IRS Updates 401(k) Hardship Distribution Rules – Are You Ready?

Labor & Employment Law Update

By Kelly Haab-Tallitsch on November 21, 2019

On September 23, 2019 the IRS issued final regulations updating the rules governing hardship distributions from 401(k) and 403(b) plans. They are generally similar to the proposed regulations issued late last year and primarily reflect changes made by the 2018 Tax Cuts and Jobs Act and the Bipartisan Budget Act of 2018.

Some of the changes in the final regulations are mandatory, requiring employers to take action by January 1, 2020.

1. **Eliminates of the 6-month contribution suspension requirement**

Beginning January 1, 2020, 401(k) and 403(b) plans will no longer be able to suspend contributions following a hardship distribution. Plans are required to eliminate the suspension period that barred participants who take a hardship distribution from making new contributions to the plan for 6 or more months.

2. **Eliminates the plan loan requirement**

The new rule removes the requirement that participants take a loan from the plan before taking a hardship withdrawal. Unlike the elimination of the 6-month suspension period, this change is optional. Plans may continue to require participants take a plan loan before being eligible for a hardship withdrawal.

3. **Expands contribution sources available for hardship distributions**

The final rule permits (but does not require) a 401(k) plan sponsor to allow hardship distributions of elective deferrals, QNECs, QMACs, and all earnings thereon. Previously, employees could only withdraw elective deferrals (and not earnings). Earnings on 403(b) contributions and certain 403(b) plan QNECs and QMACs remain ineligible for hardship withdrawals.

4. **Provides disaster relief**

To take a hardship withdrawal, employees currently must show an immediate and heavy financial need that involves one or more of the following: (1) purchase of a primary residence; (2) expenses to repair damage or to make improvements to a primary residence; (3) preventing eviction or foreclosure from a primary residence; (4) post-secondary education expenses for the upcoming 12 months for participants, spouses and children; (5) funeral expenses; and (6) medical expenses not covered by insurance.

The final rule adds a seventh safe harbor category for expenses resulting from a federally declared disaster.

5. **Eases hardship verification requirements**

Under current rules, plan administrators must take into account "all relevant facts and circumstances" to determine if a hardship withdrawal is necessary. The new rule requires only that a distribution not exceed the amount of the employee's need (including taxes), that the employee first obtains any other distributions available under the plan, and that the employee represents that he or she has insufficient cash or liquid assets "reasonably available" to satisfy the financial need.

Employee representations can be made over the phone, if the call is recorded, or can be made in writing or by e-mail. A plan administrator may rely on an employee's representation unless the plan administrator has actual knowledge to the contrary. Plans are required to apply this standard starting in 2020.

Plan Amendments Required

401(k) plans that permit hardship distributions will need to be amended to reflect the new rules by December 31, 2021, but operational changes must comply with the new rule beginning January 1, 2020.