



IRS Finalizes Hardship Distribution Regulations

The IRS has released final amendments to the hardship distribution regulations applicable to 401(k) plans (“Final Regulations”). These regulations finalize the previously proposed regulations (“Proposed Regulations”) that addressed changes in the law under the Tax Cuts and Jobs Act of 2017 (“Tax Act”) and the Bipartisan Budget Act of 2018 (“Budget Act”). The Final Regulations also make additional changes that reflect other laws and revise positions on regulatory requirements. (See [ASC Alert No. 18-03](#).)

The retirement community has anxiously awaited the issuance of these Final Regulations. The Final Regulations themselves are substantially the same as the Proposed Regulations. However, the preamble to the Final Regulations addresses several issues raised by practitioners and employers after the release of the Proposed Regulations. Generally, the preamble explanations of the revised rules provide helpful guidance on these issues. Unfortunately, one of the key areas of concern – the interim amendment deadline for pre-approved plans to be amended to reflect the regulatory changes – was addressed, but not clearly. This ASC Alert summarizes the Final Regulations and the preamble clarifications.

The Final Regulations substantially revise the rules for making hardship distributions from 401(k) plans. The changes include a rewrite of the distribution provisions under Treas. Reg. §1.401(k)-1(d) relating to the interpretation of the two requirements for a hardship distribution (i.e., a distribution is made on account of hardship only if the distribution is made on account of both (1) an immediate and heavy financial need of the employee and (2) is necessary to satisfy the financial need). Other changes are made to the regulations under Treas. Reg. §1.401(k) – 3, Treas. Reg. §1.401(m) – 3 (relating to safe harbor plans), and Treas. Reg. §1.401(k) – 6 (relating to definitions).

Effective/Applicability Dates. The Final Regulations generally apply to hardship distributions made on or after January 1, 2020. However, plans may apply certain provisions at an earlier date.

ASC Insight: The effective/applicability rules under the Final Regulations are somewhat complicated. At the end of this ASC Alert, we provide a table reflecting the various effective/applicability dates.

Safe harbor list of hardship events. The Final Regulations revise the list of safe harbor hardship events for showing that a distribution is made on account of an immediate and heavy financial need, including the following:

- **Primary Beneficiary** – The Final Regulations add “primary beneficiary under the plan” as an individual for whom qualifying medical, educational, and funeral expenses may be incurred. This change reflects the PPA change that allowed a hardship distribution on account of medical, educational and funeral expenses incurred by a “primary beneficiary.” Plans generally have already been amended to reflect this change.

Final Regulations Clarification: A plan, including a plan using the safe harbor expense standards, is not required to allow for hardship distributions on account of medical, educational and funeral expenses incurred by a “primary beneficiary.” This is an optional provision, as are allowing hardship distributions for each of the now seven safe harbor hardship expenses.

- **Casualty loss expense under Code §165** - The Final Regulations modify the expense listed in Treas. Reg. §1.401(k)-1(d)(3)(iii)(B)(6) (relating to damage to a principal residence that would qualify for a casualty deduction under Code §165) to provide that, for this purpose, the new limitations in Code §165(h)(5) (added by §11044 of the Tax Act) do not apply.

ASC Insight: The Final Regulations allow plans to provide casualty loss hardship distributions under the standard that applied prior to the Tax Act (i.e., it is not necessary to meet the requirement under newly-added Code §165(h)(5) requiring the loss to be attributable to a federally declared disaster). In addition, the Final Regulations allow a plan to retroactively apply the regulatory casualty loss standard back to 2018.

- **Disaster-related expense** – The Final Regulations add a new type of expense to the safe harbor list, relating to expenses incurred as a result of certain

disasters. The Final Regulations make it automatic, without the need for a plan amendment, that a hardship distribution for those in FEMA-designated areas is permissible when there is a major federally declared disaster (e.g., Hurricane Maria under Announcement 2017-15). Like the new rules for the casualty loss expense, the Final Regulations allow a plan to retroactively apply this new disaster event back to 2018.

The Final Regulations also clarify that a plan subject to section 409A may retain its suspension provisions or, to the extent consistent with section 409A and the regulations thereunder, such plan may be amended to remove them.

-
2. The requirement to take plan loans prior to obtaining a hardship distribution.

Final Regulation Clarification: The Final Regulations clarify that unlike under the IRS disaster-relief announcements: (1) only disaster-related expenses and losses of an employee who lived or worked in the disaster area will qualify for the new safe harbor expense, and not expenses and losses of the employee’s relatives and dependents; (2) there is no specific deadline by which an employee must request a disaster-related hardship distribution (this is determined by plan procedures and terms); and (3) the regulations do not provided for an extended deadline for employers to amend their plans to add disaster-related hardship distribution and loan provisions.

