December 2018

PENSION ANALYST

Important information—Plan administration and operation

IRS issues proposed 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, 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:

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

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

- Adopt the Bipartisan Budget Act changes;
- Modify the safe harbor list of expenses for hardship withdrawal;
- Replace the previous standards for determining whether a distribution is necessary to satisfy a financial need with a new general standard;
- Clarify 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
- Provide relief for victims of Hurricanes Florence and Michael.

Although these rules are in proposed form, they may generally be relied upon with respect to hardship distributions made in plan years beginning on or after December 31, 2018, until final rules are issued. Comments on the proposed rules are due January 14, 2018.

Action and next steps

Plan sponsors should review the information in this publication to determine potential impacts to their plans and make decisions on optional plan design provisions for the 2019 plan year.

In this issue

Safe harbor expenses

For purposes of determining whether a participant has an immediate and heavy financial need, the proposed rules change the current safe harbor list of expenses by:

- 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 rules, either definition of casualty loss is acceptable for hardship withdrawals distributed in 2018.

Deemed Necessary to Satisfy Financial Need

Elimination of suspension requirement

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 will have 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. A plan sponsor has the option to cease suspensions that are 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 proposed rules eliminate the requirement to take a loan before a safe harbor hardship withdrawal for plan years beginning after December 31, 2018. However, 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 proposed 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 administrator may rely on such a representation from the employee unless the administrator has 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 proposed 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

These proposed 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.

Relief for victims of Hurricanes Florence and Michael

Recognizing that employees adversely affected by Hurricanes Florence or Michael may need expedited access to plan funds, the IRS has included in the proposed rules relief similar to Announcement 2017-15 for similarly situated victims of Hurricanes Florence and Michael, with “Incident Dates” that are specified by FEMA for these 2018 hurricanes. This relief allows plan sponsors to make hardship distributions available on a broader basis to individuals affected the hurricanes.

This relief is provided through March 15, 2019, and any necessary plan amendments must be made by the deadline applicable to other plan amendments under these proposed rules.

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, and the proposed rules provide that they would generally apply to distributions made in plan years beginning after December 31, 2018. However, the suspension prohibition may be applied as of the first day of the first plan year beginning after December 31, 2018.

Plan amendments

The proposed deadline for amending plans for these changes to hardship provisions is the deadline for amending a disqualifying provision in Revenue Procedure 2016-37. For example, 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.

Sponsors of prototype or volume submitter plan documents will need to adopt interim amendments, which will be required after final regulations are issued. Interim amendments are generally due the later of the last day of the plan year in which the amendment is first effective, or the due date (including extensions) for filing the tax return for the employer’s tax year that includes the effective date of the amendment.

Next steps

Prudential Retirement will be contacting sponsors of 401(k) and 403(b) plans that permit hardship withdrawals regarding the administration of the hardship withdrawal provisions for their plans. An upcoming Pension Analyst will provide more information regarding the Hurricane Florence and Hurricane Michael relief.

Pension Analyst by Prudential Retirement
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