New Rules Make Hardship Easier

If your 401(k) plan allows participants to take hardship distributions, things have gotten a bit simpler for you. As required by the Bipartisan Budget Act of 2018 (BBA), the Treasury Department has issued proposed regulations that

- Remove the six-month deferral suspension requirement,
- Make more of a participant's plan assets available for hardship, and
- Eliminate the need for plan loans to be taken before qualifying for the distribution.

Our analysis shows that the proposed IRS hardship changes will benefit both plan sponsors and participants—without creating undue "hardship" in the process. These changes will, however, require modest response from plan sponsors. In the near term, you will have to make decisions about operating your plan's hardship distribution program; in the longer term, you will have to amend your plan to reflect your plan operations.

For now, let's review the hardship changes in a bit more detail.

Six-Month Deferral Suspension Is Going Away

Current rules require a plan sponsor to prevent a participant from deferring any salary or wages for six months after taking a hardship distribution. Presumably, this rule was intended to ease participants' post-hardship financial strain. As of January 1, 2020, a plan cannot require a deferral suspension as a condition of obtaining a hardship distribution. Further, the new regulations allow your plan to eliminate all suspensions as of the first day of your plan year starting after December 31, 2018. Therefore, suspensions can be turned off as of the first day of your 2019 plan year—even for hardship distributions that happened in the last half of 2018. You will need to give your payroll provider clear direction about whether to start deferrals for your affected employees.

If you do not take action: Suspensions will be removed from our system.

More Assets Are Available for Hardship Distributions

Historically, a participant's 401(k) deferrals were allowed to be taken out of the plan for hardship reasons. However, certain other plan assets could not be distributed: required matching or nonelective (e.g., safe harbor) contributions were off limits. As of January 1, 2019, for calendar-year plans, these additional asset sources may be included in hardship distributions. For any source available for hardship, earnings will also now be available. You may decide *not* to allow these assets to be taken for hardship reasons from your plan, but starting in 2019 plan years, the plan *default* will be to make such assets available.

To make plan administration easier, many plan sponsors will allow all sources in the plans, including any matching or profit sharing contributions, to be available for hardship distributions. Remember: participants still have to demonstrate that they have an "immediate and heavy financial need" in order to take a hardship distribution. We don't expect a wholesale run on retirement plan assets as a result of the new regulations.

If you do not take action: Additional asset sources are available for hardship distributions (e.g., safe harbor contributions).

Plan Loans Do Not Have to Be Taken Before a Hardship Distribution

Under the current 401(k) "safe harbor hardship" rules, a participant must obtain all currently available distributions and loans from all of the employer's plans in order to qualify for a hardship distribution. Under the new regulations, obtaining a plan loan is no longer required. This makes sense because sometimes loan repayments could extend a hardship or create an additional hardship. Our default application of this rule change will be to remove the requirement for loans before you approve a hardship, starting the first day of your 2019 plan year.

If you do not take action: Participants will not be required to first take a loan from the plan before qualifying for a hardship distribution.

Plan Amendment Will Be Needed

The IRS indicates that "plan sponsors will need to amend their plans' hardship distribution provisions." This required amendment will be combined with other rule changes and will not likely be needed until later in 2019. Once the final hardship distribution regulations are issued, we will have a better idea of the amendment timing. So for now, there is no need to take any action with your plan document. You will just need to decide whether your plan will stick with the default provisions listed above (which give effect to the new rules as soon as possible) or will operate under more restrictive rules.

If you do not take action: No action is required now and more amendment guidance will follow.

Other Changes in the Proposed Hardship Distribution Regulations

The new regulations modify the "deemed immediate and heavy financial need" criteria, which most plan sponsors use to determine whether a hardship distribution is appropriate. Here is a summary of the list, with the revised provisions in italics.

1. Certain medical expenses, *including those of a primary beneficiary*
2. Costs related directly to buying a participant's principal residence
3. Tuition and related educational expenses, *including those of a primary beneficiary*
4. Payments to prevent eviction from or foreclosure on a principal residence
5. Burial or funeral expenses, *including those for a primary beneficiary*
6. Certain expenses for repairing the participant's primary residence (casualty expenses)
7. *Expenses and losses by an employee whose principal residence or place of employment was in a FEMA disaster area*

Adding "primary beneficiaries" to items 1, 3, and 5 above simply updates the regulations for previous law changes, but item 7 is new. **NOTE:** A "primary beneficiary" is someone who is named under the plan and has an unconditional right to all **or a portion** of the plan balance upon the participant's death.

Finally, for any hardship distributions made on or after January 1, 2020, the participant "must represent, in writing" or other acceptable form, "that he or she has insufficient cash or other liquid assets to satisfy the [financial] need."

Because of these rule changes, our transaction and distribution forms will be updated soon. Watch for notification of their availability on the plan website, so you can download them to replace any currently existing forms.

If you do not take action: You may be using incorrect forms.

Two More Quick Reminders

2018 is the first tax year that participants can use the extended period for rolling over to another eligible plan for certain offset loans. The old rule gave participants 60 days from the offset date; the new rule extends the rollover deadline. Now, when a loan offset results from a plan termination or the participant's severance from employment, offset amounts can be rolled over until the participant's tax return due date, plus extensions (typically until October 15) for the tax year in which the offset occurs. The IRS Form 1099-R (due to participants by January 31) contains new codes for loan offsets—and our new distribution forms contain required disclosure language.

With the numerous natural disasters throughout the U.S. in 2018, remember that the IRS has granted extensive relief to those affected. Refer to the IRS' Tax Relief in Disaster Situations for the latest.