Bolton Insight

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Changes to Hardship Withdrawals

On September 23rd, the IRS published a final rule resulting from the Bipartisan Budget Act of 2018 (BBA). The new rules release several existing restrictions on taking hardship distributions from a 401(k) plan. Some of these changes are mandatory, requiring plan sponsors to make changes by January 1, 2020, while others are optional.

What is a hardship withdrawal?

Unlike loans, hardship withdrawals are not repaid to the plan with interest. They permanently reduce an employee's account balance. They are also subject to income tax and a 10% early withdrawal penalty if the participant is younger than age 59 ½.

What is changing?

- **Eliminate the six-month contribution-suspension**
  The final rule eliminates the suspension period that stopped participants who take a hardship distribution from making new contributions to the plan for six months.

- **Eliminate the need to take a plan loan before a hardship withdrawal**
  The new rule removes a requirement that participants first take a plan loan, if available, before making a hardship withdrawal. Unlike the elimination of the six-month suspension period, this change is *not mandatory*.

- **Make earnings available for withdrawal**
  Earnings on 401(k) contributions can be distributed for hardships, as can profit-sharing, stock-bonus, and corrective contributions. Previously, employees could only withdraw contributions, not earnings.

- **Ease hardship verification**
  The new rule requires only that a distribution not exceed what an employee needs (including State and Federal taxes associated with the withdrawal) and that employees certify that they lack enough cash to meet their financial needs. Plan administrators can rely on that certification unless they have knowledge to the contrary.

- **Provide disaster relief**
  The final rule adds a seventh safe harbor category for expenses resulting from a federally declared disaster in an area designated by the Federal Emergency Management Agency (FEMA). Currently, employees must show an immediate and heavy financial need that involves one or more of the following:

  1. Purchase of a primary residence.
  2. Expenses to repair damage or to make improvements to a primary residence.
  3. Preventing eviction or foreclosure from a primary residence.
  4. Post-secondary education expenses for the upcoming 12 months for participants, spouses and children.
  5. Funeral expenses.
  6. Medical expenses not covered by insurance.

Most of these rules also apply to 403(b) arrangements, except earnings to elective deferrals continues to be ineligible for distribution on account of hardship from a 403(b) arrangement.

IRS regulations can often be unclear as how to execute, and failure to remain in compliance can disqualify your plan. Talk to your consultant to understand how to implement the new changes to the hardship distribution rule into your plan.