May 1, 2015

Internal Revenue Service
1111 Constitution Avenue, NW
Washington, D.C. 20224

Re: Recommendations for 2015-2016 Priority Guidance Plan

To Whom it May Concern:

The SPARK Institute\(^1\) and the American Benefits Council\(^2\) are pleased to respond to the invitation by the Department of Treasury and the Internal Revenue Service (the “Service”) in Notice 2015-27 for public comment on recommendations of items for inclusion on the 2015-2016 Priority Guidance Plan. Our members have a strong interest in the Priority Guidance Plan because of its potential impact on participants in retirement plans sponsored or served by our members. As explained in more detail below, we respectfully request that the 2015-2016 Priority Guidance Plan continue to include guidance regarding substantiation of hardship distributions. We also believe the Service should clarify the substantiation of loans.

**Substantiation of Hardship Distributions**

On April 1, 2015, the Service released its latest Employee Plans Newsletter\(^3\) that, among other topics, addressed hardship distributions from qualified plans. The newsletter specified that hardship distribution records include documentation that substantiates the participant’s immediate

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\(^1\) The SPARK Institute represents the interests of a broad-based cross section of retirement plan service providers and investment managers, including banks, mutual fund companies, insurance companies, third-party administrators, trade clearing firms and benefits consultants. Collectively, our members serve approximately 70 million employer-sponsored plan participants.

\(^2\) The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council’s members either directly sponsor or provide services to retirement and health plans that cover more than 100 million Americans.

\(^3\) Issue No. 2015-4 (April 1, 2015). On April 2, 2015, the Service released its latest Retirement News for Employers newsletter that included a substantially similar article on hardship distributions and plan loans. Throughout this letter, any reference to “newsletter” is intended to refer to both newsletters.
financial need, that “it is not sufficient for plan participants to keep their own records of hardship
distributions,” and that a plan sponsor’s “failure to have these records available for examination is
a qualification failure.” In addition, the Service took a position in the newsletter that plan
sponsors could not rely on “electronic self-certification” to document the nature of a participant’s
hardship.

The newsletter statements surprised many within the retirement industry, including many
of our members who are plan sponsors, as well as members who assist plan sponsors with their
recordkeeping responsibilities. The newsletter statements appear inconsistent with other
information provided by the Service, including statements on the Service’s website and in
public forums, with respect to certifying and substantiating hardship distributions. Further,
neither the Code nor applicable regulations provide that failure to obtain and retain documentation
related to a hardship distribution is a qualification issue.

We are very concerned that the Service appears to have released a new position in a
“newsletter” – which cannot be relied upon by plans and their service providers as authoritative,
but results in confusion about compliance with the hardship distribution rules. This is not the
proper process to resolve a longstanding and significant plan qualification issue.

Due to the perceived inconsistency between various statements by the Service, we request
that the substantiation of hardship distributions be placed on the Treasury Department and
Service’s Priority Guidance Plan for 2015-2016, just as it was included in the 2014-2015 Priority
Guidance Plan. The need for formal guidance has become more important, not less, in light
of the Employee Plans News and Retirement News for Employers newsletters. In fact, we
suggest that the Service publicly confirm that the statements made in the newsletter will be
subject to formal review in order to determine the Service’s official position.

Formal guidance from the Service on this subject would help clarify the proper
substantiation requirements of hardship distributions and offer plan sponsors and their service
providers sufficient assurances that they are properly administering plans.

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4 See, e.g., ABA JCEB Q&A with IRS (May, 2014), Q&A-9, available at
http://www.americanbar.org/content/dam/aba/events/employee_benefits/2014_irs_qa.pdf. In addition, the guidance
in the letter is in direct conflict with plan language included in the pre-approved plan for at least one of our members
that was approved by the Service last year.

5 The newsletter is, of course, only informational or informal commentary, but some may incorrectly
interpret it as guidance.

