

## Proposed Hardship Distribution Regulations Mean Changes for 401(k) and 403(b) Plan Sponsors

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Employer-sponsors of certain retirement plans have work to do prior to the end of 2019. Sponsors of Internal Revenue Code ("Code") section 401(k) and 403(b) plans must analyze their plan documents and associated administrative procedures in order to ensure compliance with newly issued guidance related to hardship distributions.

On November 18, 2018, the Internal Revenue Service and Department of Treasury issued proposed regulations related to hardship distributions from Code section 401(k) and 403(b) plans ("Proposed Regulations"), which primarily respond to hardship distribution directives given by the Bipartisan Budget Act of 2018.

Plan amendments are required to reflect the changes set forth in the Proposed Regulations. Operational compliance with various provisions of the Proposed Regulations is required by January 1, 2020. This will require detailed review of administrative practices and participant communications (and very likely updates thereto) by year end.

### Background

Under existing regulations, a hardship distribution generally can be taken from a 401(k) or 403(b) plan if the participant demonstrates that (1) the hardship distribution will be made on account of an "immediate and heavy" financial need; and (2) the amount of the distribution is not in excess of the amount "necessary" to satisfy that need. To simplify plan administration, the existing regulations provide safe harbors for analyzing whether the two threshold requirements have been satisfied.

Under existing safe harbor, six types of expenses are automatically deemed to be requested on account of an "immediate and heavy" financial need ("Hardship Distribution Expenses"). Additionally, a safe harbor provides that a distribution is deemed "necessary" to satisfy an immediate and heavy financial need if (among other requirements) a participant has: (1) taken all available nontaxable plan loans from the plan and any other plan maintained by the employer before receiving the hardship distribution ("Plan Loan Requirement"); and (2) been suspended from making contributions to the plan for six months following the hardship distribution ("Six-Month Suspension Rule").

### Proposed Regulations

The Proposed Regulations include the following changes to the existing regulations:

- *Elimination of the Six-Month Suspension Rule.* Plans are required to eliminate the Six-Month Suspension Rule effective for hardship distributions made on or after January 1, 2020. However, plans are permitted to implement the deletion of the Six-Month Suspension Rule as early as the first day of the plan year beginning after December 31, 2018.
- *Elimination of the Plan Loan Requirement.* The Plan Loan Requirement is eliminated effective as of the first plan year beginning after December 31, 2018. The Plan Loan Requirement is now an optional provision that may be adopted by the employer.
- *Modification to the Hardship Distribution Expenses.* The Proposed Regulations modify and expand the list of expenses for which hardship distributions are deemed to be made on account of an "immediate and heavy"

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financial need. Plans may be amended to incorporate these changes.

- *Expansion of source of funds available for hardship distributions.* Effective for plan years beginning on or after January 1, 2019, plans are permitted, but not required, to allow participants to take hardship distributions from additional funding sources.
- *Addition of Participant Representation Requirement.* The Proposed Regulations provide a single three-prong standard for determining whether a distribution is necessary. One such prong requires, that for a distribution that is made on or after January 1, 2020, the employee must represent (in writing or by electronic medium) that he or she has insufficient cash or other liquid assets to satisfy the financial need.

### Action Items

Employer-plan sponsors should rely on the Proposed Regulations pending the issuance of final regulations. Accordingly, employer-plan sponsors must review plan provisions/procedures related to hardship distributions to determine what actions are required to ensure administrative and operational compliance. Amendments are required to reflect the mandatory provisions of the Proposed Regulations, and any desired optional provisions. The deadline for amending the plan itself to reflect the Proposed Regulations may not be immediate. However, given that operational compliance is required, employers may wish to adopt plan amendments sooner to ensure proper administration. Plan sponsors utilizing a pre-approved plan document should check with their plan vendor to coordinate compliance.

Issues for plan sponsors to consider include (but are not limited to):

- Whether the plan has or will delete the six-month suspension provision for hardship distributions issued prior to January 1, 2020;
- Whether the plan will continue to require a participant to obtain all available plan loans prior to granting a hardship distribution;
- Whether the plan will expand the sources of a participant's accounts from which hardship distributions can be made; and
- When changes to the list of Hardship Distribution Expenses will be implemented.

Participant communications and hardship distribution procedures should be reviewed and updated in conjunction with a plan's operational changes.

Plan sponsors with questions regarding hardship distributions should contact their Miller Canfield attorney.