

IRS Finalizes New Hardship Distribution Rules for 401(k) and 403 (b) Plans

On September 23, 2019, the IRS published [final regulations](#) that amend the rules for hardship distributions from 401(k) and 403(b) plans. The regulations finalize the [proposed regulations](#) issued in November 2018 to implement statutory changes made by the Tax Cuts and Jobs Act of 2017 and the Bipartisan Budget Act of 2018 intended to make it easier for plan participants to take hardship distributions. Although the final regulations make few changes to the proposed rules, they help clarify the new rules and provide other useful guidance.

Few Changes to Proposed Rules

The final regulations adopt the proposed regulations with few changes. As proposed, the final regulations:

- Prohibit conditioning hardship distributions on or after January 1, 2020, on the suspension of elective and employee contributions.
- Eliminate the requirement that a participant take all available loans from the employer's plans before taking a hardship distribution.
- Replace the facts-and-circumstances standard for determining the distribution's necessity to satisfy a financial need with a general standard, requiring that the distribution not exceed the amount needed, and that the participant have obtained all other available distributions and provide a statement, in writing or electronically, that other available liquid assets are insufficient to satisfy the need.
- Expand the permitted sources for hardship distributions to include elective contributions, qualified nonelective contributions (QNECs), qualified matching contributions (QMACs), and earnings on these amounts, regardless of when contributed or earned.
- Permit plans to require that additional conditions (other than suspension of elective and employee contributions) be met for hardship distributions.
- Broaden the list of safe harbor "deemed" hardship distribution events to include expenses and losses incurred by the participant due to a federally declared disaster, if the participant's principal residence or place of employment was located in the disaster area.
- Modify the deemed hardship for expenses incurred to repair



by Edward M. Bernard

damage to the participant's principal residence that would qualify for the casualty deduction under section 165 of the Internal Revenue Code to eliminate the requirement that the loss be attributable to a federally declared disaster.

- Add a participant's "primary beneficiary under the plan" to the list of individuals for whom qualifying medical, educational, and funeral expenses may be incurred.

Clarification of Proposed Rules

Though substantially similar to the proposed regulations, the final regulations clarify that:

- The required employee statement that other sources are unavailable to satisfy the need applies only those assets that are "reasonably available." Thus, an employee could, even if other liquid assets are available, still make the representation, but only if those assets are earmarked to pay an obligation in the near future – for example, rent.
- The provision permitting transmission of the employee statement electronically includes a verbal representation over a recorded phone line.
- The prohibition against requiring suspension of elective and employee contributions applies only to qualified plans, 403(b) plans, and eligible governmental 457(b) plans, not to nonqualified deferred compensation plans.
- If matched employee contributions are distributed in conjunction with a hardship distribution of elective contributions, a suspension of employee contributions is prohibited.

Other Helpful Guidance

The preamble to the final regulations also provides some helpful guidance. For example, the preamble:

- Explains how the new safe harbor expense for federally declared disasters is narrower than previous IRS-announced disaster-specific relief, and that the IRS anticipates that no more disaster relief announcements will be needed.
- Clarifies that the requirement that an employer not have actual knowledge contrary to an employee's statement that other resources are unavailable applies only when the employer already has sufficiently accurate contrary information; it does not require the employer to investigate the requesting employee's financial condition.
- Confirms that the new rules permit certain additional conditions for hardship distributions (other than the suspension of elective contributions and employee contributions) – for example, a nondiscretionary minimum dollar amount.
- Clarifies that safe harbor contributions to safe harbor 401(k) plans or under a qualified automatic contribution arrangement (QACA) are distributable on account of hardship because they are either QNECs or QMACs or subject to the same distribution restrictions, respectively.

Effective Dates

The final regulations, like the proposed rules, provide some flexibility regarding effective dates when implementing the new rules. The final regulations are generally effective for distributions made on or after January 1, 2020. The new rules may, however, be applied to distributions in plan years beginning after December 31, 2018. In addition, the prohibition on suspending contributions as a hardship distribution condition may be applied as early as the first day of the first plan year beginning after December 31, 2018, even if the distribution was made in the prior plan year. Finally, the changes to the deemed hardship standards may be applied to distributions made as early as January 1, 2018.

Plan Amendment Deadlines

Plan sponsors will need to amend their plans, effective for distributions no later than January 1, 2020, to reflect the changes in the final regulations. These amendments, including discretionary changes which the regulations specifically categorize as "integrally related" to the required change, will generally have to be adopted by the end of the second calendar year following the year in which the IRS Required Amendments List (RAL) that includes the change is published, even if some of the amendment provisions have an earlier effective date than required. For example, if the final regulations are included in the 2019 RAL, the amendment deadline will generally be December 31, 2021.

For more information, please contact:

Edward M. Bernard, Partner
415-995-5807
ebernard@hansonbridgett.com