



Pension Analyst

# Compliance Bulletin

January 2011

## IRS provides insight into unforeseeable emergencies

The Internal Revenue Code and related regulations allow both section 457(b) plans and section 409A nonqualified deferred compensation plans to make distributions to participants on account of an “unforeseeable emergency.” The IRS has recently published [guidance](#) providing examples of situations that do and do not qualify as unforeseeable emergencies under these rules.

### Unforeseeable emergencies under section 457(b) plans

The regulations applicable to section 457(b) plans of state and local governments and tax-exempt organizations require plan administrators to determine if an unforeseeable emergency exists based on a review of the relevant facts and circumstances of each situation. The starting point for these reviews is the determination that a participant or beneficiary has a severe financial hardship as the result of:

- His own illness or accident, or the illness or accident of his spouse or dependent;
- The casualty loss of his property; or
- A similar extraordinary and unforeseeable circumstance arising from events beyond his control.

Specific examples of possible unforeseeable emergencies include:

- The imminent foreclosure of or eviction from the participant’s or beneficiary’s primary residence;
- The need to pay medical expenses, including non-refundable deductibles and the cost of prescription drug medication; and
- The funeral expenses for the participant’s or beneficiary’s spouse or dependent.

The IRS guidance also notes that the following two situations are *not* unforeseeable emergencies:

- The purchase of a home; and
- Payment of college tuition.

If a plan administrator determines that a particular situation qualifies as an unforeseeable emergency, the plan may only make a distribution to the extent that the emergency is not or cannot be relieved:

- Through reimbursement or compensation from insurance, or otherwise;
- By liquidation of the participant or beneficiary’s assets, to the extent the liquidation would not itself create severe financial hardship; or
- By ceasing deferrals under the plan.

### Unforeseeable emergencies under nonqualified deferred compensation plans

The Internal Revenue Code itself defines an unforeseeable emergency under a section 409A plan as a participant’s severe financial hardship resulting from:

- His own illness or accident, or the illness or accident of his spouse or dependent;
- The casualty loss of his property; or
- A similar extraordinary and unforeseeable circumstance arising from events beyond his control.

Like the regulations that apply to section 457(b) plans, the regulations applicable to section 409A nonqualified deferred compensation plans provide the following specific examples of possible unforeseeable emergencies:

- The imminent foreclosure of or eviction from the participant’s primary residence;
- The need to pay medical expenses, including non-refundable deductibles and the cost of prescription drug medication; and

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- The funeral expenses for the participant's spouse, beneficiary, or dependent.

The IRS guidance also notes that the following two situations are *not* unforeseeable emergencies:

- The purchase of a home; and
- Payment of college tuition.

If a plan administrator determines that a particular situation qualifies as an unforeseeable emergency, a nonqualified deferred compensation plan may only make a distribution to the extent that the emergency is not or cannot be relieved:

- Through reimbursement or compensation from insurance, or otherwise;
- By liquidation of the participant's assets, to the extent the liquidation would not itself create severe financial hardship; or
- By ceasing deferrals under the plan.

## Recent guidance provides additional examples

In its most recent guidance, the IRS provides examples of two fairly common situations that may be considered unforeseeable emergencies and therefore eligible for distributions from either a section 457(b) plan or a nonqualified deferred compensation plan. The guidance also provides an example of a situation that would not be considered an unforeseeable emergency. In all of these situations, the participant requests a distribution to pay the expenses and an additional amount to pay federal, state and local taxes resulting from the distribution. The participant also provides adequate documentation regarding the expense, including the amount covered by insurance and attestation that he has no other source of funds to pay the expense.

### A water-damaged basement

The first situation that the IRS reviewed is a scenario where a participant's residence needs to be repaired after suffering significant water damage from a leak that was discovered in the basement. The IRS concludes that the repair costs that are not covered by insurance could qualify for an unforeseeable emergency distribution because the situation:

- Is an extraordinary and unforeseeable circumstance;
- Arose as a result of events beyond the participant's control; and
- Is substantially similar to the need to pay to repair damage to a home as a result of a natural disaster.

### Funeral expenses for an adult child who is not a dependent

In a second situation, the IRS rules that the need for a participant to pay the funeral expenses of an adult child who is not a dependent may also qualify for an unforeseeable emergency distribution because the situation:

- Is an extraordinary and unforeseeable circumstance;
- Arose as a result of events beyond the participant's control; and
- Is substantially similar to the need to pay the funeral expenses of a dependent.

### Accumulated credit card debt

In the final situation reviewed by the IRS, the IRS concludes that without supporting documentation indicating that accumulated credit card debt was the result of an unforeseeable emergency that arose as a result of events beyond the participant's control, the situation is not eligible for an unforeseeable emergency distribution.

## Application to plan administration

Sponsors of section 457(b) plans and section 409A nonqualified deferred compensation plans that permit unforeseeable emergency distributions should take note of these new examples. While they are only examples, they do illustrate the process that the IRS expects plan administrators to undertake when evaluating specific facts and circumstances in determining whether to permit a distribution under these provisions.

