

# WHAT'S NEW ABOUT 401(k) PLAN HARDSHIP WITHDRAWALS?

**Charles M. Lax, Esq.**



## What's New About 401(k) Plan Hardship Withdrawals?

- What is a hardship distribution?
- Why would a plan sponsor want to include a hardship distribution feature in their 401(k) plan?



## What's New About 401(k) Plan Hardship Withdrawals?

- What are the requirements for a hardship distribution?
  - Participant or other authorized person must have an “immediate and heavy financial need”
  - Distribution cannot exceed the amount needed to meet the financial need

## What's New About 401(k) Plan Hardship Withdrawals?

- Who may have the immediate and heavy financial need?
  - Depends on the circumstances
  - Always the participant, but may also include a spouse, dependent or primary beneficiary

## What's New About 401(k) Plan Hardship Withdrawals?

- Two ways to determine if the need is an immediate and heavy financial need
  - IRS safe harbor standards
  - Facts and circumstances
- IRS safe harbor standards
  - Most plans use the safe harbor approach
  - 6 situations that are included in the safe harbor standards



## What's New About 401(k) Plan Hardship Withdrawals?

- Medical expenses deductible under §213(d)
  - Available for participants, spouses, dependents or primary beneficiaries
  - Not subject to percentage limit, nor tied to itemizing deductions





## What's New About 401(k) Plan Hardship Withdrawals?

- Costs related to purchasing a primary residence
  - Only the participant
  - Covers purchase price, down payment and closing costs
  - May also cover land and building costs



## What's New About 401(k) Plan Hardship Withdrawals?

- Up to 12 months of post secondary education
  - Participants, spouses, dependents and primary beneficiaries
  - Tuition, fees, room and board, books, etc





## What's New About 401(k) Plan Hardship Withdrawals?

- Amounts necessary to prevent eviction or foreclosure from primary residence
  - Limited to the participant
  - Whether they rent or own



## What's New About 401(k) Plan Hardship Withdrawals?

- Funeral expenses of the participant's
  - Spouse
  - Parents
  - Dependents
  - Primary beneficiaries



## What's New About 401(k) Plan Hardship Withdrawals?

- Expenses for repair of damage to participant's primary residence if deductible under Section 165
  - Prior to the Tax Cuts and Jobs Act (“TCJA”), any casualty would qualify
  - Under TCJA, it is limited to “Presidential Declared Disasters”
  - Will the IRS modify its safe harbor standards?

## What's New About 401(k) Plan Hardship Withdrawals?

- Must not have other resources available
  - Use of assets of spouse or minor children
  - All other available distributions
  - Plan loans
    - Current law requires exhausting plan loans
    - BBA18 eliminates this requirement beginning with the 2019 plan year

## What's New About 401(k) Plan Hardship Withdrawals?

- Suspension of future referrals
  - Current law requires the suspension of deferrals for 6 months
  - BBA18 eliminates this requirement beginning with the 2019 plan year
- Exception for resources that make the financial situation worse



## What's New About 401(k) Plan Hardship Withdrawals?

- What is the maximum amount that can be distributed as a hardship distribution?
  - Employee deferrals (Roth or traditional)
  - Earnings on deferrals commencing with the 2019 plan year
  - QMACs and QNECs commencing with the 2019 plan year



## What's New About 401(k) Plan Hardship Withdrawals?

- How do you determine the amount “needed” to meet the financial need?
  - Includes the direct “out of pocket expenses”
  - Includes an amount sufficient to pay the taxes
  - Includes an amount sufficient to pay 10% excise tax, if applicable

## What's New About 401(k) Plan Hardship Withdrawals?

- What obligations do plan sponsors have before authorizing a hardship distribution?
  - No formal guidance from the IRS
  - Generally, the sponsor must obtain and maintain the source documents that demonstrate:
    - Reason for the distribution
    - Amount needed

## What's New About 401(k) Plan Hardship Withdrawals?

- In 2017, the IRS published an internal memorandum for its audit agents to be used to establish the immediate and heavy financial need requirement
  - Limited to plans using the safe harbor standards
  - Does not have the impact of law or guidance

## What's New About 401(k) Plan Hardship Withdrawals?

- What should the agent review?
  - Original source documents from third parties, if available
  - Summary of the source documents submitted to the plan by the participant if other requirements are met
    - Written notice to the participant
    - Information that must be included in the summary

## What's New About 401(k) Plan Hardship Withdrawals?

- What should the written notice include?
  - Taxability of the distribution
  - Maximum amount that may be distributed
  - Participant must preserve the source documents and make them available upon request

## What's New About 401(k) Plan Hardship Withdrawals?

- What information must be contained in the summary?
  - Depends on the type of hardship
  - Very specific information





## What's New About 401(k) Plan Hardship Withdrawals?

- What's troubling about the memorandum?
  - What happens if source documents are not available at the time of audit?
  - What happens if there are multiple hardship withdrawals?
  - Can a plan sponsor really rely on its TPA to administer hardship distribution provisions?