship-distribution-tips-from-ep-exam>; Employee Plan News Issue No. 2016-10, “Hardship Distributions” (Sept. 20, 2016); Employee Plan News Issue No. 2015-4, “It’s Up to Plan Sponsors to Track Loans, Hardship Distributions” (April 1, 2015); Fall 2009, Vol. 9; ABA Joint Committee on Employee Benefits, Q/A-9 (May 9, 2014) and Q/A-34 (May 10, 2007).

The ARA has previously commented that guidance on the recordkeeping requirements that plan sponsors must satisfy to properly document hardship distributions should be given high priority.<sup>3</sup> Other industry groups have also commented asking for such guidance. Because the Service has emphasized that the plan sponsor is still ultimately responsible for the proper administration of the retirement plan even where a third party administrator handles participant transactions, ensuring that plan sponsors have sufficient information regarding these requirements is critical to ensure compliance.<sup>4</sup>

Because of the confusion that exists, the ARA recommends that the Service provide clarification with respect to standards for documentation (which may be in the form of sub-regulatory guidance in order to expedite resolution of the issue). In addition, the ARA recommends that the Service provide liberal transitional relief for plan administrators who otherwise acted in good faith in the absence of clarifying guidance.

The following is a summary of the ARA's recommendations, which are described in greater detail in the Background and Discussion sections that follows.

**The ARA recommends** the Service issue guidance to clarify the rules applicable to the substantiation and documentation requirements related to hardship distributions and participant loans. Sub-regulatory guidance may be appropriate in order expedite resolution.

**The ARA recommends** the Service provide liberal transitional relief for plan sponsors and administrators who acted in good faith prior to the issuance of any clarifying guidance.

**The ARA recommends** the Service issue guidance permitting a plan administrator (as defined under ERISA §3(16) ) or the plan administrator's delegate to reasonably rely on the representation from the employee as to the following items, unless the plan administrator has actual knowledge or should have known from the surrounding facts and circumstances that the representation is untrue:

- The individual for whom the medical care expense that would be deductible under Code Section 213(d) is incurred is the employee, the employee's spouse, or the employee's dependent;
- The individual for whom the payments for tuition, related educational fees, and room and board expenses, for the next 12 months of post-secondary education are being made are for the employee, the employee's spouse, the employee's children, or the employee's dependents;
- The residence for which the payments are necessary to prevent eviction or foreclosure is the employee's principal residence; and
- The individual for whom the payments for burial or funeral expenses are incurred are for the employee's deceased parent, spouse, children, or dependents.

## Background

Plan sponsors are permitted to design their 401(k) plans to allow participants to access their accounts through loans or hardship withdrawal options. Although not required, our members report anecdotally that most plan sponsors they work with feel these options are important plan features. They allow participants to access their account in times of need and this flexibility, in turn, results in higher savings rates. So although overseeing plan operations would be easier without loan and hardship withdrawal

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<sup>3</sup>ARA comment letter dated June 7, 2016, responding to request for public comments with respect to 2016-2017 Guidance Priority Plan. Notice 2016-26.

<sup>4</sup> *Employee Plans News*, Issue No. 2015-4, April 1, 2015

features, plan sponsors take on these extra administrative burdens for the benefit of their employees. Like many things in life, this laudable goal often exemplifies the old adage, “no good deed goes unpunished.”

The Service stated in the April 1, 2015 *Employee Plans News*, Issue No. 2015-4, that plan sponsors must obtain and keep hardship distribution records, and further stated that it is not sufficient for participants to retain their own records of hardship distributions. Although Treasury Regulation §§ 1.401(k)-1(d)(3)(iv)(C) and (D) permits self-certification by participants to demonstrate that a distribution is the sole means to alleviate a hardship, the Service indicated that self-certification is not permitted in order to demonstrate the nature of the hardship, and instructed plan sponsors to request and retain additional documentation showing the nature of the hardship.<sup>5</sup>

The Service also addressed participant loan documentation in the April 1, 2015 *Employee Plans News*, listing certain records that plan sponsors should retain regarding the origination, administration, and collection of participant loans. In addition, the Service stated that self-certification by participants is not permitted for loans issued for the purpose of purchasing or constructing a primary residence, and instructed plan sponsors to obtain documentation of the home purchase before a participant loan is approved.<sup>6</sup>

## Discussion

The ARA generally agrees with the Service that there needs to be documentation that would allow a plan administrator (as defined under ERISA §3(16)) or the plan administrator’s delegate to reasonably conclude that the hardship necessitating the distribution constitutes an “immediate and heavy financial need” for purposes of Treasury Regulation §§ 1.401(k)-1(d)(3)(iii)(A) and (B). We are, however, reluctant to support any specific standard as to what exactly is needed to document a hardship distribution claim (or loan application). Given the variety of facts and circumstances that may be relevant, any specific standard would be difficult to craft in way that would accommodate the many variables that might be considered by the plan administrator.

Rather than a specific standard, it should be sufficient that the plan administrator, acting in the role of an ERISA plan fiduciary, reasonably determines that the documentation received is sufficient to approve a claim for benefits in accordance with the governing plan documents.<sup>7</sup> The plan administrator should maintain the documentation that formed the basis for the adjudication of the claim, and in this regard, “scanned” copies or other electronically formatted copies may be maintained in lieu of the original documents.

Notwithstanding the foregoing, the ARA believes that self-certification should be permitted for certain limited purposes to avoid unnecessary, intrusive, and potentially time-consuming inquiries by plan administrators into the private relationships and living arrangements of an employee. Specifically, an ERISA §3(16) fiduciary plan administrator (or the plan administrator’s delegate) in the absence of actual knowledge to the contrary, should be permitted to reasonably rely on the representation from the employee as to the following items, unless the plan administrator has actual knowledge or should have known from the surrounding facts and circumstances that the representation is untrue:

- The individual for whom the medical care expense that would be deductible under Code Section 213(d) is incurred is the employee, the employee’s spouse, or the employee’s

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<sup>5</sup> See *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> See ERISA §503 and ERISA Reg. §2560.503-1(b)(5)

dependent;

- The individual for whom the payments for tuition, related educational fees, and room and board expenses, for the next 12 months of post-secondary education are being made are for the employee, the employee's spouse, the employee's children, or the employee's dependents;
- The residence for which the payments are necessary to prevent eviction or foreclosure is the employee's principal residence; and
- The individual for whom the payments for burial or funeral expenses are incurred are for the employee's deceased parent, spouse, children, or dependents.

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These comments and recommendations are submitted on behalf of and were prepared by ASPPA's IRS Subcommittee, Frank Porter, QPA, QKA, Chair. If you have any questions concerning the matters discussed herein, please contact Craig Hoffman, ARA General Counsel and Director of Regulatory Affairs at (703) 516-9300.

Thank you for your time and consideration.

/s/

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/s/

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