

IRS and Treasury Department Release Final Regulations on Hardship Distributions

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On September 19, 2019, the IRS and Treasury Department issued final regulations that amend the rules regarding hardship distributions from Internal Revenue Code (“Code”) Sections 401(k) and 403(b) plans. The final regulations are substantially similar to the proposed regulations that were published on November 14, 2018, but clarify and marginally modify the proposed regulations. Consequently, the final regulations state, “plans that complied with the proposed regulations will satisfy the final regulations.” Highlights of the final regulations include:

- **Modifying the safe harbor list of expenses.** The final regulations, like the proposed regulations, modify the safe harbor list of expenses for distributions that are deemed to be made on account of an immediate and heavy financial need. The final regulations:
 - define “primary beneficiary under the plan” as an individual for whom qualifying medical, educational, and funeral expenses may be incurred,
 - clarify that the home casualty reason for a hardship distribution does not have to be in a federally declared disaster area, and
 - expand the list of qualifying expenses to include costs incurred as a result of FEMA-declared disasters, provided that the participant’s principal residence or principal place of employment at the time of the disaster was located in the disaster area.
- **Changing the rules for determining whether a distribution is necessary to satisfy an immediate and heavy financial need.** The changes include:
 - Clarifying the requirement that an employee must make a representation that he or she has insufficient cash or other liquid assets to satisfy the financial need for a hardship distribution. The final regulations state that an employee could make a representation that he or she has insufficient cash or other liquid assets reasonably available to satisfy a financial need even if the employee does have cash or other liquid assets on hand, provided that those assets are earmarked for payment of an obligation in the near future (for example, rent). The employee representation can be made in writing by an electronic medium or by verbal representation via telephone if the call is recorded. In addition, plan administrators do not have an obligation to inquire into the financial condition of employees who request a hardship distribution; however, if the plan administrator already

has sufficiently accurate information contrary to an employee's representation, then the financial need for a hardship distribution is not satisfied.

- **Eliminating requirements that employees are prohibited from making contributions after receiving a hardship distribution and must take a plan loan prior to receiving a hardship distribution.** Pursuant to the Bipartisan Budget Act of 2018, the final regulations, like the proposed regulations, eliminate (i) any requirement that an employee be prohibited from making elective contributions and employee contributions after receipt of a hardship distribution, and (ii) any requirement to take plan loans prior to obtaining a hardship distribution. Accordingly, the final regulations eliminate the safe harbor that deems a distribution is necessary to satisfy the financial need only if elective contributions and employee contributions are suspended for at least six months after a hardship distribution is made and, if available, nontaxable plan loans are taken before the hardship distribution is made. However, the final regulations clarify that the prohibition on suspensions applies only to a qualified plan, a Code Section 403(b) plan, and an eligible deferred compensation plan described in Code Section 457(b) maintained by an eligible employer. Thus, a plan subject to Code Section 409A may retain its suspension provisions.
- **Broadening the sources for hardship distributions.** The final regulations, like the proposed regulations, allow hardship distributions to be taken from elective contributions, qualified nonelective contributions ("QNECs"), qualified matching contributions ("QMACs"), and earnings on these amounts, regardless of when contributed or earned. The final regulations also clarify that safe harbor contributions—QNECs and QMACs—made to a Code Section 401(k)(12) safe harbor plan may be distributed on account of hardship.
- **Generally applying the new rules relating to hardship distributions from Code Section 401(k) plans to Code Section 403(b) plans with one exception.** QNECs and QMACs in a Code Section 403(b) plan that are not in a custodial account may be distributed on account of hardship, but QNECs and QMACs that are in a custodial account continue to be ineligible for distribution on account of hardship.

Plan sponsors will need to amend their plans to comply with the final regulations, and such amendments must be effective for hardship distributions beginning no later than January 1, 2020. The deadline for amending a disqualifying provision for individually designed plans that are not governmental plans is the end of the second calendar year that begins after the issuance of the Required Amendments List, which will be December 31, 2021, if the final regulations are included in the 2019 Required Amendments List. The Treasury Department and IRS have extended the deadline for adopting an amendment for a pre-approved plan to the 2020 tax-filing deadline plus extensions. For Code Section 403(b) plans, the deadline to adopt amendments to conform to the final regulations is March 31, 2020, but the final regulations specify that this deadline could be extended.

In light of these final regulations, plan sponsors should contact ERISA counsel for assistance to ensure that their plans comply with these final regulations in order to maintain the plans' tax-qualified status.

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