KRIEG DEVAULT

Insights

IRS Issues Proposed Regulations for Hardship Distributions

November 14, 2018

The IRS initially issued proposed regulations on Friday, November 9, 2018 and **published such regulations in the Federal Register** on November 14, 2018 providing guidance related to modifications necessary to administer hardship distributions based on the statutory changes made by the Bipartisan Budget Act of 2018 ("Act"). As background, see our **Employee Benefits Alert** dated March 12, 2018. Essentially, the Act eases restrictions related to hardship distributions by expanding resources that can be utilized by participants in obtaining hardship distributions and by removing imposed restrictions on participants from being able to continue to contribute to their retirement accounts for a six-month period after taking the hardship distributions and requiring plan loans to be exhausted prior to taking a hardship distribution.

The IRS proposes to update the current safe harbor hardship distribution regulations by modifying the regulations in the following three areas:

- the meaning of "deemed immediate and heavy financial need;"
- the imposed restrictions and required distributions necessary to satisfy financial need; and
- the resources available to use as hardship distributions.

Modification of the Meaning of "Deemed Immediate and Heavy Financial Need"

The proposed regulations modify the safe harbor meaning of "deemed immediate and heavy financial" in three ways:

1. They expand the category of people for whom the participant may have a financial need to assist. The IRS is now equating primary beneficiaries to spouses and dependents (for whom qualifying medical, educational and funeral expenses may be incurred).

2. They modify the definition of "casualty deduction" to not include new requirements implemented by the Tax Cuts Jobs Act. This Act imposed new restrictions which would have made it more difficult to qualify for a hardship distribution.

3. They establish a new expense for certain natural disasters (as deemed disasters by the Federal Emergency Management Agency). This new expense allows participants in federally declared disaster zones access funds faster.

Modification of Financial Need Requirements to Receive Hardship Distributions

The proposed regulations also eliminate three current requirements which must be met to obtain a hardship distribution.

1. The six-month mandatory suspension from making elective deferrals to retirement plans after receiving a hardship distribution is no longer valid.

2. Participants are no longer required to take a plan loan, if available, prior to obtaining a hardship distribution.

3. The "facts and circumstances" test as to whether a distribution is needed to satisfy a financial need has been replaced effective for distributions on or after January 1, 2020 with a "general standard" test that must include a representation by the participant to the plan stating that:

- the funds requested do not exceed the need;
- all other available distributions under the plan were requested and obtained; and
- the participant did not have sufficient cash or other liquid assets to satisfy the need.

Expansion of Resources to Use as Hardship Distributions

The proposed regulations also expand resources participants may utilize to request hardship distributions. Hardship distributions may now be obtained from a participant's elective deferrals, employer non-elective contributions (i.e., profit-sharing contributions), regular matching contributions, qualified non-elective contributions, qualified matching account contributions, and related earnings. Previously, hardship distributions could only be taken from elective deferrals, employer non-elective contributions (profit-sharing contributions) and regular matching contributions and grandfathered pre-January 1, 1989 earnings. (Note this is different for Internal Revenue Code Section 403(b) plans, especially as related to earnings.)

Effective Date and Plan Amendments

The Act stated that hardship distribution changes are effective for plan years after December 31, 2018; however, the preamble to the proposed regulations indicate that due to the time of year in which the regulations are being published, plans may amend their retirement plan at any time prior to the end of the second calendar year after the issuance of the final regulations and the IRS publication of the required changes in an annual list. Neither of these triggers have occurred yet as related to the proposed regulations.

Next Steps

Plan sponsors should take the following steps with respect to the proposed regulations.

- Review the proposed regulations and choices under the regulations that are specific to your plan.
- Decide whether to comment on the proposed regulations—note comments must be received by the IRS by January 14, 2019.
- Determine if administrative changes are needed effective on or after January 1, 2019 and how to communicate such changes to participants.
- Work with your attorney and service provider to discuss applicable hardship distribution changes and the timing to amend your retirement plan, based on the decisions above, board meetings, etc. Also, you may wish to wait until final regulations are issued in order to capture any changes in the final regulations.

If you have any questions, please contact your Krieg DeVault LLP benefits attorney.