Hardship Distribution Rules Are Changing

Workers who save for retirement in their employer's 401(k) plan generally don't have access to their savings until they change jobs or retire—unless they suffer a financial hardship. The retirement plan laws permit a plan participant to take a hardship distribution of their elective deferrals while they're still working if they have a financial hardship that meets certain requirements. Your plan document must include hardship distribution language in order for participants to take a hardship distribution. Recent legislation and subsequent IRS guidance have changed the rules governing these hardship distributions.[1] These changes expand the availability of hardship distributions for plan participants and simplify the steps plans must take when deciding whether a distribution is necessary to meet a hardship. Plan sponsors should understand how these changes affect their plan operations and when they will be required to implement the changes.

Existing Hardship Distribution Rules

Special rules apply when participants take a hardship distribution of 401(k) plan elective deferrals. A participant must experience an "immediate and heavy financial" need and demonstrate that the hardship distribution is necessary to satisfy the financial need. The amount distributed cannot exceed the amount needed, including amounts to pay taxes or penalties as a result of the distribution.

Most 401(k) plans adopt the regulatory safe harbor rules for hardship distributions, which provide six types of expenses that are deemed to meet the immediate and heavy financial need requirement and rules for determining whether a distribution is necessary to meet that need.

Safe Harbor Deemed Hardship Needs	Who May Incur The Expense
Medical expenses	‣ Participant ‣ Participant's spouse ‣ Participant's dependents
Post-secondary education expenses	‣ Participant ‣ Participant's spouse ‣ Participant's dependents
Funeral expenses	‣ Participant's spouse ‣ Participant's dependents ‣ Participant's parent
Costs directly related to the purchase of a principal residence	‣ Participant
Payments necessary to prevent the foreclosure on or eviction from a principal residence	‣ Participant
Expenses relating to the repair of damages to a principal residence	‣ Participant

A hardship distribution is considered to be necessary to satisfy a financial need if:

- The participant has obtained all other distributions and non-taxable loans available under all plans of the employer.
- The participant isn't allowed to make contributions to a deferred compensation plan of the employer for six months after the hardship distribution.

If a plan does not follow the safe harbor rules, the plan administrator must apply the hardship rules on a facts and circumstances basis.

Changes to Hardship Distributions Rules

As a result of law changes, including the Bipartisan Budget Act of 2018, and proposed Treasury regulations, the following changes apply.

Rule Affected	Change	Effective Date	Optional or Mandatory
Dollars available for a hardship distribution	Added ‣ Qualified non-elective contributions ‣ Qualified matching contributions ‣ Safe harbor 401(k) contributions ‣ Investment earnings	For plan years beginning on or after January 1, 2019	Optional—plans may choose which money types will be available for hardship distributions
Safe harbor expenses deemed to be a heavy and immediate financial need	Added ‣ Medical, educational and funeral expenses incurred by participant's primary beneficiary	‣ Added by Pension Protection Act of 2006, so plans have already decided whether to apply this option	Optional—plans may choose whether to add these hardship reasons
	‣ Expenses related to a FEMA-declared disaster if a participant's home or employment is located in a disaster area	‣ For hardship distributions made on or after January 1, 2018	
	Clarified ‣ Casualty loss hardships can be made even if the loss is not attributable to a federally-declared disaster		Review plan document to determine whether plan language requires a casualty loss to be due to a federal disaster

Requirement to take plan loans before qualifying for a hardship distribution	Eliminated	For plan years beginning on or after January 1, 2019	Optional—plans may choose to require loans prior to hardship distributions
Requirement to suspend contributions for six months following hardship distribution	Eliminated	For plan years or for distributions occurring during this period: January 1, 2019, to December 31, 2019	Optional—for an interim period, plans may choose whether to suspend contributions for new hardship distributions and whether to apply the change to suspensions started in 2018 that carry into 2019
		For distributions on or after January 1, 2020	Mandatory—suspension of contributions will no longer be allowed
Facts and circumstances standard for determining whether hardship distribution is necessary to satisfy a financial need	Replaced with general standard: ▸ Distribution may not exceed the amount of need, plus taxes and penalties ▸ Participant must have obtained all currently available distributions from all qualified and non-qualified plans maintained by the employer ▸ Participant must represent in writing he/ she does not have the cash or liquid assets to satisfy the financial need ▸ Plan sponsor can rely on participant's statement if no knowledge to the contrary	For distributions made on or after January 1, 2020	Mandatory

Contact your Newport Group Representative for more information.

[1]**Source:** *IRS, Treasury, Hardship Distributions of Elective Contributions, Qualified Matching Contributions, Qualified Non-elective Contributions, and Earnings, 26 CFR 1, 83 FR 56763, November 14, 2018, https://www.federalregister.gov/documents/2018/11/14/2018-24812/hardship-distributions-of-elective-contributions-qualified-matching-contributions-qualified*

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