The Budget Act Makes Some Surprising Changes to Benefit Plans

Friday, March 2, 2018

Summary

On February 9, 2018, President Trump signed a bipartisan budget deal into law, effectively extending federal funding through March 23, 2018. The act includes multiple provisions affecting employee benefit plans, including relaxed hardship withdrawal rules and relief for individuals affected by the California wildfires.

In Depth

On Friday, February 9, 2018, President Trump signed the Bipartisan Budget Act of 2018 (Budget Act) into law, ending a nine-hour funding gap created when the legislation reopening the federal government after last month’s shutdown expired. The Budget Act, which extends funding for the federal government until March 23, 2018, also includes several important provisions affecting employer-sponsored retirement plans.

What Does the Budget Act Do?

The Budget Act relaxes certain hardship withdrawal rules. The Budget Act makes three key changes that relax the rules that apply to participants requesting...
hardship withdrawals.

- It eliminates the requirement that a participant’s contributions (including pre-tax, after-tax and Roth 401(k) contributions) to his or her employer’s 401(k) plan be suspended for at least six months following the receipt of a hardship withdrawal.
- It eliminates the requirement that a participant take all available retirement plan loans before receiving a hardship distribution.
- It expands the sources of 401(k) plan accounts currently available for hardship withdrawals to include not only elective deferral contributions, but also qualified non-elective contributions (QNECs), qualified matching contributions (QMACs), and earnings on those amounts, together with earnings on elective deferrals.

These changes are effective for plan years beginning after December 31, 2018.

The Budget Act provides tax relief for individuals impacted by the California wildfires. The Budget Act also provides special tax relief for certain retirement plan and IRA distributions taken on or after October 8, 2017, and before January 1, 2019, by an individual whose primary residence was located in the federally declared California wildfire disaster area between October 8, 2017, and December 31, 2017, and who sustained economic loss as a result of the wildfires. The relief provided by the Budget Act is similar to the retirement-plan-related disaster relief enacted to benefit individuals impacted by last fall’s hurricanes. For “qualified wildfire distributions” this means that:

- It waives the 10 percent early distribution penalty tax on in-service withdrawals and distributions.
- It permits income inclusion to occur ratably over three years, beginning with the year the wildfire distribution or withdrawal is received. This allows an individual to spread out his or her tax payments on qualified wildfire withdrawals or distributions over three years.
- It exempts distributions from the 20 percent mandatory withholding that normally applies.
- It permits amounts distributed or withdrawn to be repaid within three years. If repaid, the withdrawal or distribution will be treated as a rollover and will not be subject to income tax.

This special tax treatment only applies to qualified wildfire distributions up to $100,000 (reduced by other qualified disaster distributions). In addition, the Budget Act also:

- Permits individuals who received a hardship distribution between March 31, 2017, and January 15, 2018, for the purpose of purchasing or constructing a principal residence within the wildfire disaster area, but who did not do so as a result of the wildfires, to repay the distribution on or before June 30, 2018. If repaid, it will be treated as a rollover and will not be subject to tax.
- Doubles the maximum amount an individual may borrow from a 401(k) plan or other tax-qualified retirement plan to the lesser of $100,000 or 100 percent of a participant’s benefit (reduced by prior loan balances). To qualify for the higher loan limits, the loan must be taken between February 9, 2018, and
December 31, 2018.

- Allows loan payments due before 2019 to be delayed for up to one year, though interest will continue to accrue.

For purposes of implementing this and other recent disaster relief, the Internal Revenue Service has informally indicated that plan sponsors may rely on the regulatory guidance issued in connection with similar disaster relief provided to benefit victims of Hurricane Katrina.

**The Budget Act permits distributions pursuant to invalid federal tax levies to be repaid.** The Budget Act allows an employer to permit individuals who receive retirement plan distributions to pay for a federal tax levy that is later deemed to be invalid, to repay those distributions, thereby avoiding taxation and possible penalties. This change is effective for taxable years beginning after December 31, 2017.

**The Budget Act establishes a committee to study multiemployer pension plan solvency.** In an effort to address the funding crises faced by many multiemployer pension plans, the Budget Act also establishes a Congressional committee referred to as the “Joint Select Committee on Solvency of Multiemployer Pension Plans.” The goal of this committee is to improve the solvency of multiemployer pension plans and improve the solvency of the multiemployer plan insurance program overseen by the Pension Benefit Guaranty Corporation. The Budget Act directs the committee to issue a report with its recommendations for legislative action by no later than November 30, 2018.

**What Are the Next Steps?**

If the plan sponsor of a tax-qualified retirement plan wants to take advantage of any of the relief provided by the Budget Act, the plan sponsor will need to ensure that the plan is operated in accordance with the applicable provision of the new law (when it becomes effective). This will likely require some coordination with the plan’s recordkeeper to discuss any changes to the plan’s existing rules. In addition, the plan sponsor will likely need to amend its plan document and update related plan notices and communications (including, for example, the plan’s summary plan description) accordingly.

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