

IRS Issues Proposed Regulations to Relax 401(k) Plan Hardship Distribution Rules

The IRS recently issued [proposed regulations](#) to implement changes to the rules for hardship distributions from 401(k) plans made by the [Bipartisan Budget Act of 2018](#) (“BBA”) that will take effect on January 1, 2019. The proposed changes will make hardship distributions more widely available and will ease administration of hardship distributions for plan sponsors. While employers may implement some of these changes retroactively to apply as of January 1, 2018, plans need not be amended this year for any of the changes. This alert explains the mandatory and optional plan changes, and optional effective dates for each change.

Implementation of BBA Changes

Generally, 401(k) plans can provide for hardship distributions to active employee participants, if necessary to satisfy an immediate and heavy financial need. However, plans currently are required to impose restrictions and conditions that can make hardship distributions difficult for participants to obtain and administratively complex. The proposed changes will relax some of those restrictions.

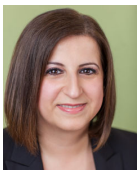
The proposed regulations contain both mandatory and optional changes to the hardship distribution rules.

Mandatory Changes

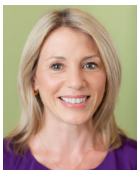
- Plans can no longer prohibit participants from making elective contributions to the plan, or other plans maintained by the employer, for six months following the hardship distribution. This rule must apply for hardship distributions made on or after January 1, 2020, but can be applied earlier.
- Plans must use a new standard to determine whether the participant has other sources available to meet the financial need, described in detail below. The new general standard must be used for distributions made on or after January 1, 2020, but can be applied earlier.

Optional Changes

- Plans may eliminate the requirement that participants take all available loans from the plan, or other plans maintained by



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- the employer, before requesting a hardship distribution,
- Plans may make funds attributable to earnings, qualified nonelective employer contributions (QNECs) and qualified matching contributions (QMACs) available for a hardship distribution; and
 - Plans may impose additional conditions to demonstrate that a distribution is necessary to satisfy an immediate and heavy financial need, as long as that condition is not a suspension of elective deferrals.

Broader List of “Safe Harbor” Events

Under current “safe harbor” rules, a plan may provide that a hardship is deemed to exist, if the distribution is for one of several enumerated reasons. The proposed regulations would make three changes to the safe harbor rules:

- In addition to a spouse or dependent child, a participant’s “primary beneficiary under the plan” is an individual for whom qualifying medical, educational, and funeral expenses may be incurred;
- a hardship distribution is available for expenses and losses (including loss of income) incurred by a participant due to a federally declared disaster, if the participant’s principal residence or principal place of employment was located within the disaster area; and
- a hardship distribution can be made for expenses incurred to repair damage to the participant’s principal residence that would qualify for the casualty deduction under section 165 of the Internal Revenue Code (“Code”), even if the loss was not attributable to a federally declared disaster.

This last provision corrects an inadvertent change made by the [Tax Cuts and Jobs Act](#) (“TCJA”), which revised Code section 165 to limit the casualty deductions to losses resulting from federally declared disasters, effective for tax years between 2018 and 2025. This meant that hardship distributions to pay for damage to a participant’s home would be limited to situations where the damage resulted from a federally declared disaster, effective as of January 1, 2018. Under the proposed regulations, plans can be amended to include this corrective provision as of January 1, 2018, so that any hardship distribution made after that date would not be affected by the TCJA change to Code section 165.

Elimination of “Facts and Circumstances” Test for Alternative Relief Sources

Under the current rules, a plan sponsor must determine whether a hardship may be relieved from other sources that are reasonably available using a “facts and circumstances” test. The proposed regulations would replace that test with a general standard, under which:

- The participant must have obtained all available distributions from the employer’s plans other than loans,
- the distribution may not exceed the amount of the employee's need, and
- the participant must represent in writing (including via electronic writing) that he or she has insufficient cash or other liquid assets to satisfy the financial need. The plan sponsor may rely on the participant’s representation, absent actual knowledge to the contrary.

Timing of Plan Amendments and Optional Effective Dates

All plan revisions related to the proposed regulations will be treated as “integrally related” to the required change to the six-month suspension rule, so there will be only one plan amendment deadline for all plan changes, even those that are optional. Based on the proposed regulations, and required adoption deadlines set forth in [IRS guidance](#), this means that plan amendments for both governmental and non-governmental plans to implement the changes will not be required until 2021, at the earliest.

Prior to adopting an amendment, plan sponsors may apply the following effective dates for the new rules:

- Six-month suspension rule: This rule can be lifted as of the first day of the first plan year starting after December 31, 2018. Calendar year plans may lift the suspension for hardship distributions taken in the second half of the 2018 plan year as of January 1, 2019 (or the plan may continue to provide that contributions will be suspended for the originally scheduled six months).
- TCJA casualty loss deduction correction: The revision to the safe harbor casualty loss deduction (eliminating the requirement that the damage resulted from a federally declared disaster) may be applied to distributions made on or after January 1, 2018.
- New safe harbor for federally declared disasters: The new safe harbor for expenses and income lost due to a federally declared disaster may be applied to losses resulting from disasters that occurred on or after January 1, 2018.
- Elimination of requirement to take plan loans: This may be applied as of the first plan year beginning after December 31, 2018.
- Inclusion of earnings, QNECs, and QMACs in amounts available for a hardship: This may be applied as of the first plan year beginning after December 31, 2018.

Hanson Bridgett's employee benefits practice group will monitor the rule-making process, and will notify clients when the regulations become final.

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