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## IRS ISSUES FINAL REGULATIONS GOVERNING HARDSHIP DISTRIBUTIONS FROM 401(k) AND 403(b) PLANS

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On September 26, 2019, the Internal Revenue Service issued final regulations for hardship distributions from 401(k) and 403(b) plans. The final regulations are generally effective for hardship distributions made on or after January 1, 2020 and incorporate statutory changes pursuant to the Bipartisan Budget Act, the Tax Cuts and Jobs Act, the Pension Protection Act and the Heroes Earnings Assistance and Relief Tax Act.

The final regulations are substantially similar to the proposed regulations published in November 2018. Plans that comply with the proposed regulations satisfy the final regulations.

### *Current Hardship Distribution Regulations:*

A hardship distribution allows participants to tap their 401(k) plan in cases of severe financial hardship. Code § 401(k) regulations provide that a distribution is made on account of a hardship only if:

- (1) it is made on account of an immediately and heavy financial need and
- (2) the amount of the distribution is not in excess of the amount necessary to satisfy that need (plus any amounts necessary to pay taxes or penalties reasonably expected to result from the distribution).

These regulations also imposed additional restrictions when a hardship distribution was approved and made:

- (1) a participant's ability to make salary deferral contributions to the 401(k) plan must be suspended for at least six months (no more than six months for a 403(b) plan) following receipt of a hardship distribution and
- (2) The maximum amount of a hardship distribution was limited to the total of the participant's elective contributions, not including earnings.

### *Final Hardship Distribution Regulations:*

The final regulations eliminate certain hardship distribution requirements, expand available sources for hardship distributions and modify the list of expenses for which a hardship distribution may be made.

- Elimination of Certain Requirements – The final regulations remove the requirement that a participant who receives a hardship distribution be prohibited from making salary deferral contributions within six months of the distribution. Also removed is the requirement that an employee take any available plan loans before qualifying to receive a hardship distribution.
- Available Sources – The final regulations expand the available sources for hardship distributions from 401(k) plans to include QNECs, QMACs and earnings on these amounts regardless of when contributed or earned. For hardship distributions from a 403(b) plan, income attributable to elective deferrals continues to be ineligible for distribution on account of hardship. Also, QNECs and QMACs in a 403(b) plan are eligible for hardship distribution unless they are in a custodial account.
- Safe Harbor Expenses – The final regulations contain the following changes to the list of safe harbor expenses:
  - Addition of a new category for expenses and losses incurred on account of a federally declared disaster provided the employee’s principal residence or principal place of employment at the time of the disaster is located within the designated disaster area. The IRS clarified that (1) the safe harbor for disaster-related expenses only applies to expenses of the participant and does not extend to expenses of his or her relatives and dependents and (2) there is no specific deadline by which a request for a disaster-related hardship distribution must be made.
  - Addition of “primary beneficiary under the plan” to the list of individuals for whom medical, educational and funeral expenses may qualify for a hardship distribution.
  - Modification of safe harbor relating to expenses for the repair of damage to the employee’s principal residence to clarify that the new Code limitations limiting the deduction for personal casualty loss to the extent the loss is attributable to a federally declared disaster do not apply in the case of a hardship distribution.

*What Does This Mean for Sponsors of 401(k) Plans?*

Employers can take advantage of these changes to these hardship distribution rules by amending their plan. under the final regulations to help employee participants qualify for a hardship distribution

*Effective Date and Amendments:*

The regulations allow employers to apply these changes in plan years beginning after December 31, 2018. With regard to the elimination of the six-month prohibition of employee contributions following receipt of a hardship distribution, employers may elect to apply this change as of the first day of the first plan year beginning after December 31, 2018, even if the distribution was made in a prior year. The changes to the safe harbor list of expenses may also be applied to distributions made on or after a date that is as early as January 1, 2018.

Plan amendments to reflect the final regulations must be effective for distributions beginning no later than January 1, 2020. The deadline for adopting such an amendment depends on the type of plan involved:

- *Individually designed, non-governmental plans* – the deadline is expected to be December 31, 2021, provided the hardship rule changes are included in the 2019 List of Required Modifications to 401(k) plans.
- *Pre-approved plans* – generally, the tax-filing deadline (plus extensions) for the 2020 tax year.
- *403(b) plans* – March 31, 2020; however, the IRS is considering providing for a later amendment deadline in separate guidance.

If you are interested in amending your plan for these changes or have any questions concerning them, please contact any attorney at Holifield Janich & Ferrera. We will be happy to assist you.

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