



Proposed IRS Regulations Clarify New Rules Relating to Hardship Distributions

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The IRS recently issued proposed regulations that would expand the availability of hardship distributions under 401(k) and 403(b) plans (the "Proposed Regulations"). The Proposed Regulations reflect the changes that were implemented by the Bipartisan Budget Act of 2018 (the "Act"), and address many of the questions that were left unanswered by the Act. (Click [here](#) for our previous article regarding the changes that were implemented under the Act). A summary of the Proposed Regulations appears below.

A. Expansion of Safe Harbor Expenses

As a general rule, a hardship distribution is permitted under a 401(k) or 403(b) plan only if (1) the distribution is on account of an immediate and heavy financial need; and (2) the amount of the distribution does not exceed the amount necessary to satisfy that need. The current hardship distribution regulations provide a safe harbor under which distributions for six types of expenses are deemed to be made on account of an immediate and heavy financial need. The Proposed Regulations would expand the safe harbor as indicated below.

1. The Proposed Regulations would codify prior sub-regulatory IRS guidance by adding a new class of individuals for whom qualifying medical, educational, and funeral expenses may be incurred. This new class would include any "primary beneficiary under the plan."
2. The Proposed Regulations would restore the safe harbor that applies to expenses that would qualify for a casualty loss deduction under Internal Revenue Code 165 (e.g., costs to repair damage to a principal residence). The Tax Cuts and Jobs Act, enacted in 2017, had eliminated the casualty loss deduction unless the loss was due to a federally-declared disaster. The Proposed Regulations would allow plans to disregard this provision so that hardship distributions can be taken for any casualty loss.

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3. The Proposed Regulations would add a seventh type of "safe harbor" expense that would apply to any expenses or losses that are incurred as a result of a federally declared disaster. This change is intended to allow affected participants to immediately access plan funds after such a disaster, without having to wait for the IRS to provide guidance that is specific to each disaster.

The revised list of safe harbor expenses may be applied to distributions that are made on or after a date that is as early as January 1, 2018. For example, if a plan continued to allow for casualty loss hardship distributions without regard to the changes imposed by the Tax Cuts and Jobs Act, it could be retroactively amended to conform to the new Proposed Regulation.

B. Elimination of Six-Month Suspension of Contributions

The Proposed Regulations would eliminate the requirement that an employee must be prohibited from making elective deferral contributions for six months after receipt of a hardship distribution.

The elimination of the 6-month suspension of elective deferrals may be applied on the first day of the first plan year beginning after December 31, 2018, even if a hardship distribution was made in the prior plan year. For example, a calendar-year plan that provides for hardship distributions under the pre-2019 safe harbor standards may be amended to provide that the suspension period will end on January 1, 2019.

The Proposed Regulations further provide that for any distribution made on or after January 1, 2020, a plan may not provide for a suspension of contributions as a condition of obtaining a hardship distribution. In other words, the elimination of the six-month suspension of employee contributions is required after 2019.

C. Elimination of Loan Requirement

The Proposed Regulations would eliminate the requirement that a participant must take all available loans under a plan in order to qualify for a hardship distribution.

The elimination of the plan loan requirement would be effective for hardship distributions made in plan years beginning after December 31, 2018. Unlike the elimination of the six-month suspension period, the elimination of the plan loan requirement is not mandatory. Plans may therefore continue to require that participants take all available plan loans in order to qualify for a hardship distribution.

D. Expanded Sources for Hardship Distributions

The Proposed Regulations provide that a 401(k) plan sponsor may, but is not required to, expand the sources that are available for hardship distributions to include qualified non-elective contributions ("QNECs"), qualified matching contributions ("QMACs"), employer safe harbor contributions and earnings on those contributions as well as earnings on elective deferral contributions.

E. Reliance on Participant Representation



The Proposed Regulations provide that, with regard to hardship distributions made on or after January 1, 2020, a plan participant must represent in writing, by an electronic medium, or in such other form as may be dictated by the IRS, that he or she has insufficient cash or other liquid assets to satisfy the immediate and heavy financial need. A plan administrator may rely on the employee's representation, unless the plan administrator has actual knowledge to the contrary.

F. Application to 403(b) Plans

The Proposed Regulations clarify that the new rules that are described above generally apply to hardship distributions under 403(b) plans, with the exception of the new rules relating to the expanded sources of hardship distributions. Earnings on elective deferrals made to a 403(b) plan would continue to be ineligible sources for hardship distributions. However, QNECs and QMACs in a 403(b) plan that are not held in a custodial account could be distributed on account of hardship. QNECs and QMACs in a 403(b) plan that are held in a custodial account could not be distributed on account of hardship.

G. Timing of Plan Amendments

With regard to discretionary changes to individually designed plans, the plan amendment deadline is the end of the plan year in which the plan amendment is operationally put into effect. For example, if a calendar year plan operationally implements any discretionary provision of the Proposed Regulations in 2019, the plan would need to be amended on or before December 31, 2019 to reflect that provision.

The deadline for amending the plan to reflect a change in qualification requirements is the end of the second calendar year that begins after the IRS issues the Required Amendments List that includes the change.

The IRS is accepting comments regarding the Proposed Regulations until January 14, 2019. The Proposed Regulations will not be finalized until after the comment period has closed.

If you have any questions regarding these changes, or if you would like assistance with reviewing or amending your plan to incorporate any of these changes, please contact Mindi Johnson or Julie Hamlet.