

## IRS Issues 401(k) Safe Harbor Hardship Distribution Substantiation Guidelines

On February 23, 2017, the IRS issued a [memorandum](#) to its employee plan auditors to provide guidelines for substantiating 401(k) plan safe harbor hardship distributions. Although directed to employee plan auditors for audit purposes, the memorandum provides guidance on the steps that plan administrators should take to substantiate safe harbor hardship distributions.

In order to qualify as a hardship distribution, which is an exception to the prohibition against in-service distributions of 401(k) elective deferrals, a distribution must be on account of an "immediate and heavy financial need." Generally, whether a distribution meets this requirement is determined based on all relevant facts and circumstances. Under IRS safe harbor standards, however, a distribution is deemed to be on account of an immediate and heavy financial need if it is for:

- Deductible expenses for medical care for the employee or his or her spouse, children, dependents, or primary plan beneficiary;
- Costs directly related to the purchase of the employee's principal residence;
- Payment of tuition, related educational fees, and room and board expenses for up to the next 12 months of post-secondary education for the employee, or his or her spouse, children, dependents or primary plan beneficiary;
- Payments necessary to prevent the employee's eviction from his or her principal residence or foreclosure of the mortgage on that residence;
- Payments for burial or funeral expenses for the employee's deceased parent, spouse, children, dependents or primary plan beneficiary; or
- Expenses for the repair of damage to the employee's principal residence that would qualify for the casualty tax deduction.

As the memorandum confirms, substantiation that a distribution is for one of these types of expenses is required to qualify for the safe harbor. The guidelines provided in the memorandum for meeting this requirement include the following:

- The plan administrator must provide certain notifications and information about hardship distributions to employees before



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making hardship distributions. These are described in the attachment to the memorandum.

- Plan administrators must collect (1) the participant's name, (2) the total cost of the hardship-causing event, (3) the amount of the distribution requested, and (4) the participant's certification that the information provided is true and accurate.
- The participant must agree, as a condition of receiving the hardship distribution, to keep source documents, such as estimates, contracts, bills, and statements from third parties, and provide them, upon request, to the employer or plan administrator.
- Plan administrators do not need to collect source documents, if they collect a written, electronic, or telephone record summary of the information contained in source documents.
- If the summary is incomplete, upon audit, the IRS may request source documents from the plan administrator.
- If an employee has received more than two hardship distributions in a plan year, the auditor may, absent an adequate explanation, request source documents from the plan administrator.

Plan sponsors should review and, as needed, update their safe harbor hardship distribution substantiation procedures to ensure that they can satisfy these requirements in the event of an IRS employee plan audit. If you have questions about the new guidelines, please contact the Hanson Bridgett Employee Benefits Group.

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