Published on *The National Law Review* https://natlawreview.com

Employer Benefit Plan Assistance FAQs: California Wildfires

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In the wake of the horrific wildfires in Los Angeles (which are ongoing as of today), employees based in the Los Angeles area may have questions about available support from employer-sponsored 401(k) plan accounts and other impacts on benefits. Below are some considerations for employers about making 401(k) plan funds available to employees and related issues during this extremely challenging time.

Can employees withdraw money from 401(k) plan accounts for wildfire-related expenses? This depends on the terms of the underlying plan, but most 401(k) plans provide some type of withdrawal right on account of hardship. By way of quick background, participants usually cannot take distributions from a 401(k) plan account until a distribution event, such as severance of employment, attainment of age 59½, or disability. However, many 401(k) plans provide exceptions to this rule whereby a participant can take an in-service withdrawal before a distribution event under the following circumstances:

- *Hardship distributions.* Plans may allow in-service distributions to participants who experience a covered hardship that creates an immediate and heavy financial need that cannot be met from other assets reasonably available to them. Covered hardships relevant to the wildfires include expenses and losses (including loss of income) related to a major disaster if the participant lived or worked in the disaster area designated by FEMA for individual assistance, expenses for repairs to the participant's primary residence, and purchase of a new principal residence. As there is already a federal disaster declaration in place for the wildfires, impacted participants should generally be eligible for a hardship distribution to the extent permitted by the plan. Hardship distributions are typically subject to income tax in the year of distribution and an additional 10% early withdrawal penalty if the participant is under age 59½. To qualify, the participant may self-certify to the plan administrator that they experienced a covered hardship, the distribution does not exceed the amount of need, and they do not have other assets reasonably available to meet the need.
- *Qualified disaster recovery distributions.* SECURE 2.0 created a new in-service distribution option for losses sustained because of a federally-declared disaster—qualified disaster recovery distributions. If a participant's principal residence is in a qualified disaster area and the participant sustains economic loss due to the disaster, the participant may request one or more in-service distributions totaling up to $22,000 (which is measured across all plans and

IRAs owned by the employee). These distributions generally must be requested within 180 days after the event. Unlike hardship distributions, qualified disaster recovery distributions are not subject to the 10% early withdrawal penalty, and are included in income for tax purposes ratably over a three-year period (unless the participant elects to include the full amount in the year of distribution). More on qualified disaster recovery distributions may be found here.

- *Emergency personal expense withdrawals.* SECURE 2.0 also created an in-service distribution option to cover unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses. These distributions are limited to the lesser of $1,000 or the participant's vested balance minus $1,000 and may only be taken once per calendar year. These distributions are exempt from the 10% early withdrawal penalty but are generally subject to income tax in the year of distribution. The IRS issued FAQs on emergency personal expenses, which can be found here.
- *Plan loans.* Plans may allow a participant to take a loan from their 401(k) plan account, up to the lesser of 50% of their vested balance or $50,000; this limit is reduced for any outstanding loans. Under SECURE 2.0 disaster relief, participants residing in a qualified disaster area may increase the loan limit up to the lesser of 100% of their vested balance or $100,000 (again, reduced for any outstanding loans).

Can an employee pay back amounts withdrawn for wildfire expenses to her 401(k) plan account? Possibly—that will depend on the nature of the withdrawal. Hardship withdrawals cannot be repaid, subject to a limited exception for withdrawals taken to construct a new primary residence that could not be used because of a qualified disaster. However, if a participant took a qualified disaster recovery distribution, emergency personal expense distribution, or plan loan, those amounts are generally eligible for repayment as summarized below:

- Qualified disaster recovery distributions and emergency personal expense distributions may be recontributed to an eligible retirement plan (including the employer's 401(k) plan) within three years after the distribution date. If the participant takes an emergency personal expense distribution, the participant is not eligible to take another emergency personal expense distribution during the three-year repayment period until they have recontributed the full amount of the prior distribution to the plan.
- Plan loans are generally repaid through payroll deduction over a period not to exceed five years (the repayment period may be extended if the loan was for the purchase of a principal residence). If a plan loan is not repaid within the repayment period, the outstanding balance is a deemed distribution and subject to income tax. Under changes made by SECURE 2.0, to the extent permitted by the underlying plan, participants residing in a qualified disaster area with an outstanding loan due during the period from the first day of the incident period (*i.e.*, the period when the disaster occurred) up to 180 days after the incident period may delay repayment on any outstanding loan for up to one year.

Would an employer or plan sponsor need to amend its 401(k) plan to permit the relief described above? Potentially. Many 401(k) plans already permit hardship withdrawals, qualified disaster recovery distributions and plan loans. For those plans, a plan amendment is not necessary. If a 401(k) plan does not currently permit in-service withdrawals under the circumstances noted above and an employer desires to add them in response to the L.A. wildfires, the sponsor should coordinate with its recordkeeper to confirm those options can be implemented for the plan, with the understanding that any required plan amendment would be adopted by the applicable deadline.

Plans adopting the SECURE 2.0 disaster relief noted above must be amended for such purposes by December 31, 2026 (December 31, 2028 for collectively bargained plans). However, if a plan makes a discretionary change unrelated to SECURE 2.0 (*e.g.*, implementing in-service hardship withdrawals for the first time), that amendment would be due by the end of the plan year.

We don't have regular access to our workplace because of the wildfires. Is there any relief for an employer or plan sponsor that misses required benefit deadlines—for example, sending out COBRA election notices or other required notices? At this admittedly early moment in time, the government agencies have not announced any specific tolling relief that would apply to benefit administration. In the past, as covered in our blog post here, the agencies have offered limited relief for plan sponsors and fiduciaries who fail to timely provide a notice or other document that must be furnished to plan participants during a set relief period, provided that the fiduciary acts in good faith and does so as soon as administratively practicable under the circumstances. That agency guidance also typically extends benefit plan deadlines for individuals affected by natural disasters. While our expectation is that the agencies would issue something similar in response to the L.A. wildfires, that is not guaranteed and it is unclear at this point whether such relief will be issued.

Final thoughts on employee relief? Given the wide range of in-service distributions theoretically available to participants, most 401(k) plans are positioned to make relief available to eligible participants. For 401(k) plans that currently permit hardship distributions, other in-service distributions or plan loans, the next step may be publicizing the relief already available to impacted participants. Plan sponsors who have not adopted these features—or who are looking to expand or modify distributions options in response to the L.A. wildfires—should coordinate with their recordkeepers regarding the implementation steps and timeline.

National Law Review, Volume XV, Number 13

Source URL:https://natlawreview.com/article/employer-benefit-plan-assistance-faqs-california-wildfires