

November 2018

IRS Issues Long-Awaited Hardship Distribution Guidance

Plan sponsors have been anxiously awaiting additional guidance affecting hardship withdrawals since the changes brought by the Bipartisan Budget Act of 2018, and nearly nine months to the day the IRS finally delivered with the issuance of proposed rulemaking. With the exception of the elimination of the six-month suspension of elective deferrals, the provisions of the [proposed regulations](#) generally apply to hardship distributions made in plan years beginning after December 31, 2018.

The [Bipartisan Budget Act of 2018](#) (Budget Act) was signed into law by the President on February 9, 2018, and included certain provisions impacting retirement plans that were initially considered for inclusion in the [Tax Cuts and Jobs Act](#) (TCJA), but were dropped before the final tax bill was passed. Among those provisions were certain changes to hardship withdrawals for plan years beginning after December 31, 2018, including the removal of the six-month prohibition on elective deferrals following a hardship withdrawal; the inclusion of qualified non-elective contributions, qualified matching contributions and profit sharing contributions in hardship withdrawals; and the elimination of the requirement that a participant take a plan loan prior to a hardship withdrawal.

ELIMINATION OF THE SIX-MONTH SUSPENSION ON ELECTIVE DEFERRALS FOLLOWING A HARDSHIP

Following the Budget Act, plan sponsors became aware that changes were coming with respect to the mandatory six-month suspension on elective deferrals following a hardship. However, it was unclear whether the elimination of the suspension was mandatory or discretionary.

The IRS guidance clarifies that this will be a mandatory change, and takes a unique approach to the effective date for this change. Plan sponsors may apply the elimination of the suspension for plan years beginning after December 31, 2018 for those already in suspension due to a hardship distribution taken during the prior plan year and for those who receive a hardship distribution in the 2019 plan year. In other words, a plan sponsor may choose to leave the current suspensions in place, or to end the suspensions, effective January 1, 2019 (for calendar-year plans), or at any time during the 2019 plan year. However, for distributions made on or after January 1, 2020, a plan is prohibited from enforcing a suspension following a hardship distribution. This mandatory change does not require a plan to remove a suspension that was in effect on the first day of the 2020 plan year.

ELIMINATION OF THE REQUIREMENT TO TAKE PLAN LOAN PRIOR TO HARDSHIP DISTRIBUTION

The proposed rules would make it discretionary for plan sponsors as to whether they keep or

eliminate the requirement that a plan participant take a plan loan prior to taking a hardship distribution for plan years beginning after December 31, 2018.

EXPANSION OF HARDSHIP DISTRIBUTIONS FOR EXPENSES INCURRED BY "PRIMARY BENEFICIARIES"

The proposed rules provide that a plan participant may take a hardship distribution to cover qualifying medical, educational, or funeral expenses incurred by a participant's "primary beneficiary," that is, someone named as the beneficiary who has an unconditional right to the participant's plan account upon the participant's death. For purposes of the hardship distribution rules, a primary beneficiary is no longer required to be a relative of the participant.

CASUALTY LOSS HARDSHIP DISTRIBUTIONS AND FEDERALLY-DECLARED DISASTERS

The TCJA eliminated the casualty loss deduction for any loss not incurred as a result of a federally-declared disaster. This effectively prohibited participants from taking a hardship distribution if their home were to be damaged for any reason other than a federally-declared disaster, in what many believed to be an unintended consequence of the TCJA. The proposed regulations restore the casualty loss hardship distribution back to the pre-TCJA standard, effective January 1, 2019.

Separately, those participants who incur expenses or a loss due to a federally-declared disaster will also be permitted to take a hardship distribution immediately, without having to wait for IRS guidance specific to that disaster.

EXPANSION OF SOURCES OF FUNDS FOR HARDSHIP DISTRIBUTION

Following the guidance in the Budget Act, the proposed regulations expand the sources of funds for hardship distributions to include earnings on elective deferrals, qualified non-elective contributions (including earnings), and qualified matching contributions (including earnings). *Earnings on pre-tax deferrals made to a Section 403(b) plan and qualified non-elective contributions as well as qualified matching contributions made to a Section 403(b) plan not in a custodial account are still ineligible for hardship distributions.*

PARTICIPANT REPRESENTATIONS

For hardship distributions made on or after January 1, 2020, plan sponsors may now rely on written or electronically submitted representations from plan participants of their insufficient cash or liquid assets to satisfy the financial need requirement, absent actual knowledge by the plan sponsor or administrator to the contrary.

If you would like to discuss the impact of these new laws, please contact any member of the firm's [Employee Benefits and Compensation Group](#) listed below:

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