



OCTOBER 25, 2019

BENEFITS & COMPENSATION UPDATE

By: Norman J. Misher and Ariel B. Woldar

401(k) Hardships Made A Little Easier

Final regulations amending the hardship distribution rules for 401(k) plans were recently issued by the IRS (the "Hardship Regulations"). These new Hardship Regulations attempt to make it less burdensome for employees to take hardship distributions and streamline the process for plan sponsors. The 401(k) hardship rules, as amended by the Hardship Regulations, are summarized below.

Overview of the Hardship Regulations

Distributions from a 401(k) plan are allowed only under specific circumstances, one of which is a participant's hardship. Hardship distributions provide a way for employees to access 401(k) funds prior to age 59 1/2, so long as the distributions meet strict regulatory requirements. In order for an employee to take a hardship distribution, the distribution must be (i) on account of an immediate and heavy financial need and (ii) necessary to satisfy such financial need.

Determination of an Immediate and Heavy Financial Need

The Hardship Regulations list the expenses considered to satisfy the requirement that an

employee have an immediate and heavy financial need. Under the Hardship Regulations, hardship distributions can be taken for the following reasons:

- Medical expenses of an employee, family member or primary beneficiary under the plan.
- Costs related to the purchase of an employee's principal residence or expenses to prevent eviction from or foreclosure on such primary residence.
- College education expenses of an employee, family member or primary beneficiary under the plan.
- Funeral expenses of an employee, family member or primary beneficiary under the plan.
- Casualty losses on an employee's principal residence.
 - The Hardship Regulations clarify that the casualty loss is not required to be incurred in a federally declared disaster area to qualify as a hardship event.

- Losses or expenses (including loss of income) as a result of a federal disaster.
 - This is a new category for eligible hardship expenses.
 - The Hardship Regulations provide that disaster related expenses will apply only to the expenses of an employee who lived or worked in the disaster area and will not include relatives or dependents.

Determination of Necessity to Satisfy Financial Need

The Hardship Regulations significantly modify the rules for purposes of determining if a distribution is necessary to satisfy a financial need. Under the new rules, a distribution is treated as necessary to satisfy a financial need only if:

- The distribution includes only the amounts needed to satisfy the hardship (including taxes and penalties as a result of the distribution from the plan).
- The employee has sought all other available distributions under the plan and all other qualified or nonqualified deferred compensation plans maintained by his or her employer.
 - Importantly, the Hardship Regulations removed the requirement that employees must first seek a loan from the plan. Plans may, however, still require a participant to take a plan loan prior to receiving a hardship distribution.
- The employee represents in writing, including by any electronic medium, that he or she does not have sufficient funds or liquid assets reasonably available to satisfy the financial need.
 - The Hardship Regulations clarify what it means to be "reasonably

available," specifically noting that an employee could make a representation of need even if the employee has cash or liquid assets on hand, provided those assets are to be used for payment of ordinary course living expenses that occur during times of hardship (for example, rent).

- The administrator of the plan does not have actual knowledge that is contrary to the employee's representation.
 - The Hardship Regulations explain that an employer is not obligated to inquire further to determine whether the employee's representation is truthful but should question the representation if they have accurate information that contradicts the representation.

Suspension of Employee Deferrals:

Prior to the Hardship Regulations, an employee who took a hardship distribution under a plan would be suspended from making additional deferrals for six months after such employee received a hardship distribution. The Hardship Regulations **prohibit** this suspension of employee deferrals after a hardship distribution, thereby making it possible for employees to begin deferring immediately after a hardship distribution. Plans must implement this rule by January 1, 2020 but can begin to utilize the rule in 2019.

Additional Conditions: The Hardship Regulations are clear that additional conditions may be provided by a plan to substantiate necessity but those restrictions cannot include the suspension of deferrals. For example, a plan may continue to require an employee to complete the plan's hardship application process and to provide the necessary documentation in support of hardship.

Sources of Hardship Distributions

The Hardship Regulations expand the sources of funds available for a hardship distribution so that a hardship distribution can be made not only from elective deferrals, but also from qualified nonelective contributions ("QNECs") and qualified matching contributions ("QMACs"), as well as from earnings on all of those amounts, without regard to when the amount is contributed or earned.

Effective Dates and Required Amendments

The Hardship Regulations apply to distributions made on or after January 1, 2020. However, plan sponsors may apply the changes to distributions made in plan years that begin after December 31, 2018.

Plans are required to be amended to incorporate the revised hardship rules contained in the Hardship Regulations. For individually designed 401(k) plans, the deadline for these amendments will likely be December 31, 2021.

This update is not intended to provide legal advice with respect to any particular situation, and no legal or business decision should be based solely on its content.

If you have any questions about this update, please contact:

Norman J. Misher	212-903-8733	nmisher@rhtax.com
Allen J. Erreich	212-903-8769	aerreich@rhtax.com
Judy M. Hensley	212-903-8737	jhensley@rhtax.com
Charles C. Shulman	212-903-8687	cshulman@rhtax.com
Chase B. Steinlauf	212-903-8736	csteinlauf@rhtax.com
Ariel B. Woldar	212-903-8718	awoldar@rhtax.com

The **Employee Benefits and Executive Compensation Group of Roberts & Holland LLP** concentrates on a wide variety of employee benefits and executive compensation matters in both the transactional and compliance contexts. We focus on tax, ERISA and other legal considerations relating to all aspects of employee benefit plans, programs and arrangements, including design, administration and compliance of tax-qualified plans and ERISA fiduciary matters for investment funds and plan fiduciaries. We also regularly represent clients in designing, negotiating and drafting equity compensation arrangements and nonqualified deferred compensation plans, as well as executive employment, severance and change-in-control agreements and provide advice on the associated ERISA and tax implications.