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Client Alert

Employee Benefits & Executive Compensation

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Proposed IRS Regulations Ease Restrictions on Hardship Withdrawals

By Andrew E. Graw and Megan Monson

On November 14, 2018, the Internal Revenue Service (the IRS) published proposed regulations regarding hardship withdrawals from Section 401(k) plans (the proposed regulations). Hardship withdrawals are generally available, if permitted by the terms of a 401(k) plan, to satisfy an immediate and heavy financial need. A participant's ability to take a hardship distribution from a Section 401(k) plan must comply with a number of requirements, which can make it difficult for a participant to take a needed distribution. The proposed regulations would also apply to hardship distributions from a Section 403(b) plan.

The proposed regulations are largely intended to address changes made by the Bipartisan Budget Act of 2018 (the 2018 Budget Act). The 2018 Budget Act eased hardship withdrawal rules for withdrawals made on and after January 1, 2019, by:

- Eliminating the requirement that a participant take all loans permitted under an employer's tax-qualified plans before receiving a hardship withdrawal.
- Expanding the source of hardship withdrawals to include contributions to a profit-sharing plan, qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs) as well as earnings on elective deferrals. Currently, a participant may take a hardship withdrawal only from deferral contributions, excluding earnings accrued after December 31, 1988.
- Eliminating the requirement that a participant be suspended from making contributions for six months following a hardship withdrawal.

In practice, we see most plan sponsors opting to apply each of these changes, except for expanding hardship withdrawals to QNECs and QMACs. In addition, we see most plan sponsors opting to allow but not require participants who took hardship withdrawals prior to 2019 to recommence making contributions before expiration of the six-month suspension period.

The proposed regulations address the 2018 Budget Act changes as well as certain changes made by the 2017 Tax Cuts and Jobs Act (the 2017 Act) and the Pension Protection Act of 2006 (the 2006 Act). Specifically, the proposed regulations:

- Require plans to eliminate the six-month contribution suspension effective beginning January 1, 2020.
- Permit but do not require plans to require participants to exhaust plan loan opportunities before taking a hardship withdrawal.
- Permit but do not require plans to expand the sources for hardship withdrawals to include QNECs, QMACs and earnings on 401(k) contributions.
- Permit hardship distributions for expenses incurred as a result of federally declared disasters.
- Clarify that a hardship withdrawal may be obtained to cover damage to a principal residence that qualifies for a casualty loss deduction without regard to whether the loss was caused by a federally declared disaster (the change was needed because the 2017 Act limited casualty loss deductions to damages caused by a federally declared disaster).

- Reflect changes made by the 2006 Act that permit hardship withdrawals for qualifying medical, educational and funeral expenses of a participant's primary beneficiary under the plan.
- Ease the requirements needed for a plan administrator to approve a hardship withdrawal. Under current rules, a plan administrator must take into account all facts and circumstances to determine whether a hardship withdrawal is necessary to satisfy a financial need. If finalized in their proposed form, beginning January 1, 2020, the regulations permit a plan administrator to rely (absent actual knowledge to the contrary) on a participant's representation that he or she has insufficient cash or liquid assets to satisfy the financial need.

The changes to hardship withdrawal rules are welcome news to both participants and employers. The new rules should make it easier for participants to access their 401(k) accounts in an emergency and for employers to administer their 401(k) plans. If you need assistance with deciding whether and to what extent to adopt the changes allowed by the 2018 Budget Act and the proposed regulations, please contact one of the attorneys in our Employee Benefits and Executive Compensation Practice Group.

Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

ANDREW E. GRAW
Partner
T: **973.597.2588**
agraw@lowenstein.com

MEGAN MONSON
Associate
T: **973.597.2570**
mmonson@lowenstein.com