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## IRS Issues on Proposed Regulation on Hardship Distributions



As [directed by the Bipartisan Budget Act of 2018](#), the Internal Revenue Service has issued a [notice of proposed rulemaking relating to hardship distributions from section 401\(k\) plans](#). The amendments reflect statutory

changes affecting section 401(k) plans, including recent changes made by the Bipartisan Budget Act of 2018. These regulations would affect participants in, beneficiaries of, employers maintaining, and administrators of plans that contain cash or deferred arrangements or provide for employee or matching contributions.

The proposed rules delete the 6-month prohibition on contributions; removes the requirement to distribution be treated as failing to be made upon the hardship of an employee solely because the employee doesn't take any available loan under the plan; and permits additional contribution amounts, including qualified nonelective contributions and qualified matching contributions and their earnings be distributed upon hardship. The proposed rules are to apply to plan years beginning after December 31, 2018.

Comments to the IRS must be received by January 14, 2019.

Below are more specifics taken from the IRS proposed regulations. Plan sponsors should consult their advisors and/or ERISA counsel for specific questions as to how these regulations will impact their plan.

## **Explanation of Provisions**

### **Overview**

These proposed regulations update the section 401(k) and (m) regulations to reflect: (1) The enactment of (a) sections 41113 and 41114 of Bipartisan Budget Act of 2018, Public Law

115-123 (BBA 2018), (b) sections 826 and 827 of Pension Protection Act of 2006, Public Law 109-280 (PPA `06, and (c) section 105(b)(1)(A) of the HEART Act; and (2) the application of the hardship distribution rules in light of the modification to the casualty loss deduction rules made by section 11044 of the Tax Cuts and Jobs Act, Public Law 115-97 (TCJA).

### **Deemed Immediate and Heavy Financial Need**

The proposed regulations modify the safe harbor list of expenses in current Sec. 1.401(k)-1(d)(3)(iii)(B) for which distributions are deemed to be made on account of an immediate and heavy financial need by: (1) Adding "primary beneficiary under the plan" as an individual for whom qualifying medical, educational, and funeral expenses may be incurred; (2) modifying the expense listed in Sec. 1.401(k)-1(d)(3)(iii)(B)(6) (relating to damage to a principal residence that would qualify for a casualty deduction under section 165) to provide that for this purpose the new limitations in section 165(h)(5) (added by section 11044 of the TCJA) do not apply; and (3) adding a new type of expense to the list, relating to expenses incurred as a result of certain disasters. This new safe harbor expense is similar to relief given by the IRS after certain major federally declared disasters, such as the relief relating to Hurricane Maria and California wildfires provided in Announcement 2017-15, 2017-47 I.R.B. 534, and is intended to eliminate any delay or uncertainty concerning access to plan funds following a disaster that occurs in an area designated by the Federal Emergency Management Agency (FEMA) for individual assistance.

### **Distribution Necessary To Satisfy Financial Need**

Pursuant to BBA 2018 sections 41113 and 41114, the proposed regulations modify the rules for determining whether a distribution is necessary to satisfy an immediate and heavy financial need by eliminating (1) any requirement that an employee be prohibited from making elective contributions and

employee contributions after receipt of a hardship distribution, and (2) any requirement to take plan loans prior to obtaining a hardship distribution. In particular, the proposed regulations eliminate the safe harbor in current Sec. 1.401(k)-1(d)(3)(iv)(E), under which a distribution is deemed necessary to satisfy the financial need only if elective contributions and employee contributions are suspended for at least 6 months after a hardship distribution is made and, if available, nontaxable plan loans are taken.

In addition, the proposed regulations eliminate the rules in current Sec. 1.401(k)-1(d)(3)(iv)(B) (under which the determination of whether a 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 distribution is necessary. Under this general standard, 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), 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 other liquid assets to satisfy the financial need. A plan administrator may rely on such a representation unless the plan administrator has actual knowledge to the contrary. In light of the timing of the publication of these proposed regulations, the requirement to obtain this representation would only apply for a distribution that is made on or after January 1, 2020.

The proposed regulations clarify that a plan generally may provide for additional conditions, such as those described in 26 CFR 1.401(k)-1(d)(3)(iv)(B) and (C) (revised as of April 1, 2018) or, for distributions made before January 1, 2020, the representation described in the preceding paragraph, to demonstrate that a distribution is necessary to satisfy an

immediate and heavy financial need of an employee. To implement Congress' purpose in enacting section 41113 of BBA 2018 (for example, Congress' concern that a suspension impedes an employee's ability to replace distributed funds), the proposed regulations do not permit a plan to provide for a suspension of elective contributions or employee contributions as a condition of obtaining a hardship distribution. However, in light of the timing of the publication of these proposed regulations, this prohibition would only apply for a distribution that is made on or after January 1, 2020.