Final Regulation Clarification: The Final Regulations note that plan sponsors may impose a broad range of conditions, including a condition that plan loans must be taken, before obtaining a hardship distribution. Examples of conditions provided in the preamble include completing the plan’s application process, providing required documentation and imposing a minimum nondiscriminatory dollar amount for a hardship distribution. However, in no event may a plan impose a suspension on elective deferral or employee contributions for hardship distributions made on or after January 1, 2020.

Distribution necessary to satisfy financial need. The Final Regulations include revisions mandated by the Budget Act relating to the rules for determining whether a distribution is necessary to satisfy an immediate and heavy financial need by eliminating:

Facts and circumstances determination of financial need.

The Final Regulations eliminate the rules in current Treas. Reg. §1.401(k)-1(d)(3)(iv)(B) (under which the determination of whether a hardship distribution is necessary to satisfy a financial need is based on all the relevant facts and circumstances) and provide one general standard for determining whether a hardship distribution is necessary. Under this general standard, (1) a hardship distribution may not exceed the amount of an employee’s need (including any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution); (2) the employee must have obtained other available distributions under the employer’s plans; and (3) the employee must represent that he or she has insufficient cash or other liquid assets to satisfy the financial need. A plan administrator may rely on such a representation (“self-certification”), unless the plan administrator has “actual knowledge” to the contrary. Plans must apply the self-certification standard for hardship distributions made on or after January 1, 2020.

1. Any requirement that an employee be prohibited from making elective deferrals and after-tax employee contributions after receipt of a hardship distribution and eliminating the 6-month suspension requirement under the financial need safe harbor approach.

Final Regulation Clarification: The so-called “applicability date” under the Final Regulations for eliminating the 6-month suspension requirement is confusing. The Final Regulations provide an explanation of the various times when a plan may (and must) eliminate the 6-month suspension requirement. Under the Final Regulations, no 401(k), 403(b) or 457(b) Governmental plan may impose a suspension requirement on any hardship distribution made on or after January 1, 2020. (Note this is not based on plan years, but on the hardship distribution date.) A plan implementing the rule for hardship distributions made on or after January 1, 2020 may continue to apply the suspension requirement to hardship distributions made prior to that time. Alternatively, a plan could apply the new rule (i.e., no 6-month suspension) as early as the first day of the first plan year beginning after December 31, 2018, even if the hardship distribution was made in the prior year.

Final Regulations Clarifications: Practitioners have raised questions relating to the self-certification requirement. The Final Regulations address several of these questions. Under the Final Regulations, (1) the employee representation only relates to whether the employee has cash or other liquid assets that are “reasonably available” to satisfy the need; (2) the rule that the employee may make the representation “in writing, by an electronic medium, or in such other form as may be prescribed by the Commissioner”

includes a verbal representation via telephone that is recorded; and (3) the “actual knowledge” requirement does not impose upon plan administrators an obligation to inquire into the financial condition of employees who seek hardship distributions. (Rather, the rule is limited to situations in which the plan administrator already possesses sufficiently accurate information to determine the veracity of an employee representation.)

Expansion of sources for hardship distributions. The Final Regulations modify Treas. Reg. §1.401(k)-1(d)(3) to permit hardship distributions from 401(k) plans from elective deferrals, QNECs, QMACs, and earnings on these amounts, regardless of when contributed or earned. The regulations clarify that allowing hardship distributions from these sources is discretionary and a plan may restrict access to any particular source. This means that plans may, but are not required to, allow access to the newly available sources, starting with the 2019 plan year.

Final Regulations Clarification: The Final Regulations clarify that the expansion of hardship distributions sources applies to “traditional” safe harbor plans under Code §401(k)(12) as well as qualified automatic contribution arrangements (QACAs) under Code §401(k)(13).

Application to 403(b) plans. The Final Regulations GENERALLY apply to 403(b) plans. However, the statutory requirement that 403(b) plans cannot distribute earnings on elective deferrals, as required under Code §403(b)(11), continues to apply.

Final Regulations Clarification: The Final Regulations reiterate that the ability for 403(b) plans to make hardship distributions from the QNEC, QMAC and safe harbor plan sources is limited to annuity contracts under Code §403(b)(1) and does not apply to custodial accounts under Code §403(b)(7) (generally, accounts invested in mutual funds). Hardship is not a permissible distribution event for amounts in 403(b) custodial accounts, except for elective deferrals (not including earnings).

