

The Rules for Hardship 401(k) Withdrawals Have Changed



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Generally, participants in 401(k) plans can't withdraw their retirement funds until age 59½ as long as they remain with their employer. However, employees can take money out, including earnings on their contributions, if they have a financial hardship — that is, they can demonstrate an “immediate and heavy financial need.” Still, the employer as the 401(k) plan sponsor must elect to allow for hardship distributions in the plan, and adhere to strict rules. Thanks to provisions of the Bipartisan Budget Act of 2018 (BBA) however, the rules are easing a bit. Following is an explanation of the legislative changes:

REMOVAL OF THE SIX-MONTH DEFERRAL SUSPENSION REQUIREMENT

Current rules require a plan sponsor to suspend a participant's right to make salary deferral contributions for a period of six months after taking a hardship distribution. As of January 1, 2020, a plan cannot require a deferral suspension as a condition for a hardship distribution. Further, the new regulations allow a plan to eliminate existing suspensions — including for hardship distributions that occurred in the last half of 2018 — as of the first day of the plan year starting January 1, 2019.

MORE OF A PARTICIPANT'S PLAN ASSETS AVAILABLE FOR HARDSHIP

Historically, a participant's 401(k) deferrals — plan contributions taken directly from their salary — could be taken out of the plan for hardship reasons. However, certain other plan assets could not be distributed, including earnings and certain employer contributions (for example, safe harbor contributions). As of January 1, 2019, for calendar-year plans, these additional asset sources, and any earnings on them, can be included in the amount available for hardship distributions.

Note that plan sponsors may elect to keep these additional assets from being taken for hardship reasons. However, to make plan administration easier, we believe many plan sponsors will allow it.

ELIMINATION OF THE REQUIREMENT THAT PLAN LOANS BE TAKEN BEFORE QUALIFYING FOR A HARDSHIP DISTRIBUTION

Under the current 401(k) hardship rules, a participant must first take all distributions and loans currently available to that person in order to qualify for a hardship distribution. Under the new regulations, obtaining a plan loan is no longer required.

The new regulations also modify the “deemed immediate and heavy financial need” criteria, which most plan sponsors use to determine whether a hardship distribution is appropriate. Here is a summary of the criteria with the revised provisions in italics.

1. Certain medical expenses, *including those of a primary beneficiary.*
2. Costs related directly to buying a participant’s principal residence.
3. Tuition and related educational expenses, *including those of a primary beneficiary.*
4. Payments to prevent eviction from or foreclosure on a principal residence.
5. Burial or funeral expenses, *including those for a primary beneficiary.*
6. Certain expenses for repairing the participant’s primary residence (casualty expenses).
7. *Expenses and losses by an employee whose principal residence or place of employment was in a FEMA disaster area.*

Finally, for any hardship distributions made on or after January 1, 2020, the participant “must represent, in writing” or other form acceptable to the plan sponsor, “that he or she has insufficient cash or other liquid assets to satisfy the financial need.”

Plan sponsors who offer hardship distributions should contact their plan’s record keeper or third-party administrator to determine what modifications to their plan, if any, need to be done at this time.

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