### **Expanded Sources for Hardship Distributions**

Pursuant to section 41114 of BBA 2018, the proposed regulations modify Sec. 1.401(k)-1(d)(3) to permit hardship distributions from section 401(k) plans of elective contributions, QNECs, QMACs, and earnings on these amounts, regardless of when contributed or earned. However, plans may limit the type of contributions available for hardship distributions and whether earnings on those contributions are included. Safe harbor contributions made to a plan described in section 401(k)(13) may also be distributed on account of an employee's hardship (because these contributions are subject to the same distribution limitations applicable to QNECs and QMACs). See Sec. 1.401(k)-3(k)(3)(i).

### **Section 403(b) Plans**

Section 1.403(b)-6(d)(2) provides that a hardship distribution of section 403(b) elective deferrals is subject to the rules and restrictions set forth in Sec. 1.401(k)-1(d)(3); thus, the proposed new rules relating to a hardship distribution of elective contributions from a section 401(k) plan generally apply to section 403(b) plans. However, Code section 403(b)(11) was not amended by section 41114 of BBA 2018; therefore, income attributable to section 403(b) elective deferrals continues to be ineligible for distribution on account of hardship.

Amounts attributable to QNECs and QMACs may be distributed from a section 403(b) plan on account of hardship only to the extent that, under Sec. 1.403(b)-6(b) and (c), hardship is a permitted distributable event for amounts that are not attributable to section 403(b) elective deferrals. Thus, QNECs and QMACs in a section 403(b) plan that are not in a custodial account may be distributed on account of hardship, but QNECs and QMACs in a section 403(b) plan that are in a custodial account continue to be ineligible for distribution on account of hardship.

### **Relief for Victims of Hurricanes Florence and Michael**

The Treasury Department and the IRS realize that employees adversely affected by Hurricane Florence or Hurricane Michael may need expedited access to plan funds. Accordingly, the relief provided under Announcement 2017-15 is extended to similarly situated victims of Hurricanes Florence and Michael, except that the "Incident Dates" (as defined in that announcement) are as specified by FEMA for these 2018 hurricanes, relief is provided through March 15, 2019, and any necessary amendments must be made no later than the deadline for plan amendments set forth in this preamble under Plan Amendments.

### **Applicability Dates and Reliance**

The changes to the hardship distribution rules made by BBA 2018 are effective for plan years beginning after December 31, 2018, and the proposed regulations provide that they generally would apply to distributions made in plan years beginning after December 31, 2018. However, 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. Thus, for example, a calendar-year plan that provides for hardship distributions under the pre-2019 safe harbor standards may be

amended to provide that an employee who receives a hardship distribution in the second half of the 2018 plan year will be prohibited from making contributions only until January 1, 2019 (or may continue to provide that contributions will be suspended for the originally scheduled 6 months).

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. Thus, for example, a plan that made hardship distributions relating to casualty losses deductible under section 165 without regard to the changes made to section 165 by the TCJA (which, effective in 2018, require that, to be deductible, losses must result from a federally declared disaster) may be amended to apply the revised safe harbor expense relating to casualty losses to distributions made in 2018 so that plan provisions will conform to the plan's operation. Similarly, a plan may be amended to apply the revised safe harbor expense relating to losses (including loss of income) incurred by an employee on account of a disaster that occurs in 2018 (such as Hurricane Florence or Hurricane Michael), provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for individual assistance with respect to the disaster.

### **Plan Amendments**

The Treasury Department and the IRS expect that, if these regulations are finalized as they have been proposed, plan sponsors will need to amend their plans' hardship distribution provisions. The deadline for amending a disqualifying provision is set forth in Rev. Proc. 2016-37, 2016-29 I.R.B. 136. For example, with respect to 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 Required Amendments List described in section 9 of Rev. Proc. 2016-37 that includes the

change. A plan provision that is not a disqualifying provision, but is integrally related to a plan provision that is a disqualifying provision, may be amended by the same deadline applicable to a disqualifying provision.


A plan amendment that is related to the final regulations, but does not correct a disqualifying provision, including a plan amendment reflecting (1) the change to section 165 (relating to casualty losses) or (2) the addition of the new safe harbor expense (relating to expenses incurred as a result of certain federally declared disasters), will be treated as integrally related to a disqualifying provision. Therefore all amendments that relate to the final regulations will have the same amendment deadline. This deadline will also apply to an amendment reflecting the extension of the relief under Announcement 2017-15 to victims of Hurricanes Florence and Michael, as provided in this preamble.

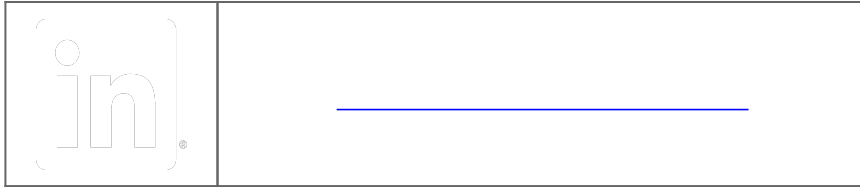


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## Who We Are

Torrillo & Associates, LLC specializes in employee benefit plan audits including 401k audits, 403b audits, pension plan audits, and other retirement plan audits. We are licensed in 10 states including Pennsylvania, New Jersey, Delaware, New York and Florida. We are also able to practice in additional states that have passed firm mobility.

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