Required Reading: Hardship Distribution Rules have Changed

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Although 401(k) plans are intended to accumulate savings for participants' retirement, the reality is that when unexpected expenses arise, participants may ask whether they can get a distribution from their 401(k) account. Federal tax rules permit a hardship distribution if (a) the participant experiences an "immediate and heavy financial need," and (b) the distribution is no greater than the amount "necessary to satisfy the financial need." If a plan administrator permits a hardship distribution that does not fit within the hardship rules, the result is an operational error that must be corrected in accordance with IRS rules. To avoid the time and expense involved with corrections, plan administrators should stay current with rules in this area. In recent legislation, Congress has loosened restrictions on hardship distributions in some ways and tightened them in others.

Under the Bipartisan Budget Act of 2018 (HR 1892), effective for plan years beginning after December 31, 2018, Congress expanded the scope of hardship distributions in the following ways:

- Participants are not required to take all available plan loans before requesting a hardship distribution.
- Hardship distributions can be made from a participant's 401(k) salary deferral contributions, but also from
  - safe harbor contributions,
  - qualified nonelective contributions or qualified matching contributions ("QNECs" and "QMACs"), and/or
  - earnings on any of the above.
- Participants will not be required to stop making salary deferral contributions (or exercising stock options) for 6 months after taking a hardship distribution.

Regarding the last change, Congress directed the IRS to modify its hardship distribution regulations. This is noteworthy because, in such guidance, the Service may address items related to the changes

– for instance, whether a participant will be able to receive a hardship distribution from the new money sources (i.e., QNECs, QMACs, safe harbor contributions, and/or earnings) that accrued before the rule changed, or what result occurs if a plan sponsor wishes to continue to require a plan participant to sit out 6 months from making salary deferral contributions after taking a hardship distribution.

Not all changes have been to the benefit of participants. In the Tax Cuts and Jobs Act, adopted in late 2017, Congress narrowed the scope of one particular type of hardship distribution. Specifically, Congress changed the definition of casualty loss deductions in a section of the federal tax code that is incorporated by reference in one of the safe harbor rules for a hardship distribution. It appears that, if your plan uses the IRS safe harbor rules for hardship distributions, a plan participant will be able to receive a hardship distribution to pay for property damage to the participant's home only if the property damage was the result of a federally declared disaster. This may mean that participants who normally would have been able to seek a hardship distribution to pay for house repairs after, say, flooding, will not be able to access their 401(k) account unless they qualify for some other in-service distribution. Although some have speculated that this result may have been unintentional, it appears to be the law. Moreover, it's a change that became effective for plan years after 2017, so it's already in effect. If your plan has permitted a participant to take a hardship distribution for casualty loss in situations other than federally declared disasters during the 2018 plan year, you should talk to experienced benefits counsel – you may, unfortunately, need to take your own steps to clean up a mess.

With respect to whether you need to amend your plan to reflect these changes, that may depend on a variety of factors, including whether your plan is a pre-approved plan or an individually designed plan and when the IRS lists these changes on its Required Amendment List. Generally, a plan sponsor of an individually designed plan has until the end of the plan's remedial amendment period to adopt amendments, which is typically two years after the changes are listed on the IRS Required Amendment List.

Remember, however, that plan operations are required to follow applicable law. So no matter how those factors apply to your plan, you should ensure your plan administrator's practices are updated appropriately.

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