

IRS Delays Effective Date of New Hardship Withdrawal Rules

On December 23, 1998, the IRS issued [Notice 99-5](#). This notice delayed the effective date of the new rules relating to the rollover eligibility of hardship withdrawals from 401(k) plans and 403(b) programs. All such withdrawals made during 1999 may continue to be treated as eligible rollover distributions. This one-year delay in the effective date of the change made by the Internal Revenue Service Restructuring and Reform Act of 1998 (IRRA) gives plan sponsors more time to educate participants about this change and ensure that computer systems are ready for the new rules.

New Definition of Eligible Rollover Distribution

IRRA modified the definition of "eligible rollover distribution" by adding 401(k) and 403(b) elective deferral hardship withdrawals to the list of items that are not eligible for rollover. As a result, they will no longer be subject to the mandatory 20% withholding rules. Unless the individual elects otherwise, 10% federal withholding will apply to these payments. However, hardship withdrawals taken from other contributions made to a participant's account are still considered eligible rollover distributions subject to mandatory 20% withholding.

IRS Relief

Under IRRA, the revised definition of eligible rollover distribution was to apply to all distributions made on or after January 1, 1999. However, the IRS is now providing some flexibility around this effective date. For distributions made during 1999, either the pre-IRRA definition of eligible rollover distribution or the IRRA definition may be used to determine the amount of a hardship withdrawal that is eligible for direct rollover.

The IRS has also provided flexibility at the participant level for withdrawals taken in 1999. If the IRRA definition of eligible rollover distribution is applied to 1999 distributions and, therefore, participants cannot make direct rollovers of the elective deferral portions of their hardship withdrawals, they may still elect to roll over those amounts on their own within 60 days of the distribution.

Prudential's Response

Prudential will take advantage of this transitional relief to give our plan sponsors more time to understand this change and to educate their participants about its effects. At this time, we are planning to begin using the new definition of eligible rollover distribution when processing hardship withdrawals distributed in the second quarter of 1999. We will keep plan sponsors

*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business.

informed of the steps we are taking so they will know specifically when we do implement this change.

Plan Sponsors' Next Steps

Plan sponsors should use this time to explain these changes to participants. This change could have a large impact on the decisions that participants make about their hardship withdrawals.

Plan sponsors should also review their plan documents to determine if they contain a definition of "eligible rollover distribution" that must be revised. If a plan amendment is needed, that amendment must be adopted by the last day of the plan's 1999 plan year. This amendment would generally be included in the amendment made to comply with other recent legislation, such as the Small Business Job Protection Act of 1996 (SBJPA) and the Taxpayer Relief Act of 1997 (TRA'97). If a plan applies the new definition of eligible rollover distribution during 1999, the plan amendment must specify the date that change became effective. At this time, plan sponsors that have adopted a Prudential Prototype document should not take any actions regarding their plan documents. We will inform you in the future if any action is necessary.

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