

IRS PUBLISHES FINAL HARDSHIP WITHDRAWAL REGULATIONS

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The Pension Protection Act of 2006 (PPA), the Tax Cuts and Jobs Act of 2017 (TCJA), and the Bipartisan Budget Act of 2018 (the Budget Act) included statutory changes affecting the hardship withdrawal rules for 401(k) plans. As we reported in our [November 2018 Employee Benefits Newsletter](#), the IRS published proposed regulations that addressed changes made to the hardship withdrawal rules. After receiving relatively few comments on the proposed regulations, the IRS has now published the final version of those hardship withdrawal regulations.

In publishing the final regulations, the Department of the Treasury states that the “final regulations are substantially similar to the proposed regulations,” and confirmed “plans that complied with the proposed regulations will satisfy the final regulations.” Nonetheless, there are minor clarifications made by the final regulations that are noteworthy:

- Under both the proposed and final regulations, the employee must represent (in writing or by an electronic medium) that he or she has insufficient cash or other liquid assets to satisfy the financial need. A plan administrator may rely on that representation unless the plan administrator has actual knowledge to the contrary. The requirement to obtain this representation generally applies to any distribution that is made on or after January 1, 2020. The final regulations, however, clarify that an acceptable form of electronic medium for receiving the representation includes an employee’s verbal representation that is obtained via telephone if it is recorded.
- Both the proposed and final regulations included language that prohibits a plan from including a provision under which an employee’s elective contributions would be suspended as a condition of obtaining a hardship distribution. The final regulations, however, now limit the prohibition on suspensions of employee elective contributions to qualified retirement plans, section 403(b) plans, and eligible deferred compensation plans described in Code Section 457(b) maintained by governmental entities. Accordingly, a plan subject to Code Section 409A (i.e., a nonqualified deferred compensation plan) may retain its elective contribution suspension provisions (or, to the extent consistent with Code Section 409A, the plan may be amended to remove them).

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Many of the hardship rule changes that were otherwise addressed in the proposed regulations are now finalized by the final hardship regulations and remain optional (expanded sources for hardship distributions; eliminating the “deemed necessary” standard under which an employee first must take available plan loans prior to obtaining a hardship distribution; adding the “primary beneficiary under the plan” as an individual for whom qualifying medical, educational, and funeral expenses may be incurred; adding a new type of safe harbor expense for expenses and losses (including loss of income) incurred by the employee on account of a federally-declared disaster; etc.). The final regulations provide that the hardship distribution rule changes generally may apply to distributions made on or after January 1, 2020 (rather than, as in the proposed regulations, to distributions made in plan years beginning after December 31, 2018).

However, the hardship distribution rule changes, at the option of the plan sponsor, may be applied to earlier distributions made in plan years beginning after December 31, 2018. And the prohibition on suspending an employee’s elective contributions and employee contributions as a condition of obtaining a hardship distribution 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 the prior plan year. In addition, the revised list of safe harbor expenses may be applied to distributions made on or after a date that is as early as January 1, 2018.

The required changes (i.e., the required employee representation, and prohibiting suspensions of elective deferrals as a condition for obtaining a hardship distribution) must in any event take effect January 1, 2020, and *plans that offer hardship withdrawals must begin to comply with those required rule changes at that time even if the deadline for amending the plan is somewhat later*. If a plan sponsor chooses to apply the hardship distribution rule changes to distributions made before January 1, 2020, the new rules requiring an employee representation and prohibiting a suspension of contributions may be disregarded with respect to those earlier hardship distributions.

Plans that offer hardship distributions will need to be amended to reflect both the required hardship rule changes as well as any optional rule changes plans choose to implement. For an individually designed plan that is not a governmental plan, the deadline for amending the plan to reflect a change in qualification requirements is the end of the second calendar year that begins after the issuance of the annual Required Amendments List (RAL) that includes the change. Assuming the final hardship regulations are included in the 2019 RAL, the amendment deadline for such individually designed plans is expected to be December 31, 2021. For an employer using a pre-approved plan, the amendment deadline will be the interim amendment deadline for making required changes, which might make the amendment deadline somewhat earlier (e.g., due by the tax-filing deadline (plus extensions) for 2020). The amendment deadlines for pre-approved and individually designed section 403(b) plans is March 31, 2020, but the Treasury Department and IRS are still considering a possible later amendment deadline for the amendments relating to the final regulations.