Proposed Regulations Issued on Hardship Distributions

Labor & Employment Law Update

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The IRS has issued proposed regulations on hardship distributions under section 401(k) and 403(b) plans ("Proposed Regulations"), addressing issues raised by the Bipartisan Budget Act of 2018 ("Budget Act") and the 2018 Tax Cuts and Jobs Act ("Tax Act"). Plan sponsors need to consider administrative and plan amendment changes promptly.

There are two requirements for a permissible hardship distribution:

- The withdrawal must be made due to an immediate and heavy financial need; and
- The amount of the withdrawal must be limited to the amount necessary to satisfy that financial need.

Elimination of Six-Month Contribution Suspension

Under current regulations, participants who take a hardship distribution are prohibited from making contributions to the plan and other employer-sponsored plans for six months. The Proposed Regulations eliminate the six-month contribution suspension requirement.

Plan Loans Not Required Before a Hardship Distribution

Previously, a requested hardship distribution could be approved only if the participant has taken all plan loans otherwise available. The Proposed Regulations would remove this requirement. Unlike the elimination of the six-month suspension period, however, the elimination of this requirement is not mandatory.

New Circumstances for Hardship Distributions

Under current regulations, an employee is considered to have an immediate and heavy financial need in one of six categories of hardship events. The Proposed Regulations liberalize these rules:

- A participant could take a hardship distribution for expenses to repair damage to his principal residence if the damage qualified for a casualty loss deduction under Code Section 165. The Proposed Regulations would restore the casualty

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loss hardship distribution even though the casualty loss deduction has generally been repealed.

- Hardship distributions for qualifying medical, educational, and funeral expenses include those expenses incurred by a participant's "primary beneficiary."
- Under a new category of permitted hardship distribution events, participants may take a hardship distribution due to expenses and losses (including loss of income) incurred after federally-declared disasters (as long as the participant's home or principal place of business at the time of the disaster was located in an area designated for federal assistance).

Expansion of Sources

The Proposed Regulations expand the sources available for hardship distributions. Proposed Regulations confirm that safe harbor 401(k) employer contributions (and earnings thereon) and a number of other plan "buckets" are available sources for hardship distribution. Plan sponsors would not be required to expand the available sources for hardship distributions.

Plan Administrators May Rely Solely on New Participant Representation

A participant need only represent (in writing or *by electronic means*) that they have insufficient cash or liquid assets to satisfy the financial need. A plan administrator could rely on the representation in the absence of actual knowledge to the contrary.

Effective Date

The Proposed Regulations generally apply to hardship distributions made in plan years starting after December 31, 2018, but some special rules apply. There may be additional changes in final regulations.