

Final Hardship Distribution Regulations, Part Two: Implementation Considerations

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As discussed in our [prior blog entry](#), the IRS recently released final regulations making a number of significant changes to the rules applicable to hardship distributions from 401(k) and 403(b) plans. As part of our continuing series on these final regulations, this blog entry will focus on two specific issues: (1) the elimination of the six-month suspension of contributions following a hardship distribution; and (2) the revised standard used to determine whether a hardship distribution is necessary to meet the financial need.

Elimination of Six-Month Suspension: Under the prior safe harbor hardship distribution standard, employees who took hardship distributions were prohibited from making contributions for at least six months. The final regulations eliminate this prohibition, meaning that plans cannot apply this contribution suspension for hardship distributions from 401(k) and 403(b) plans made on or after **January 1, 2020**.

- **Applicability dates.** Although plans cannot apply the six-month suspension on or after January 1, 2020, plan sponsors may opt to remove the six-month suspension earlier than the required date. Plan sponsors should coordinate with their record-keeper and/or third-party administrator to confirm that their desired applicability date is consistent with operational capacities and will not incur additional service charges.
- **Nonqualified plans.** In response to the proposed regulations, many practitioners had questioned whether nonqualified plans could continue to impose suspensions of contributions following an employee's hardship distribution from a 401(k) or 403(b) plan. The regulatory preamble confirms that the prohibition on suspension of contributions applies only to a qualified plan, 403(b) plan, and most 457(b) plans. Plans subject to section 409A may retain existing suspension provisions *or*, to the extent consistent with section 409A, may be amended to remove suspension provisions.

- **Safe harbor 401(k) plans.** Safe harbor 401(k) plans are required to issue certain initial and annual notices. These notices must include a description of the withdrawal provisions applicable to plan contributions. If a plan's existing safe harbor notices describe the prior rules that applied to hardship distributions (such as the six-month suspension of contributions), the notices should be updated to reflect the new rules. Employees should then be provided with an updated safe harbor notice and be given a reasonable opportunity to change existing contribution elections.

Revised Standard for Determining Necessity of Hardship Distribution: Under the prior regulations, a hardship distribution was only treated as satisfying an immediate and heavy financial need if there were no alternative means of satisfying the need, as determined under the facts and circumstances. The final regulations eliminate the facts and circumstances analysis in favor of a general standard providing that the distribution is not deemed necessary to satisfy the financial need unless all of the following requirements are satisfied:

- The employee has obtained all other currently available, non-hardship distributions under plans maintained by the employer (including both qualified and nonqualified plans).
- The employee represents to the plan administrator in writing that the employee has insufficient cash or other liquid assets that are "reasonably available" to satisfy the financial need. (The regulatory preamble confirms that this representation may be made by telephone, provided it is recorded.)
- The plan administrator does not have "actual" knowledge that is contrary to the employee's representation. (The plan administrator is not required to inquire into the employee's financial condition for purposes of this rule.)

The regulatory preamble confirms that ESOP dividends that have been paid to the plan and that are available for the employee to elect to receive in cash are generally considered “available” plan distributions that must be taken prior to a hardship distribution. Extending its prior guidance in IRS Notice 2002-2, the IRS confirmed that if an employee has made an irrevocable election to reinvest ESOP dividends and then requests a hardship distribution after that dividend reinvestment election has become effective, any ESOP dividends paid while the irrevocable election is in place are not considered “available” distributions. Further guidance about the extent to which non-irrevocable ESOP dividend reinvestment elections should be overridden before making a hardship distribution would be helpful. In the meantime, plan administrators will need to consider how to determine whether ESOP dividends should be taken into account when a hardship distribution is being approved.

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Stay tuned for our next blog entry, which will focus on the new FEMA disaster hardship event (including its potential impact on future IRS individualized disaster relief) and modified casualty loss definition, as well as the new contribution sources available for hardship distributions

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