VOLUME 74 ◆ NUMBER 1

Employee Benefit Plan Review

Final Regulations Update and Modify 401(k) Hardship Distribution Rules

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The Internal Revenue Service has finalized proposed regulations relating to hardship distributions under an Internal Revenue Code ("IRC") 401(k) plan. The final regulations differ little from the proposed regulations published on November 14, 2018, and, like the proposed regulations, reflect changes made under the Bipartisan Budget Act of 2018 ("BBA 2018"), and provide updates reflecting changes (already in practice) made under the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act") and the Pension Protection Act of 2006 ("PAP 2006"). They also modify the existing "non-safe harbor" determination of whether a distribution is necessary to satisfy an immediate and heavy financial need.

The following lists the changes:

Changes Under the BBA 2018

- The six-month suspension of employee pretax and aftertax contributions after a hardship distribution is eliminated effective for distributions occurring on or after January 1, 2020. The final regulations permit optional implementation of this rule for distributions occurring in plan years beginning after December 31, 2018. The final regulations clarify that suspension is still permitted under nonqualified deferred compensation plans.
- Qualified nonelective employer contributions ("QNECs"), qualified matching contributions ("QMACs"), and earnings on all contributions may be withdrawn due to hardship. The IRC, not the final regulations, provides the effective date for this change, which is for plan years beginning after December 31, 2018.
- A plan need not require that a participant take available plan loans in order to determine that a hardship distribution is necessary to satisfy a participant's financial need, effective for distributions occurring on or after January 1, 2020. The final regulations permit optional implementation of this rule for distributions occurring in plan years beginning after December 31, 2018. As a matter of plan design, however, a plan may still require that available loans be taken before a hardship distribution, even though it need not do so.

Changes Under the HEART Act and PPA 2006

The final regulations reflect the following:

- The six-month suspension on employee pretax and aftertax contributions after a participant takes a distribution while actively performing service in the uniformed services for a period of more than 30 days (the HEART distribution). There is nothing in either the BBA 2018 or the final regulations that impacts this suspension.
- A plan may treat a participant's beneficiary the same way it treats a participant's spouse

or dependent in determining whether the participant has had a hardship.
- A participant may withdraw pretax contributions under a qualified reservist distribution.

Other Changes

- Section 1.401(k)-1(d)(3)(ii)(B)(6) of the final regulations provides that IRC Section 165(h)(5) does not apply (for the purpose of determining whether expenses for the repair of damage to a participant's principal residence would qualify for the casualty deduction under IRC 165). Thus, under the final regulations, the change to IRC Section 165 made under the Tax Cuts and Jobs Act is inapplicable. Consequently, home repairs need not be deductible for income tax purposes in order to qualify for a hardship distribution. This change applies to distributions occurring on or after January 1, 2020. The final regulations permit optional implementation of this change for distributions made on or after a date as early as January 1, 2018.
- A new safe harbor expense is added. A participant's expenses and losses (including loss of income) due to a disaster declared by the Federal Emergency Management Agency ("FEMA") under the Robert T. Stafford Disaster Relief and Emergency Assistance Act qualify as a safe harbor expense, as long as the participant's principal residence or principal place of employment at the time of the disaster was in an area designated by FEMA for individual assistance due to that disaster. This change applies to distributions occurring on or after January 1, 2020. The final regulations permit optional implementation of this change for distributions made on or after a date as early as January 1, 2018.

Plan amendments (for nongovernmental individually designed plans) need not be adopted until December 31, 2021, the end of the second calendar year that begins after the publication of these changes in the 2019 IRS "Required Amendment List."

- The non-safe harbor "facts and circumstances" determination of whether a distribution is necessary to satisfy an immediate and heavy financial need is eliminated. Instead, a distribution is necessary to satisfy an immediate and heavy financial need only if (1) the participant has obtained all other currently available distributions under the plan and all other plans (qualified and nonqualified) of the employer, (2) the participant provides the plan administrator with a written (or electronic) representation that he or she has insufficient cash or other liquid assets reasonably available to satisfy the need, and (3) the plan administrator does not have actual knowledge contrary to the participant's representation. These changes apply to distributions occurring on or after January 1, 2020. The final regulations permit optional implementation of these changes for distributions occurring in plan years beginning after December 31, 2018.

Plan amendments (for nongovernmental individually designed plans) need not be adopted until December 31, 2021, the end of the second calendar year that begins after the publication of these changes in the 2019 IRS "Required Amendment List." However, sponsors of safe harbor 401(k) plans may wish to modify the safe harbor notice they distribute prior to the 2020 plan year if those notices provide detail on hardship distributions.

Plan sponsors should consider how they would like to receive the participant representation discussed above, and produce any forms they would like to use for this purpose. They should also work with their recordkeepers to put into place the new provisions under the final regulations and remove the old from their systems and plan administration manuals.

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