Plan Amendments. Plan sponsors will need to amend their plans’ hardship distribution provisions to reflect the Final Regulations, and any such amendment must be effective for hardship distributions beginning no later than January 1, 2020. The deadline for amending an individually designed plan is the end of the second calendar year that begins after the issuance of the IRS’ Required Amendments List (RAL) that includes the hardship distribution changes. It is expected that the 2019 RAL will reference the Final Regulations. If so, the

amendment deadline will be December 31, 2021.

Unlike in the preamble to the Proposed Regulations, the Final Regulations provide a discussion of the hardship distribution interim amendment deadline for pre-approved plans. Unfortunately, the discussion raises questions with respect to the deadline for certain plans. As stated in the preamble, irrespective of other guidance on the timing of pre-approved plan interim amendments, the deadline for plans to adopt an interim amendment reflecting the hardship distribution changes is extended. “Under this extension, for an employer using a pre-approved plan, the interim amendment deadline for the required amendment to the hardship distribution provisions of the plan will also be the deadline for all amendments integrally related to the hardship distribution provisions...” Thus, if an employer with a calendar tax year “were to implement the prohibition on suspensions effective for distributions made on or after January 1, 2020, the interim amendment deadline to add the new safe harbor expense would be the same as the deadline for the required amendment (that is, the tax-filing deadline (plus extensions) for 2020), even if the new safe harbor expense is effective in an earlier year.”

ASC Insight: Based on the discussion in the preamble, most employers will have until the due date of their 2020 tax return (plus extensions) to adopt an interim amendment for their pre-approved plans. Unfortunately, the application of the interim amendment deadline is not clear for all employers, such as employers with non-calendar tax years and employers who implemented all the regulatory changes prior to 2020. ASC is working with other retirement industry practitioners to get clarification on these matters from the Treasury Department and the IRS. We will inform you of the government’s response as soon as we receive one.

With respect to interim amendments for pre-approved 403(b) plans, the Final Regulations indicate that the amendment deadline is March 31, 2020. However, the preamble states that the IRS is considering providing for a later amendment deadline for the amendments relating to the Final Regulations in separate guidance.

ASC Insight: At the time of release of this ASC Alert, the IRS just issued Revenue Procedure 2019-39, which provides a later amendment deadline for 403(b) plans. Under the Revenue Procedure, an interim amendment is not required until the end of the calendar year after the calendar year in which the change is effective. Generally, this will be December 31, 2021. ASC will provide a separate, detailed analysis of Revenue Procedure 2019-39 which relates to 403(b) plan documents, including pre-approved 403(b) plan documents.

Final Regulation Change	Effective/Applicability Dates
General applicability of Final Regulations	The regulations generally apply to hardship distributions made on or after January 1, 2020. Plans may apply certain provisions at an earlier date, as described below.
Safe harbor hardship events, including revised casualty loss event and the disaster relief event	Plan may make the events effective for hardship distributions made on or after January 1, 2018.
Prohibition on the suspension of elective deferrals and after-tax employee contributions	Generally, effective for hardship distributions made on or after January 1, 2020. (i.e., employers may decide to apply the prohibition on suspending elective deferrals and after-tax employee contributions starting with hardship distributions made on or after January 1, 2020.) However, plans may apply the prohibition on the suspension of elective deferrals and after-tax employee contributions as of the first day of the first plan year beginning after December 31, 2018, even if the hardship distribution was made in the prior plan year.
Requiring participants to take available loans as a condition of receiving a hardship distribution	Employer may EITHER eliminate the need to take available loans for hardship distributions made in plan years beginning after December 31, 2018 OR continue to apply this as a condition of receiving a hardship distribution.
New standard for facts and circumstances determination of financial need	Generally, effective for hardship distributions made on or after January 1, 2020. However, may apply the new standard (without regard to the employee representation requirement) for hardship distributions made in plan years beginning after December 31, 2018.
Expansion of sources for hardship distributions	Plan may provide for the expansion of sources. Generally, effective for plan years beginning after December 31, 2018.
Application to 403(b) plans	Same effective/applicability dates as for 401(k) plans, except that 403(b) plans cannot allow for the distribution of earnings on elective deferrals.
Plan amendments	For individually designed plans, amendments will be required after the IRS lists the requirements in the Required Amendments List. For pre-approved plans, see discussion under Plan Amendments.

ASC Alerts are published as an information service for ASC clients. Articles are general in nature and are not a substitute for professional advice or opinion in a particular case.

To access ASC Alerts go to www.asc-net.com

ASC provides software and web applications for retirement plan professionals including: DC/DB Software, Plan Documents, EFAST2 5500 System and ERISA consulting. To contact ASC, email: info@asc-net.com