Final Regulations on Hardship Distributions: Not Much New News is Good News

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If your company sponsors a 401(k) or 403(b) plan that allows participants to take hardship distributions, you probably had a conversation with your plan recordkeeper last year about changes to the rules on hardship distributions under those plans. Your company may even have already adopted related plan amendments or approved related plan operation changes, and that action was likely based on proposed hardship distribution regulations that the Internal Revenue Service (IRS) issued late last year (as described in this December, 2018, blog post from my colleague Belinda Morgan).

Last week, the IRS issued final 401(k)/403(b) plan hardship distribution regulations, found here. Thankfully, if your company was one of those employers that already took action based on the proposed regulations, the final regulations make only a handful of changes, so chances are that any changes you already made will still work. The following are the few noteworthy items from the final regulations:

- When requesting a hardship distribution, a participant only needs to represent that he or she has insufficient cash or other liquid assets reasonably available to cover expenses resulting from a hardship. This is more flexible than the rule under the proposed regulations, which did not include the “reasonably available” language. If your company has an individually designed plan and has already amended the plan to reflect the new hardship rules, you may want to consider whether your company wants to further amend its plan to add this “reasonably available” standard.

- The final regulations clarify that a participant may make the above “reasonably available” representation in writing or by electronic medium such as a website, email, or phone.

- The final regulations clarify that the prohibition on suspension of deferrals following a hardship distribution, which is mandatory for 401(k) and 403(b) plan hardship distributions occurring on or after January 1, 2020, does not apply to nonqualified deferred compensation plans.

If your company is still deciding how to implement the new hardship distribution rules under your 401(k) or 403(b) plan, here are a few key items to consider:

- Effective for distributions occurring on or after January 1, 2020, a 401(k) or 403(b) plan can no longer suspend a participant’s deferral contributions following a hardship distribution. As noted above, a company could choose to continue to suspend a participant’s nonqualified deferred compensation plan deferrals following a 401(k) or 403(b) plan hardship distribution. Plans must be amended to reflect this change as well as the new participant representation rules described above (which also include requirements that the hardship distribution not exceed the participant’s need and that the participant take all other available plan distributions before a hardship distribution) by the yet-to-be-established IRS deadline, which will be no earlier than December 31, 2021.

- Your company may choose but is not required to amend its plan to do any or all of the following:
- Expand hardship distribution events as permitted by the final regulations (e.g., to add distributions for certain FEMA disasters and casualty losses);
- Eliminate the requirement that a participant take all available plan loans before taking a hardship distribution; and
- Expand the sources available for hardship distributions to include safe harbor contributions, qualified nonelective contributions, qualified matching contributions, and earnings on all available sources.

If your company desires to make any of these optional changes, it must adopt a plan amendment reflecting such changes by December 31 of the year in which the change is effective. We are seeing a mix of approaches among our clients – some do not want to encourage hardship distributions and others want to make them as easy as possible for participants.

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