THE QUALITY FORUM

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Hardship Withdrawals in an Uncertain Economy

The media have recently cited a Fidelity Investments report that reflected a 10-year high in the number of hardship withdrawals from its 401(k) plans during Q2 of 2010. In the current uncertain economy, call centers, inevitably, will continue to be confronted with these requests. Whether participants appropriately proceed with these transactions often depends upon how well-equipped call center representatives are to communicate all of the nuances of such a transaction.

Hardship withdrawal provisions are not a feature of every plan and participants are sometimes surprised that their employers' plans do not permit them. Even if the plan permits hardship withdrawals, participants are often dismayed to learn that, generally, these withdrawals may only be made from salary deferral contribution accounts (although some plans include a provision that also permits hardship withdrawals from the vested portion of employer nonelective contribution accounts).

Call center representatives need to keep in mind that even though a significant number of participants requesting hardship withdrawals appear to be primarily concerned with the expediency of receiving the funds, these same taxpayers also should be made aware of the requirements and repercussions of these transactions so that they can make informed investment decisions with regard to the withdrawals.

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Announcing NQR's 2011 Client Conference

Please mark your calendars to attend NQR's dynamic 2-day Client Conference at the Seaport Hotel and World Trade Center on Boston's beautiful waterfront. The conference, which is scheduled for Tuesday-Wednesday, October 4-5, 2011, will provide a great opportunity for networking with your peers in the industry. Additional information about the conference theme and registration will be available shortly on NQR's website at www.nqrinc.com. ■

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Representatives should be aware that a participant must:

- Satisfy the immediate and heavy financial needs test;
- Exhaust all other sources of funds reasonably available, including any participant loan option under the plan;
- Limit the request to no more than is required to meet the immediate need;
- Provide documentation of the need to the plan administrator.

Because the majority of participants who request hardship withdrawals are already experiencing severe financial hardship, it is vitally important that verbal and written communications establish realistic expectations about the hardship withdrawal. Firms should try to ensure that all forms of communication clearly explain that:

1. Hardship Withdrawals are subject to ordinary income tax and may be subject to the 10% penalty tax on premature distributions (for distributees under the age of 59 ½).
2. Because Hardship Withdrawals are not Eligible Rollover Distributions:
   - they are not subject to 20% mandatory withholding;
   - any portion of the Hardship Withdrawal not, ultimately, needed to satisfy the financial hardship may not be "redeposited" back into the 401(k) account.
3. During the 6-month period immediately following the withdrawal, the participant:
   - is precluded from making Salary Reduction Contributions to the plan;
   - remains eligible to share in the allocation of Employer Discretionary NonElective Contributions and Employer Qualified NonElective Contributions (QNECs) and the reallocation of forfeitures.

Even in the current "down" economy and even when faced with severe financial hardship, some plan participants might seek another source of funds once made aware of the substantial impact of taking a hardship withdrawal from their retirement accounts. ■

457(b) Plans and the Penalty Tax Rule on Premature Distributions

When the IRS is involved, nothing is ever as simple as it seems. That is certainly true when it comes to governmental 457(b) plans. The basic rules are not always so "basic". Take the issue of Premature Distributions. The "basic" provisions of the Internal Revenue Code state that premature distributions (prior to attainment of age 59 ½) from 457(b) plans are not subject to the 10% penalty tax on early distributions. In addition, amounts rolled into a governmental 457(b) plan from another governmental 457(b) plan are not subject to the 10% penalty when distributed.

However, what many plan sponsors and participants have not been aware of is that:

- Amounts rolled into a governmental 457(b) plan from a 401(a)/(k) plan, a 403(b) plan, or an IRA must be separately accounted for in the 457(b) plan, and when distributed, will be subject to the 10% penalty tax rule;
- Amounts rolled from a governmental 457(b) plan into another type of eligible retirement plan [401(a)/(k), 403(b), IRA] will be subject to the 10% penalty tax rule when distributed because "a distribution of amounts attributable to a rollover contribution is subject to the additional income tax on premature distributions as applicable to the surviving plan" *[IRC Section 72(t)] [Rev. Rul. 2004-12]*. ■

