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Client Alert

IRS Proposes New Hardship Distribution Rules for 401(k) and 403(b) Plans

November 30, 2018 – On November 9, 2018, the Internal Revenue Service ("IRS") released proposed regulations (found here) governing hardship distributions from 401(k) and 403(b) plans (the "Proposed Regulations"), reflecting various changes made by recent federal legislation, including the Bipartisan Budget Act of 2018 and the Tax Cuts and Jobs Act.

Background

Participants' ability to withdraw money from their retirement accounts under 401(k) and 403(b) plans is subject to significant limitations, but with certain exceptions. One exception (if a plan permits it) is the participant's ability to draw on their retirement savings to obtain "hardship distributions" – that is, distributions to satisfy an immediate and heavy financial need. Existing IRS regulations provide "safe harbor" rules that plans may follow in deciding whether to permit a hardship distribution.

Proposed Changes

The Proposed Regulations update and generally relax the existing hardship rules, making it easier for participants to obtain hardship distributions from 401(k) and 403(b) plans. While a complete summary of the Proposed Regulations is beyond the scope of this alert, the regulations propose the following key changes:

- Expand the available sources for hardship distributions
- Expand the list of permitted safe harbor hardship circumstances
- Eliminate the requirement to suspend a participant's elective deferrals for 6 months after a hardship distribution
- Eliminate the requirement for a participant to obtain all available loans before they may receive a hardship distribution
- Relax the hardship substantiation requirements

The Proposed Rules generally apply to distributions in plan years beginning after 2018, but some of the proposed new rules may be applied earlier. For example, plan sponsors may generally eliminate the 6 month suspensions on elective deferrals starting in 2019 even for participants who obtained their hardship distributions in 2018.

While the Proposed Rules are yet to be finalized, it is unlikely that the final rules will vary drastically. Sponsors of 401(k) and 403(b) plans that permit hardship distributions should review their plans' existing hardship rules and consider whether any changes should be made for 2019, and whether a plan amendment is appropriate.

For questions about the new hardship rules and their impact on your employee benefit plan, please contact a Morrison Cohen LLP attorney.

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