6 As an example, some participants request hardship distributions in an effort to prevent foreclosure on their
primary residence. It is not clear what documentation is necessary, and whether there must be actual foreclosure
proceedings. This is just one example where guidance is needed with respect to the proper substantiation of hardship
distributions.
Other Methods for Documenting Hardship

The current Treasury Regulations do not specify what procedures are required to verify a participant’s claimed hardship event. The Service has consistently indicated that plans should establish effective internal controls that are reasonably designed to facilitate compliance. We believe that an appropriate internal control process for authorizing hardship distributions could include the following elements, for example:

- Having a participant complete an application with specific information regarding the applicable hardship, which the participant must certify is true and accurate.
- Having the participant certify that the participant possesses supporting documentation consistent with the information provided.
- Having the participant certify that the hardship cannot be relieved by other resources.  
- Requiring the participant to agree to maintain the documentation for a specified period of time.
- Requiring the participant to agree to provide this documentation upon request from the IRS and/or the plan administrator.
- Follow up from the plan administrator if it has actual knowledge that the information provided by the participant is not accurate.

Such a procedure is more robust than simply requiring a participant to self-certify by “checking a box,” which appears to be the Service’s concern.

Documentation for Loans

The same newsletter has raised a series of concerns and questions regarding loans, particularly principal residence loans.

The Service suggested that a plan sponsor should document that a principal residence loan was, in fact, used to purchase or construct a primary residence. (By implication, one might read into the newsletter a parallel requirement for “after the fact” verification for hardships.) We are aware of no authority in the Treasury Regulations under Internal Revenue Code Section 72(p) or otherwise suggesting there is an “after-the-fact” documentation requirement for principal residence loans. To our knowledge, few – if any – plans follow such a process; as money is fungible, there would be virtually no way to verify that the loan proceeds were actually used to purchase or construct a primary residence. The Service should clarify this position.

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7 Because of the uncertainty generated by the newsletter, the guidance should also confirm that the rule in Treas. Reg. § 1.401(k)-1(d)(3)(iv)(C), regarding alternative means of relieving the need, remains valid.

8 The tracing rules of Code section 163(h)(3)(B), which are referenced in Q&A-7 of the Treasury regulations under Section 72(p), do not require such “after-the-fact” documentation.
In addition, the Service took a position in the newsletter that plan sponsors could not rely on “electronic self-certification” to document that the proceeds of a loan would be used to purchase a principal residence. For the reasons stated above regarding certification of the nature of a participant’s hardship, similar appropriate internal control processes could be established allowing a plan administrator to reasonably approve a loan term in excess of five years. Both the substantiation of hardship distributions and primary residence loans present similar administration concerns, and we believe that the substantiation of primary residence loans should be included on the Service’s Priority Guidance Plan for 2015-2016.

Finally, although the newsletter does state that records for loans may be kept in “electronic format,” our members are concerned that the newsletter overall leaves the impression that electronic processing of loans is disfavored. For example, loan notes are often executed electronically. We recommend the Service clarify that electronic loan processing, if consistent with applicable law, is acceptable.

Record Retention

The newsletter suggested that a plan sponsor must keep records of hardship and loan substantiation independent of the plan’s recordkeeper or third party administrator. We believe that the Service was merely trying to make the uncontroversial point that a plan sponsor, who is typically the named plan administrator, is ultimately responsible for compliance with the plan document and the Internal Revenue Code. Unfortunately, the language in the newsletter states repeatedly that a plan sponsor must retain records. We are aware of no authority for such a position, which is contrary to accepted practice and would significantly increase costs of offering a plan. The Service should clarify its position.

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The substantiation of hardship distributions and the documentation requirements for principal residence loans are critical components to properly administering plans for tens of millions of participants, and as a result, we respectfully request that they be included in the 2015-2016 Priority Guidance Plan.

The SPARK Institute and the American Benefits Council appreciate the opportunity to provide these comments to the Treasury Department and the Service. If you have any questions, please contact us or Michael Hadley, Davis & Harman LLP (mlhadley@davis-harman.com, 202-347-2210).

Sincerely,

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