

Publications

Labor and Employment Alert: Final Hardship Regulations Are Here – Get Ready to Amend Your Plans

Related Attorneys

Jennifer Bibart Dunsizer

Christine M. Poth

Dawne McKenna Parrish

Margaret "Peggy" M. Baron

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On September 23, 2019, the Treasury Department published **final regulations** affecting hardship distributions for 401(k) and other retirement plans.

Background

The final regulations are substantially similar to the proposed regulations, which we had described in our prior **labor and employment alert**. Plans that had been amended in compliance with the provisions of the proposed regulations will satisfy the final regulations. However, because the final regulations expanded the proposed regulations in some respects, a plan sponsor may want to further amend the plan.

What changed and what stayed the same?

The final regulations include the following provisions:

Expanded List of Hardship Reasons

The final regulations, like the proposed regulations, expand the list of safe harbor expenses eligible for hardship distributions:

- **“Primary Beneficiaries”** were added to the individuals whose medical, educational, or funeral expenses qualify.
- **Casualty losses relating to a principal residence** are no longer limited to losses incurred during a federally declared disaster. The old hardship standard required that the casualty loss be deductible (but for a dollar limit). The Tax Cuts and Jobs Act eliminated the tax deduction for casualty losses except for losses that occurred in connection with a federally declared disaster, which had the unintended consequence of eliminating the ability to take a hardship distribution for most casualty losses. The final regulations reverses this unintended consequence.

- **Expenses and losses affecting participants who live or work in an area affected by a federally declared disaster** were added to the list of eligible expenses. This is consistent with the proposed regulations but is narrower than some disaster specific announcements that the IRS has offered in the past. Specifically, a participant may only take a hardship withdrawal for their own expenses and cannot take a withdrawal in connection with losses sustained by a relative or dependent. The IRS is not expected to issue future disaster-specific relief announcements.
- All of the other safe harbor reasons remain unchanged. Remember that a plan does not have to include all of the hardship distribution reasons.

Expanded Sources for Hardship Distributions

The final regulations allow distributions from 401(k) plans of elective contributions, QNECs, QMACs, safe harbor matching contributions and earnings on these amounts. This effectively allows hardship distributions from most contribution sources. Note, however, that earnings on 403(b) account balances still cannot be taken as a part of a hardship distribution (because of a continuing statutory limitation). Employers should think about what contribution sources should be distributable.

Remember, if an employer expands their current process to allow hardship distributions from safe harbor matching contributions, an updated safe harbor notice reflecting that hardship withdrawal opportunity must be distributed.

Financial Need

- **Six Month Suspension.** Beginning no later than January 1, 2020, certain plans may not suspend employee contributions for the six months following a hardship distribution.
 - The final regulations clarify that the provision that eliminated the suspension of contributions only applies to qualified plans, section 403(b) plans, and 457(b) plans. Importantly, employers may retain suspension provisions in non-qualified deferred compensation plans. The preamble to the final regulations hints that it may be possible to remove suspension provisions from a plan subject to 409A, but only if that amendment would otherwise be permissible under 409A. Until further guidance is issued, we would recommend not adopting such an amendment.
- **General Standard for Financial Need.** The final regulations eliminated the facts and circumstances test previously used to determine financial need. Under the new standard:
 - A distribution may not be more than the amount needed to satisfy the financial need plus any applicable state, federal, and local taxes.
 - The employee must make a representation that he or she has insufficient cash or other liquid assets that are reasonably available to meet the financial need.
 - In response to comments, the IRS will allow an employee to disregard certain assets if they are earmarked to pay for other known expenses that will be due in the near future.
 - The distribution may not be made if the *plan administrator* has actual knowledge that the representation is false. This test may cause some plans to rethink the current plan administrator designation.

- The employee must have taken all other available plan distributions other than loans.
- Although the prior mandate to take plan loans before a hardship distribution has been relaxed, the IRS confirmed that a plan may keep that requirement if it chooses.
- Note, ESOP dividends may qualify as available plan distributions in unusual circumstances.

Imposition of Other Limitations

The final regulations confirm that a plan can impose other limitations on hardship distributions, like setting a minimum withdrawal amount and requiring submission of supporting documentation.

When do the changes take effect and what changes should plan administrators make?

Change Plan Operation. If a plan administrator has not already changed its hardship distribution process, it will need to take action to comply with the new rules. Plan administrators that have already implemented the new rules may not need to make any operational changes. Plan sponsors should be prepared to tell their plan document provider when the different rule changes were implemented so that an amendment can be drafted with appropriate effective dates.

Adopt Plan Amendments. Employers should amend their plan documents to reflect these changes. The deadline will depend on your plan:

Plan Type

Amendment Deadline

Individually designed – non-governmental

December 31, 2021

Pre-approved plan

Tax filing deadline plus extensions for 2020

403(b) plans

March 31, 2020 (but the IRS is considering an extension)

Contact your Vorys lawyer if you have questions about the effect the new rule will have on your benefit plans.