



IRS issues final hardship withdrawal rules

Who's affected

This information applies to sponsors of and participants in 401(k) plans and 403(b) plans that permit hardship withdrawals.

Background and summary

In February 2018, President Trump signed into the law the [Bipartisan Budget Act of 2018](#) (the Act), which directed the Department of Treasury to make regulatory changes to the hardship withdrawal rules in Section 401(k) and 403(b) plans effective for plan years beginning after December 31, 2018. This legislation:

- Eliminated the requirement for safe harbor hardship distributions to take any available plan loan before receiving a hardship withdrawal;
- Eliminated the requirement for safe harbor distributions to suspend employee contributions for at least 6 months following receipt of a hardship withdrawal; and
- Allowed the hardship distribution of earnings on elective deferrals, as well as qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs) with associated earnings from 401(k) plans.

On November 14, 2018, the IRS issued [proposed rules](#) that include a number of changes related to hardship withdrawals. The proposed rules:

- Adopted the Bipartisan Budget Act changes;
- Modified the safe harbor list of expenses for hardship withdrawal;
- Replaced the previous standards for determining whether a distribution is necessary to satisfy a financial need with a new general standard;
- Clarified the application of the hardship distribution rules in light of the changes to casualty loss deductions under the Tax Cuts and Jobs Act, P.L. 115-97; and
- Provided relief for victims of Hurricanes Florence and Michael.

The proposed rules were able to be relied upon with respect to hardship distributions made in plan years beginning on or after December 31, 2018, until the issuance of final rules.

On September 23, 2019, the IRS issued [final hardship withdrawal rules](#), adopting the provisions of the proposed rules. Plans that complied with the proposed rules will satisfy the final rules.

Action and next steps

Plan sponsors should review the information in this publication to determine potential impacts to their plans and make any necessary plan design changes to comply with these rules.

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Safe harbor expenses

For purposes of determining whether a participant has an immediate and heavy financial need, the final rules adopted the proposed changes to the safe harbor list of expenses including:

- Adding “a primary beneficiary under the plan” as an individual for whom qualifying medical, educational, and funeral expenses may be incurred. This change was originally permitted by the Pension Protection Act of 2006 (PPA);
- Adding a seventh safe harbor expense to the list for expenses and losses incurred as a result of certain disasters that occurs in an area designated by the Federal Emergency Management Agency (FEMA); and
- Modifying the casualty loss deduction expense to clarify that limitations under the Tax Cuts and Jobs Act narrowing the definition of casualty loss do not apply for hardship withdrawal purposes. Under the proposed and final rules, either definition of casualty loss is acceptable for hardship withdrawals distributed in 2018.

The IRS has indicated that making expenses related to certain federally declared disasters a safe harbor expense is intended to eliminate any delay or uncertainty concerning access to plan funds that might otherwise occur following a major disaster. As a result, the IRS does not expect to issue disaster-relief hardship and loan announcements like those issued in past. However, the IRS and Treasury are considering separate guidance to address delayed amendment deadlines when the new safe harbor expense or loan provisions are added to a plan at a later date in response to a particular disaster.

Deemed necessary to satisfy financial need

Elimination of suspension requirement

The final rules, like the proposed rules, eliminate the safe harbor hardship withdrawal requirement to suspend participants from making elective deferrals or after-tax contributions to a 401(k) or 403(b) plan for a period of at least six months. A plan sponsor had the option to eliminate suspensions for the 2019 plan year. However, for hardship withdrawals made on or after January 1, 2020, suspensions of elective contributions or employee contributions will no longer be permitted from qualified plans, 403(b) plans, and governmental 457(b) plans as a condition of obtaining a hardship withdrawal. A plan sponsor had the option to cease suspensions that were in effect as of the end of the 2018 plan year, or to continue them in accordance with the originally scheduled suspension period.

Elimination of requirement to take a loan before hardship withdrawal

The final rules eliminate the requirement to take a loan before a safe harbor hardship withdrawal for distributions made on or after January 1, 2020 (rather than, as in the proposed rules, to distributions made in plan years beginning after December 31, 2018). However, the rule may be applied to distributions made in plan years beginning after December 31, 2018. Additionally, if a plan sponsor would like to continue to require participants to take a loan before a hardship withdrawal, they would be permitted to do so.

