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LEGAL ALERT

November 11, 2010

IRS Expands Unforeseeable Emergency Distributions for 409A and 457(b) Plans

On November 8, 2010, the IRS published Rev. Rul. 2010-27, providing additional guidance regarding permissible "unforeseeable emergency" distributions from deferred compensation plans governed by § 409A or § 457(b). Generally, these plans are subject to distribution requirements or restrictions that allow, among other specified payouts, unforeseeable emergency distributions. The Revenue Ruling approves two types of unforeseeable emergency distributions not explicitly discussed in prior guidance.

Prior Guidance

"Unforeseeable emergency" guidance was first issued under § 457(b). Section 1.457-6(c)(2)(i) of the Treasury Regulations defines an unforeseeable emergency as a participant's or beneficiary's "severe financial hardship" resulting from one of a number of enumerated occurrences, including:

- An illness or accident of the participant or beneficiary, his or her spouse, or his or her dependent;
- A loss of his or her property due to casualty; or
- Similar extraordinary and unforeseeable circumstances arising as a result of events beyond the participant's or beneficiary's control.

A determination of whether the participant or beneficiary is confronted with an unforeseeable emergency is generally determined based on the relevant facts and circumstances. In no event, however, may such distribution be taken to cover costs that are otherwise relieved through reimbursement or compensation from insurance. Moreover, a participant or beneficiary must be able to show that he or she has no assets that could be liquidated to relieve the hardship, to the extent that such liquidation would not itself constitute a severe hardship. This definition is intended to be more restrictive than, for example, the § 401(k) hardship rule.

The IRS also previously published a "Model Amendment" for 457(b) plans that authorizes unforeseeable emergency distributions under all conditions permitted under the regulations, as well as other similar circumstances arising beyond the control of the participant or beneficiary. *See* Section 5.10 of the Appendix to Rev. Proc. 2004-56.

This prior guidance explicitly provides that casualty loss (e.g. from a natural disaster), foreclosure, eviction, medical expenses, prescription drug costs, and funeral expenses of a spouse or dependent may constitute unforeseeable emergencies; home purchase or college tuition do not.

With respect to § 409A plans, Reg. §1.409A-3(i)(3) defines "unforeseeable emergency" in terms substantially similar to the § 457(b) regulation.

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Guidance Under the Revenue Ruling

The Revenue Ruling considers three exemplary claims for unforeseeable emergency distributions and approves two of them.

- *Exigent Home Repair*. In the first example, a § 457(b) plan participant requests an unforeseeable emergency distribution to pay for the repair of his principal residence in the aftermath of a water leak. The participant documents the request with written estimates of the repair cost. The IRS characterized the claim as meeting the unforeseeable emergency distribution requirements, stating that, despite the fact that the participant's situation is not identical to any of the specific examples listed in the regulations or the Model Amendment, the expenses arise "as a result of events beyond the control of the participant or the beneficiary" and are substantially similar to expenses that would result in the wake of a natural disaster.

- *Funeral Expenses of a Non-Dependent*. In the second example, a § 457(b) plan participant requests an unforeseeable emergency distribution to cover funeral expenses for an individual who is not a dependent of the participant. An itemized bill from the funeral home is submitted. The IRS held that this too is appropriately characterized as an unforeseeable emergency distribution because, while the regulations explicitly allow only for the payment of *dependent* funeral costs, the situation at issue is both sufficiently extraordinary and unforeseeable as well as substantially similar to the circumstances prescribed in the regulations to warrant treatment as an unforeseeable emergency.

- *Credit Card Debt*. In the last example, a § 457(b) plan participant requests an unforeseeable emergency distribution to pay off credit card debt that was not incurred due to any extraordinary or unforeseeable circumstances beyond the participant's control. The IRS declined to characterize this distribution as an unforeseeable emergency distribution, arguing it neither fits within any of the specified examples nor results from circumstances arising beyond the participant's control.

While each of these examples is framed in terms of § 457(b) plan participants, the ruling provides that "the principles and rulings set forth in this revenue ruling apply to an amount deferred under a nonqualified deferred compensation plan subject to § 409A(a) that may be paid under the terms of the plan upon the occurrence of an event constituting an unforeseeable emergency that complies with § 409A(a) and § 1.409A-3(i)(3)."

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