APPLIED KNOWLEDGE | RESOURCE GUIDE

Unforeseeable emergencies under IRC Section 409A

For nonqualified plans

This resource guide is designed for administrative committees of plan sponsors whose nonqualified deferred compensation plans allow participants to apply for unforeseeable emergency distribution. This educational information is designed to help the administrative committee determine whether a participant's application for relief may be approved. It's important to consult with appropriate counsel or other advisors on all matters pertaining to legal, tax, or accounting obligations and requirements.

An "unforeseeable emergency" is defined as a **severe financial hardship to the participant** resulting from an illness or accident of the participant, his or her spouse, beneficiary, or dependent (generally using the same requirements as a dependency exemption), the loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising because of events beyond the participant's control.

If a plan design allows, a participant may petition the plan sponsor to stop deferrals only, or to stop the deferrals and make a distribution from the plan upon the occurrence of an unforeseeable emergency.

Please check your plan document for all unforeseeable emergency provisions. The plan document may:

- Limit the amount of money available for distribution to vested amounts under the plan.
- Limit unforeseeable emergency applicants to active plan participants.
- Limit the distribution to certain money types—for example, employee deferrals only.
- Be amended to add an unforeseeable emergency provision (applicable to plans governed by IRC Section 409A), effective upon proper documentation.

The participant seeking the distribution must apply to the administrative committee of the plan sponsor for a distribution, and show the emergency expenses are not covered by insurance, liquidation of assets, or cessation of deferrals under the plan.

A distribution can be made of all or part of the participant's account(s), up to the amount needed to satisfy the emergency, plus amounts necessary to pay any taxes on it. If a participant has multiple accounts, the administrative committee should decide which account(s) the distribution should come from without input from the participant.

Scenarios

The availability of unforeseeable emergency distributions was the subject of guidance issued in 2010 by the IRS (Rev. Rul. 2010-27). The guidance described these three scenarios:

1. **To repair significant water damage to the participant's principal residence not covered by insurance.** The distribution is allowable because the damage to the participant's primary residence is an extraordinary and unforeseeable circumstance and is substantially similar to the need to pay for damage to a home from a natural disaster.
2. **To pay funeral expenses of the participant's non-dependent adult son.** The distribution is allowable because it is for an extraordinary and unforeseeable circumstance and is substantially similar to the need to pay for funeral expenses of a dependent.
3. **To pay credit card debt.** The distribution is not allowable because it is not due to an extraordinary and unforeseeable circumstance or the result of events beyond the participant's control.

The following are additional examples of items that probably do not qualify as an unforeseeable emergency distribution:

- Purchase of a vehicle
- Cost of divorce or separation
- Cost of child support
- Cost of bankruptcy
- Cost of education
- Normal monthly expenses
- Payment of Federal, state, or local property taxes
- Legal judgments or fees
- Investment losses
- Gambling losses
- Elective or cosmetic surgery

Except in extraordinary circumstances, the purchase of a home or the payment of college tuition are not unforeseeable emergencies.

The following suggests documentation that the plan sponsor may want to require when reviewing the application:

Eviction. Foreclosure or eviction notice

Medical. Doctors or hospital bill, plus evidence that insurance does not cover

Funeral. Funeral bill

Loss of property due to casualty. Repair bills, plus evidence that insurance does not cover

National financial emergency. Proof of reduction in income or increase in expenses due to emergency

If expenses are for anyone other than the participant, the individual should provide documentation of the relationship, such as a birth certificate, marriage license, tax return, insurance coverage documentation, or any other relevant documents.

Unforeseeable emergency application assessment

Does the participant's request qualify as an unforeseeable emergency? IRC Section 409A dictates what qualifes. Follow the flowchart below:

1 Is unforeseeable emergency a qualifying distribution event in the plan?	If **yes,** continue to next question	If **no,** request would be denied
2 Is there a severe financial emergency?	If **yes,** continue to next question	If **no,** request would be denied
3 Is the above financial emergency caused by an event?	If **yes,** continue to next question	If **no,** request would be denied
4 Was the event unforeseeable?	If **yes,** continue to next question	If **no,** request would be denied
5 Was the financial emergency incurred by the participant resulting from an illness or accident of the participant, spouse, dependent, or beneficiary? Did the emergency result from the loss of the participant's property due to a casualty or other similar extraordinary circumstances?	If either question is **yes,** continue to next question	If both questions are **no,** request would be denied
6 Is the severe financial emergency covered by insurance or payable by someone or some other means that would eliminate the severe financial emergency?	If **no,** continue to next question	If **yes,** request would be denied
7 Is there sufficient documentation to prove the severe financial emergency?	If **yes,** continue to next question	If **no,** request would be denied
8 Is the amount requested less than or equal to the financial need, plus taxes payable on it?	**Yes**	

Approve request

Additional items to consider:

- If an event is deemed an unforeseeable emergency, the deferral election must be canceled, not merely postponed or delayed.
- If the deferral election is canceled and the participant wishes to make new deferral elections in the future, these will be governed by IRC Section 409A initial deferral timing rules.
- Upon a "hardship" distribution for 401(k) purposes, some deferred compensation plans may require participant deferrals to automatically be canceled. (Note that "hardship" has a different definition for 401(k) plans versus IRC Section 409A plans.) Check your plan document to see if a 401(k) hardship automatically cancels a nonqualified deferral election.

You may want to develop a procedure to determine whether a request qualifies as an unforeseeable emergency under IRC Section 409A. The information and sample flow chart in this document are based on Principal's understanding of the relevant statute and/or regulations and is provided for educational purposes only. Neither Principal nor its employees or agents are responsible for the legal or tax aspects of the information provided, nor its appropriateness for your situation. Consult your tax and/or legal counsel regarding any legal implications of an unforeseeable emergency distribution or cancellation of deferrals.

Neither Principal nor its employees or agents can be responsible for the legal or tax aspects of the form, nor its appropriateness for your situation. Principal is not responsible for anything you decide to include, add, delete, or modify with regards to the form. Use or modification of the sample form should be reviewed by your legal counsel before providing to your participants.

Request for cancellation of employee deferrals and/or unscheduled plan distribution as a result of an unforeseeable emergency

Submission of this form initiates the review process. The administrative committee has established uniform, nondiscriminatory guidelines to use in determining whether an unforeseeable emergency exists. The administrative committee's determination shall be final. The participant has no legal or equitable right to a plan distribution.

Additional forms may be required from the participant.

Participant (employee) name ____

The plan permits cancellation of employee deferrals and/or unscheduled distributions under unforeseeable emergency guidelines. You (the participant) must demonstrate that the reason for the distribution is in compliance with the requirements of the plan document and the Internal Revenue Code. You must demonstrate that you have a severe financial emergency that was unforeseeable and cannot be remedied by certain other methods.

Taxation

An unscheduled distribution, if allowed, will be taxable. You may withdraw enough to cover the need, plus any taxes you expect to pay on it.

Description of the unforeseeable emergency

In the area below, describe the unforeseeable emergency. You may attach additional pages if more space is needed. Please attach any documents you feel would help demonstrate that you have a severe financial emergency.

____

____

____

____

____

___ I hereby request to cancel my nonqualified plan deferrals as of ______/_______/________________.
(date)

___ I hereby request to cancel my nonqualified plan deferrals as of ______/_______/________________
(date)
and request a distribution in the amount of $____________________.

I hereby certify that I have an unforeseeable emergency as outlined above and do not have any other resources to use to meet the needs of this unforeseeable emergency.

Participant (employee) signature _________________________________ Date ______________