New general standard for financial determination

Under the final rules, the determination of whether a distribution is necessary to satisfy a financial need is changed to provide one general standard that applies to both safe harbor and facts and circumstances hardship distributions. Under this general standard, a hardship distribution:

- May not exceed the amount of an employee’s need (including amount necessary to pay federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution);
- The employee must have obtained other available distributions under the employer’s plans; and
- The employee must represent that he or she has insufficient cash or liquid assets to satisfy the financial need. A plan

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administrator may rely on such a representation from the employee unless the administrator has actual knowledge to the contrary. The requirement to obtain this representation will apply to distributions made on or after January 1, 2020.

Expanded sources for hardship withdrawal

The final rules permit hardship withdrawals from 401(k) plans consisting of elective contributions, QNECs, QMACs, and earnings on those amounts, regardless of when contributed or earned. However, a plan may limit the type of contributions available for hardship withdrawal and whether earnings on those contributions are included. The rules also clarify that safe harbor contributions, including qualified automatic contribution arrangement (QACA) safe harbor contributions may also be distributed due to hardship.

Section 403(b) plans

The final rules generally also apply to 403(b) plans. However, earnings on elective deferrals are not available for hardship withdrawal from a 403(b) plan. Additionally, amounts attributable to a QNEC or QMAC may be distributed from a 403(b) plan on account of hardship only to the extent that hardship is a permitted distributable event for amounts that are not attributable to 403(b) elective deferrals. As a result, QNEC or QMAC amounts in a custodial account may not be distributed on account of hardship.

Applicability dates and reliance

The changes to the hardship rules made by the Bipartisan Budget Act of 2018 are effective for plan years beginning after December 31, 2018. The final rules provide plan sponsors with a number of applicability-date options. Although presented differently in the proposed rules, the options available to plan sponsors under the final rules are the same as those available under the proposed rules.

The final hardship withdrawal rules apply to distributions made on or after January 1, 2020, but may be applied to distributions beginning after December 31, 2018. The prohibition on the six-month suspension of contributions applies to distributions made on or after January 1, 2020, but may be applied as of the first day of the first plan year beginning after December 31, 2018, even if the distribution was made in a prior year. The requirement that plan sponsors obtain the participant's representation regarding insufficient cash or liquid assets to meet a financial need would apply to distributions made on or after January 1, 2020.

Plan amendments

Plan sponsors will need to amend their plans' hardship distribution provisions to reflect the final rules. These amendments must be effective for distributions beginning no later than January 1, 2020.

The deadline for an individually designed plan that is not a governmental plan is the end of the second calendar year that begins after the issuance of the Required Amendments List that includes the change. If the final rules are included in the 2019 Required Amendments List, the deadline will be December 31, 2021.

The deadline for pre-approved plans depends on several factors, including the type of entity sponsoring the plan and the period used for the plan year. However, the IRS has extended the deadline for adopting optional/discretionary amendments for pre-approved plans to the deadline of required changes.

Sponsors of 403(b) plans using pre-approved and individually designed plan documents currently have an amendment deadline of March 31, 2020. However, the Treasury department and IRS are considering providing a later amendment deadline in separate guidance. *(Note: On September 30, the IRS issued Revenue Procedure 2019-39, which establishes a recurring remedial amendment period and provides limited extensions on amendment deadlines for 403(b) plans. Prudential Retirement will be addressing this guidance under a separate publication in the near future.)*

Next steps

Effective for hardship withdrawals taken on or after January 1, 2020, suspensions of elective deferrals and employee contributions in qualified plans, 403(b) plans, and governmental 457(b) plans are no longer allowed. For affected plan sponsors that haven't already removed the suspension requirement, Prudential Retirement will no longer process suspensions of elective deferrals and employee contributions following hardship withdrawals for hardship distributions made on or after January 1, 2020.

Sponsors that use outside-drafted plan documents should send Prudential Retirement copies of all adopted amendments. Sponsors that use Prudential's document services will receive information regarding these plan amendments at a later date.

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Editor: Julie Koos

(563) 585-6811

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