ROTH FEATURES COMPARISON CHART FOR 2010

ROTH 401(K)	ROTH IRA
402(g) Contribution Limit = $16,500	Contribution Limit = $5,000
Age 50 Catch-up Contribution = $5,500	Age 50 Catch-up Contribution = $1,000
Contribution may be matched by employer	No matching contributions
Post-tax contribution; no current tax benefit	Same
Contributions not allowed beyond age 70	Contributions allowed beyond age 70
Must be an active plan participant to contribute	No plan participation requirement
Available to all participants regardless of income	Contributions limited to people whose income does not exceed $120,000/single or $176,000/married
Subject to Required Minimum Distribution rules	Not subject to Required Minimum Distribution rules
Offers anti-alienation protections (including rollovers from IRAs)	Anti-alienation protection not available
Distributions to finance first-time home purchase are not "qualified" or tax-free	Distributions to finance first-time home purchase are "qualified" and tax-free
Participant loans permissible	Loans not permitted

COMPLIANCE CALENDAR

Q4 2010

October 3 401(k) Plan Safe Harbor Notice due to eligible employees from October 3 through December 1 for calendar year plans (at least 30 days, but no more than 90 days prior to the beginning of the 2011 plan year).

October 15 Due date of 2009 Series 5500 Forms to the IRS for plans with December 31 plan year that are on two and a half month extension with Form 5558.

October 15 Extended deadline for filing tax returns for unincorporated businesses and final deadline for making deductible contributions for these entities.

November 15 Summary Annual Report due to Participants if Form 5500 deadline was extended due to corporate tax filing extension.

December 2 Qualified Default Investment Alternative Notice due, at least 30 days prior to the beginning of the plan year, to all Participants who have been defaulted into a QDIA in calendar year plans.

December 2 Annual Automatic Enrollment Notice to all eligible Participants in calendar year plans.

December 15 Summary Annual Report due to Participants if Form 5500 deadline was extended with Form 5558.

December 31 Age 70½ Required Minimum Distributions due to Plan Participants and IRA Account Owners who have begun receiving distributions.

December 31 Deadline for plans to make ADP/ACP corrective distributions for previous plan year in order to maintain qualified status.

December 31 Deadline for plans to correct a failed ADP/ACP test with a QNEC (qualified non-elective/failsafe contribution). ■

NEWS CLIPS

DOL HEARING: LIFETIME INCOME OPTION

As we went to press, the Employee Benefits Security Administration (EBSA) of the Department of Labor and the Internal Revenue Service were preparing to hold a hearing on September 14-15 in Washington, D.C., related to retirement plan design strategies that would include a lifetime income option for plan participants.

The importance of these hearings was reflected in the results of a recent survey conducted by Ipsos, a global, survey-based market research company. Seventy-four percent of the survey respondents indicated that they would like to have a fixed-rate annuity option inside a 401(k) plan that would provide guaranteed lifetime income. ■

IRS ASKING FOR COMMENTS ON ROTH 401(K)S

The Department of the Treasury (IRS) is asking the public for comments on existing final regulation, REG-15234-04, Designated Roth Contributions to Cash or Deferred Arrangements Under Section 401(k). Comments are due to the IRS by October 8, 2010.

Plan sponsors as well as plan service providers will be waiting to see if the comments result in any IRS changes to the regulation. A recent study by Hewitt Associates indicates that, in addition to the 29% of mid-large employers who already offer the designated Roth option in their retirement plans, another 25% of these employers are contemplating adding the option during 2010. ■

MASSACHUSETTS CONGRESSMAN INTRODUCES AUTOMATIC IRA LEGISLATION

Congressman Richard E. Neal of Massachusetts recently introduced to the House of Representatives a bill that would require all employers in business for at least 2 years and with at least 10 employees to sponsor a plan that would automatically enroll all employees in IRAs. The Automatic IRA Act of 2010 is intended to provide for the retirement of the almost 50% of Americans who are currently not covered by a workplace retirement plan. A similar bill was introduced to the Senate by Senator Jeff Bingaman of New Mexico. ■

ASPPA SENDS RECOMMENDATIONS TO DOL ON FINAL RULE FOR FEE DISCLOSURE

On August 29, 2010, the American Society of Pension Professionals & Actuaries (ASPPA) and the Council of Independent 401(k) Recordkeepers (CIKR) sent an 11-page letter to the Employee Benefits Security Administration (EBSA) at the Department of Labor (DOL) regarding the final rule on fee disclosure to retirement plan fiduciaries. Although the communication also made suggestions regarding definitions and descriptions of services, the retirement industry seemed most interested in the substantive changes recommended by these two organizations relative to the format of disclosure including:

- Mandatory inclusion of a summary of relevant disclosure information in the final regulation;
- A one year transition period during which disclosure summaries are permitted, but not mandatory;
- A clarification of electronic transmission/delivery rules with guidance on permitted procedures;
- A recommendation that the safe harbor for dissemination of investment information apply to covered service providers when that information is excerpted from source materials.

The letter also emphasized that both ASPPA and CIKR strongly support fee transparency. ■

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