D.C. Update

Tax Reform Heats Up
After canceling the vote to repeal and replace the Affordable Care Act due to lack of support, President Trump and Republicans in Congress have put health care reform on the back burner and turned up the heat on tax reform. Democrats seem to be interested in tax reform as well, evidenced by a recent tax reform proposal by Senator Ben Cardin (D-Maryland). But other important issues such as budget reconciliation and foreign policy matters must be addressed first, which may push tax reform further out into 2017 than some had planned.

If Congress and the president are to make good on their tax reform promises, the Republican party will have to reach a consensus on how to pay for tax reform. Some members want to see at least some of the proposed tax cuts offset by revenue generating provisions to avoid significantly increasing the federal deficit. Discussions include reducing the tax advantages associated with saving for retirement by eliminating pre-tax deferrals in favor of after-tax Roth contributions, eliminating or reducing tax deductions for contributions, and reducing plan contribution limits. In the meantime, industry advocates have formed the Save our Savings Coalition to help ensure that tax reform efforts don’t compromise Americans’ access to the private sector retirement system and meaningful savings incentives. More to come on this hot topic...

New Guidance for 401(k) Plans
Despite President Trump’s inaugural directive to the Treasury Department to hold off issuing any new regulations, the Treasury/IRS has since checked off two items from its 2016-2017 Priority Guidance Plan:

• Using plan forfeiture dollars. When plan participants terminate service before vesting 100% in the employer contributions made to their account, the non-vested portion of their account is forfeited. Forfeitures remain in the plan and must be used for the benefit of the plan or plan participants. Most plans provide that forfeitures may be used to pay plan expenses (e.g., recordkeeping fees) and offset certain types of employer contributions. The IRS has proposed a regulation that would expand the types of contributions that may be funded with forfeitures to include safe harbor 401(k) contributions as well as contributions used to correct failed nondiscrimination testing in 401(k) plans (Qualified Nonelective Contributions (QNECs) and Qualified Matching Contributions (QMACs)). Plan sponsors may rely on the proposed regulation immediately, even though it’s not yet final. Some plan documents may need to be amended before this option may be used.

• Documenting hardship distribution requests. New examination guidelines for IRS employees provide insight on the type of documentation plan sponsors should obtain to substantiate a plan participant’s request for a hardship distribution. Examiners will now allow plan sponsors to rely on employee summaries and...
certifications to substantiate a participant’s “heavy and immediate” financial need. Plans must keep records of the information that was used to determine a participant’s eligibility for a hardship distribution. (See page 3 for more information.)

### Let's talk about the options available to your plan.

Your Wells Fargo Advisors Financial Advisor can help you work with your plan service providers to review your current forfeitures and hardship distribution procedures and explore whether your plan may benefit from the changes in the rules.

### Decreasing Plan Leakage

Many plan sponsors are worried that some of their employees will not be adequately prepared for retirement because a portion of their retirement savings is evaporating before retirement. The industry term for this is “plan leakage.” One study has calculated that plan leakage accounts for a 25% reduction in aggregate retirement accumulations in 401(k) plans. Plan leakage can occur in the form of:

- Lump sum distributions before retirement age, including mandatory cashouts, that are not rolled over to another employer plan or an IRA
- Plan loans that are defaulted and never paid back
- In-service distributions of employer contributions
- Hardship distributions of employee deferrals

To determine whether your plan is experiencing significant leakage, you may want to evaluate plan data such as:

- Volume of hardship distributions processed in the last plan year
- New loans processed in the last plan year
- Outstanding loans, as well as the average outstanding loan balance
- Defaulted loan, both number of participants and total dollars
- Participants who terminated service and took lump sum distributions rather than requesting a direct rollover

### Strategies to help decrease plan leakage

After you have reviewed the volume of hardship distributions, loans, and distributions in your plan, work with your financial advisor to determine whether allowing participants to access their retirement assets while employed is still aligned with your plan objectives. If you find your leakage level is not acceptable, there are a number of strategies you can explore.

If you still want to offer loans, for example, you may want to consider plan design options to reduce the likelihood of loan defaults such as setting a limit on the number of outstanding loans to one at a time or allowing only one loan per year. Another strategy to reduce leakage includes setting a minimum loan amount to discourage small loans that may go unpaid. You may want to apply the same philosophy to hardship distributions, allowing only one hardship distribution per year or reducing the sources available for hardship distributions.

Another strategy for decreasing leakage that your Wells Fargo Advisors Financial Advisor could assist with is educating plan participants about the benefits
of retirement savings and the long-term cumulative impact of even small amounts of plan leakage. The participant education should also address the tax and penalty consequences associated with hardship distributions and defaulted loans. You may also want to conduct training to ensure that your participants understand their options for moving their account balance to a new employer’s plan or an IRA when they terminate service.

Let’s get started.
Your Wells Fargo Advisors Financial Advisor can help you assess the level of plan leakage in your plan. If you are not satisfied with your plan’s metrics, your Wells Fargo Advisors Financial Advisor can introduce plan design options, educational programs, and other strategies that may help reduce the opportunities for leakage from your plan.

Hardship distribution rules refresher

A plan may permit participants to take distributions from their elective deferral accounts while they are still working if they experience a financial hardship. In 2017, the IRS published new examination guidelines for plan auditors on the documentation plans need to prove that a participant qualifies for a hardship distribution. Hardship distributions of employee deferrals are typically allowed only for:

- Medical expenses
- Purchase of a principal residence
- Tuition and related educational fees
- Preventing eviction or foreclosure on a principal residence
- Funeral expenses
- Repair of certain damages to a principal residence

A hardship distribution (excluding Roth deferrals and after-tax contributions) is taxable to the participant in the year distributed. If the participant is younger than age 59½, a 10% early distribution tax applies to the taxable portion of distribution unless an exception applies. Hardship distributions are not eligible to be rolled over to an IRA or other employer-sponsored retirement plan. Generally, the participant will be suspended from making elective deferrals for six months.

The plan sponsor must obtain documentation to substantiate that the participant’s financial need meets the safe harbor distribution requirements.

IRS guidance on documentation
The IRS has instructed its plan examiners on what to look for to determine whether a plan obtained the appropriate documentation prior to making a hardship distribution.\(^2\)

If a plan is following the safe harbor rules for hardship distributions of employee deferrals, the plan sponsor should collect from the participant either:

- Source documents (such as estimates, contracts, and invoices), substantiating the participant’s heavy and immediate financial need, or
- A summary of the information contained in the source documents

If a summary is used to verify hardship eligibility, it may be paper or electronic or in telephone records. Participants must provide certain information specific to the type of hardship. General information that must be provided for all hardships includes:

- The participant’s name
- The total cost of the event causing hardship
- The amount of distribution requested
- Participant certification that the information provided is true and accurate

Plan sponsors must notify employees that hardship distributions are taxable and subject to penalty, and that participants must preserve source documents and make them available upon the plan sponsor’s request.

1 Center for Retirement Research at Boston College, The Impact of Leakages from 401(k)s and IRAs, February 2015

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