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IRS PUBLISHES SUBSTANTIATION GUIDANCE FOR 401(K) HARDSHIP DISTRIBUTIONS

By Frank J. Del Barto

On February 23, 2017, the Acting Director of the IRS's Employee Plans Examinations unit issued a memorandum to EP Examination employees that sets forth certain substantiation guidelines that such employees should follow when determining whether a 401(k) hardship distribution is to be "deemed on account of an immediate and heavy financial need," under the safe-harbor regulations.

Many 401(k) plans permit employees to receive a distribution of their elective deferrals if the distribution is required to meet the employee's immediate and heavy financial need. In accordance with the regulations, a distribution is deemed to be for an immediate and heavy financial need if it is provided for one or more of the following six reasons: (1) expenses for medical care deductible under section 213(d), (2) costs related to the purchase of a principal residence, (3) payment of tuition and room and board expenses for up to the next 12 months of post-secondary education, (4) payment necessary to prevent the eviction of employee from principal residence or the foreclosure of the mortgage on a principal residence, (5) payments for burial expenses, and (6) expenses for repair of damages to the principal that would qualify as a casualty deduction under section 165.

The memorandum instructs the Employee Plans Examiner personnel to follow a two-step process in order to determine if a distribution was actually made for one of the six immediate and heavy financial needs noted above. In order to meet the substantiation requirements for making a hardship distribution on account of an immediate and heavy financial need, the plan examiner must find that both Step 1 and Step 2 are satisfied. To view the memorandum and view Step 1 and Step 2, click here.

Although the IRS's internal memorandum does not have the force of law, by understanding how the IRS will analyze a plan sponsor's hardship withdrawal substantiation process, plan sponsors should be able to improve their compliance posture. We recommend that plan sponsors print the IRS memorandum and place a copy in their plan document binder near the hardship withdrawal section for future reference. Should you have any questions, please call your relationship attorney.

CALIFORNIA'S FEHC REGULATIONS TO FURTHER RESTRICT USE OF CRIMINAL HISTORY IN EMPLOYMENT DECISIONS

By Jiwon J. Yhee

Recently, California's Fair Employment and Housing Council ("FEHC") finalized new regulations that, among other things, would further restrict a California employer's ability to use criminal history in employment decisions. A major highlight of these new regulations is a prohibition against an employer's consideration of a job applicant or employee's criminal history in making an employment decision if doing so would result in an adverse impact on individuals within a protected class, such as gender, race, and national origin. These new regulations open an additional avenue for job applicants and employees to bring claims against employer's, as an employer's use of an individual's criminal history in a manner that has an adverse impact on any protected class will now be liable under the Fair Employment and Housing Act ("FEHA").

In order to make out a FEHA claim on an adverse impact theory under the new FEHC regulations, a job applicant or an employee must first successfully meet the burden of showing that an employer's consideration of criminal history has an adverse impact on a protected group. Adverse impact may be established through the use of conviction statistics or by offering any other evidence that establishes an adverse impact. State or national level statistics that show "substantial disparities" in the conviction records of individuals with one or more protected characteristics are presumptively sufficient to establish an adverse impact, though such a presumption may be rebutted.

Once a job applicant or employee successfully establishes that an employer's consideration of criminal convictions creates an adverse impact, the burden then shifts to the employer to establish that its criminal history/conviction consideration policy or practice is nonetheless justifiable because it is job-related and consistent with business necessity. The employer must show that its policy or practice bears a reasonable relationship to successful performance on the job and in the workplace and measures the fitness of the job applicant or employee for specific positions. The employer must demonstrate that its policy or practice is appropriately tailored to the job position at issue and that it takes into account at least the following factors: (1) the nature and gravity of the criminal offense or conduct; (2) the time that has passed since the offense or conduct and/or completion of the sentence; and (3) the nature of the job held or sought. Depending on the policy or practice of the employer, the regulations set out in detail the ways in which an employer can prove that its policy or practice is appropriately tailored.

Even if the employer is able to meet its burden of showing that its policy or practice is justifiable because it is job-related and consistent with business necessity, a job applicant or employee can still prevail on an FEHA claim if he or she can show that there is a less discriminatory policy or practice that serves the goals of the employer just as effectively as the challenged policy or practice without significantly increasing the cost or burden on the employer. A less discriminatory policy may be one that, for example, looks for and at a more narrowly targeted list of convictions that are directly applicable to the job position sought by a job applicant or employee.

The new FEHC regulations are expected to take effect on July 1, 2017, and its obligations and restrictions with respect to the obtainment and use of criminal history in employment decisions are in addition to those of the

federal Fair Credit Reporting Act ("FCRA") and state and local "ban the box" laws that extend various protection to ex-offenders in California. In light of the growing complexity of the laws governing the use of an individual's criminal history in employment decisions, including the new FEHC regulations, California employers should: (1) assess whether criminal background checks are beneficial or necessary to their business, (2) consult with legal counsel to determine the interplay between various federal, state, and local statutes and/or regulations with respect to seeking and using an individual's criminal history in employment decisions, and (3) work with legal counsel to craft a narrow, appropriately tailored policy or practice that is job-related, consistent with business necessity, and that ideally provides for an individualized assessment of each job applicant or employee.

For more information about this or any other employment law topic, please contact Frank Del Barto, Chair of the Employment, Labor & Benefits Group, at 847.734.8811 or via email at fdelbarto@masudafunai.com.