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## IRS Proposes Hardship Distribution Regs, Including Some Permanent Disaster Relief

Taking hardship distributions just got a lot easier and the sources available a lot broader. No longer must plan loans first be taken, and hardships due to disaster-related expenses and losses will be deemed an immediate and heavy financial need permanently; qualified nonelective contributions and qualified matching contributions and earnings on these amounts will be available; plan administrators can rely on participants' representations about their needs, although participants must still first obtain all available distributions under all employer plans — qualified and nonqualified. However, to encourage continued plan participation, the six-month deferral suspension period following a hardship distribution will no longer apply.

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### Authors

Joanne Jacobson, JD, LLM  
Marjorie Martin, FSPA, EA,  
MAAA

### Background

Since 2006, several pieces of legislation have modified the 401(k) plan hardship distribution rules. The most recent, the Bipartisan Budget Act of 2018 (Budget Act), permits qualified nonelective contributions (QNECs), qualified matching contributions (QMACs), and earnings on those contributions (as well as earnings on elective employee contributions) to be available for hardship distribution, eliminates the requirement to take a plan loan before a hardship distribution, and directs the Secretary of Treasury to revise the 401(k) regulations to remove the six-month prohibition on contributions following a hardship distribution.

The Tax Cuts and Jobs Act of 2017 (TCJA) indirectly modified one of the expenses deemed to be a hardship under the 401(k) regulations by revising the conditions for deducting casualty losses. The deemed hardship allows withdrawals for "expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under Section 165...." New Section 165(h)(5) provides that, for taxable years 2018 through 2025, the deduction for a personal casualty loss generally is only available to the extent the loss is attributable to a federally declared disaster. Read literally, the safe harbor expense would now be limited to damages to an employee's residence because of a federally declared disaster, not, for example, due to a fire unrelated to a federal disaster.

Speaking of federally declared disasters ... there have been many extraordinary ones lately. Some, but not all, have been favored with special plan distribution exceptions from the agencies. The IRS and DOL responded to each disaster individually as they arose. The 2017 relief in connection with Hurricanes Harvey, Irma, and Maria — as well as select 2017 California wildfires — generally mimicked the extra relief announced in 2016 for victims of Hurricane Matthew and the Louisiana flooding by relaxing standards for processing hardship withdrawals and plan loans and allowing more time to adopt plan amendments. Our [November 15, 2017 For Your Information](#) described the relief for the 2017 events. And now with Hurricanes Florence and Michael in September and October of 2018, additional guidance has been anticipated.

## Sources available for distribution

IRS has proposed regulatory modifications to reflect the changes made by the Budget Act as outlined above, effective for plan years beginning after 2018. The proposed regulations would permit hardship distributions from elective employee contributions, QNECs, QMACs, and earnings on these amounts, regardless of when the contributions were made, or the income earned. Plans would not be required to offer hardship withdrawals from these amounts. The proposed rule would extend to contributions made to pass the nondiscrimination safe harbors for ADP and ACP tests because these contributions are subject to the same distribution limitations as QNECs and QMACs.

## Expenses deemed immediate and heavy financial need

The proposed regulation would modify the list of expenses deemed “immediate and heavy financial needs” to address the casualty loss deduction change, disaster status, and beneficiaries.

**Casualty loss deduction.** Plans would not be required to limit principal residence casualty expenses to losses in federally declared disasters and could be amended retroactive to January 1, 2018 so that provisions conform to the plan’s operations to the extent not modified to reflect the TCJA change in the casualty loss cross-reference.

**Buck comment:** Employers that treat property damage to a principal residence as an eligible hardship even if unrelated to a federally declared disaster must amend their plans to exclude the condition that the loss be of a type deductible based on the current 401(k) regulation, assuming they plan to conform to the revised safe harbor list.

**Disasters.** Added to the current list of six types of expenses deemed to be made on account of an immediate and heavy financial need would be expenses incurred as a result of certain disasters. This new safe harbor expense would be similar to the relief given by the IRS in Announcement 2017-15 for Hurricane Maria and California wildfires and is intended to eliminate any delay or uncertainty concerning access to plan funds for expenses and losses incurred in a federally declared disaster area provided that the employee’s principal residence or principal place of employment at the time of the disaster was located in that disaster area.

**Buck comment.** This proposed criterion is different from the relief in Announcement 2017-15 and earlier announcements in two respects. First, it does not provide relief from documentation protocols, and second, it does not draw in expenses for participants with lineal ascendants or

descendants, spouses or dependents who lived or worked in an area impacted by the disaster. Also note that the preamble to the proposed regulation announces disaster relief specifically for Hurricanes Florence and Michael that does parallel Announcement 2017-15. Watch for an upcoming *For Your Information* for details on the IRS, DOL and PBGC relief for those storms.

**Beneficiaries.** The proposed regulation would memorialize previous PPA guidance in Notice 2007-07 allowing a plan to treat the participant's plan beneficiary the same as their spouse or dependent in determining whether the participant has incurred a hardship.

## Distribution to meet a need

Instead of the current safe harbor — which includes a six-month elective deferral suspension and the requirement to take all other distributions, including loans — a distribution would be viewed as necessary to satisfy an immediate and heavy financial need only to the extent the employee has taken all other available distributions from the plan and other deferred compensation plans of the employer other than loans. In addition, effective for distributions made on or after January 1, 2020, employees would be required to represent that they do not have any other available cash or liquid assets to satisfy the need. If they have no reason to know otherwise, plan administrators could rely on the employee's representation that the amount requested does not exceed the employee's need. While a plan may continue to require that the employee take a plan loan before a hardship distribution, effective for distributions made on or after January 1, 2020, the elimination of the six-month suspension of employee contributions following a hardship distribution would become *mandatory*.

Note that a plan may curtail the six-month period for plan years beginning after 2018 even if the distribution was made in a prior plan year. In addition, note that the January 1, 2020 deadline would be the same for all plans — it is not based on plan year.

**Buck comment:** The requirement that employees take all available distributions from the employer's plans is not new. What is new, however, is the effect the elimination of the six-month suspension may have on nonqualified plans that are subject to Code Section 409A. Section 409A regulations permit the cancellation of deferrals due to a hardship distribution from a 401(k) plan. For plans that have incorporated this option, the nonqualified deferral election must be canceled and cannot be postponed or delayed, so any later deferral election is treated as an initial deferral election. With the elimination of the 401(k) suspension period, plans that provide for the cancellation should either ensure that the plan is appropriately administered or consider the possibility of amending the plan to eliminate this provision.

## 403(b) plans

403(b) plans did not enjoy all the Budget Act changes made for 401(k) plans: earnings on employee deferrals under a 403(b) plan are still not eligible for hardship distribution and employer contributions (including QNECs and QMACs) may only be withdrawn on account of hardship if held in annuity contracts, but not if held in a mutual fund custodial account. The 403(b) regulations cross-reference the 401(k) hardship criteria, so to the extent hardship withdrawals are available, the revised criteria would apply.

## In closing

The deadline for making the necessary amendments to the plan's hardship provisions would be the end of the second calendar year that begins after the IRS includes these changes on a Required Amendments List. While this means that there is no hurry for plan sponsors to amend their plans, if other amendments are going to be made and a plan sponsor wants to tie down 2019 provisions as early as possible, amending now is recommended.

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