



Retirement Plan Services

IRS Releases Position on Hardship Distribution Documentation

In February 2017, the Internal Revenue Service (IRS) published a memo to internal examiners for employee retirement savings plan regarding hardship distributions. The memo provided guidance to examiners regarding substantiation of hardship distributions that the IRS had not previously addressed. Although the memo is not considered official guidance and may not be relied upon as such, it does provide insight into what IRS examiners may expect to see during the course of an audit.

Since the IRS has been silent in the past about documentation requirements, plan sponsors and third party administrators (TPA) have had to create their own standards of documentation for hardship distributions. One such method is to have the participant self-certify that the distribution request meets the safe harbor criteria and that there are no other financial means to meet the obligation. Often, the participant has the ability to do this electronically and therefore does not provide any hard copy documentation to the plan sponsor or TPA. Under an audit, the plan sponsor has the ultimate responsibility to provide documentation for any hardship distributions approved. So, the potential danger with participant self-certification is that the employee may leave employment or may not retain the appropriate documentation to be produced later upon request.

The new informal guidance in the memo from the IRS does allow participant self-certification provided certain criteria are met. If source documents were provided by the participant, the examiner will ensure the information in the documents substantiates the hardship withdrawal. If the participant provides a summary of the source document(s), the examiner must confirm that the plan sponsor or TPA provided the employee with notice, prior to granting the distribution that identifies the rules of a hardship. The examiner will also review the summary to ensure it adequately substantiates the hardship need. If the employee notice is incomplete, missing or the participant summary is inadequate, the examiner may ask for source documents for further review.

There may be times when a participant requests multiple hardship distributions in a year. A common example is to pay higher education expenses of a dependent. In situations where the same participant has taken more than two distributions in a year without providing an explanation, the examiner may request the source documents from the plan sponsor or TPA.

The memo also instructs the examiners to review any report the TPA provides the plan sponsor of all hardship distributions where only a participant summary was provided to substantiate the need. The IRS implies that this report should be provided by the TPA at least annually.

If a plan uses participant self-certification to request a hardship, the employer should provide the following information to the participant in a notice prior to approval of distribution:

- The hardship distribution is taxable and additional taxes may apply.
- The amount of the distribution cannot exceed the immediate and heavy financial need.



- Hardship distributions cannot be made from earnings on employee elective contributions or from Qualified Non-Elective Contribution (“QNEC”) or Qualified Matching Contribution (“QMAC”) accounts, if applicable.
- The recipient agrees to preserve source documents and to make them available at any time, upon request, to the employer or administrator.

The following is information to be collected from the participant when there is a self-certification process in place and the TPA or employer accepts a summary of source documents:

General Information for All Hardship Requests

- Participant’s name
- Total cost of the event causing hardship
- Amount of distribution requested
- Certification by the participant that the information provided is true and accurate

Specific Information on Deemed Hardship

A. Medical Care

- Who incurred the medical expenses?
- What is the relationship to the participant?
- Purpose of the medical care?
- Name and address of the service provider
- Amount of medical expenses not covered by insurance

B. Purchase of Principal Residence

- Will this be the participant’s principal residence?
- Address of the residence
- Purchase price of the principal residence
- Types of costs and expenses covered
- Name and address of the lender
- Date of the purchase/sale agreement

C. Educational Payments

- Who are the educational payments for?
- Relationship to the participant
- Name and address of the educational institution
- Categories of educational payments involved
- Period covered by the educational payments

D. Foreclosure/Eviction from Your Principal Residence

- Is this the participant’s principal residence?
- Address of the residence
- Type of event (foreclosure or eviction)
- Name and address of the party that issued the foreclosure or eviction notice
- Date of the notice of foreclosure or eviction
- Due date of the payment to avoid foreclosure or eviction



E. Funeral and Burial Expenses

- Name of the deceased
- Relationship to the participant
- Date of death
- Name and address of the service provider

F. Repairs for Damage to Principal Residence

- Is this the participant's principal residence?
- Address of the residence that sustained damage
- Briefly describe the date and cause of the casualty loss
- Briefly describe the repairs, including the date(s) of repair

With this informal guidance from the IRS, plan sponsors should consider if their current process will adequately document hardship distributions from the plan. In light of the information in the memo and the IRS providing more detailed information on what is considered adequate documentation, plan sponsors and TPAs may reconsider the use of participant self-certification.

Our team can assist you in reviewing your hardship distribution approval process so that you are not caught unprepared in the event of an IRS audit. Contact any member of our team at (312) 564-3806 for more information or visit our website at: <https://us.cibc.com/en/commercial/corporate-retirement.html>.

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