401(k) and 403(b) plans must be updated January 1, 2020

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The IRS recently issued final regulations to standardize the administration of hardship distributions. Plans that permit hardship distributions must implement operational changes for hardship distributions by January 1, 2020, with plan amendments to follow. A 403(b) plan's hardship distribution deadline is March 31, 2020, however, the IRS may revisit this deadline.

Generally, the final regulations make it easier for participants to receive hardship distributions. The new standards are summarized below.

- Heavy financial need safe harbor modified:
    - Hardship distributions no longer require or permit employers to suspend employee contributions for six months following a hardship distribution. This was an optional provision to implement in 2019 that becomes mandatory for 2020.
        - Employees are no longer required to exhaust available plan loans before exercising the hardship distribution option. Plans may maintain or dispense with the plan loan requirement for 2019, 2020 and thereafter.
- New standard to determine whether a distribution is necessary to satisfy an immediate and heavy financial need of the employee:
    - Distribution does not exceed the amount of the employee's need, accounting for taxes and any penalties.
    - The employee must first obtain non-hardship distributions from other eligible defined contributions plans of the employer (excluding loans).

    - The employee must attest to insufficient cash or other assets for an expanded list of expenses, upon which the employer may rely, with limits. Expenses may now include expenses and losses incurred during a FEMA-declared disaster. Withdrawal reasons must now include casualty loss for damage to primary residence not within the disaster area (with limits).
    - A primary beneficiary's medical, education and funeral expenses may qualify for a participant's hardship distribution.
- Available sources of hardship distributions in 401(k) plans may include qualified non-elective contributions (QNECs) and qualified matching contributions (QMACs) and earnings. For 403(b) plans, the IRS retained existing rules that do not permit hardship distributions from QNECs and QMACs in custodial accounts.

Employers still have some flexibility in hardship distribution administration. In addition to the new standards provided by the IRS, employers may still require plan loans to be accessed first, having a minimum dollar amount for hardship distributions, requiring documentation to substantiate the amount of distribution necessary or requiring certification that the expense is not reimbursable through other means.

To ensure compliance with the final regulations, employers should confirm that their plan's service provider(s) will implement the final regulations on January 1, 2020. Employers should also timely amend their plan to match 2019 and future practices, notify participants in a Summary of Material Modification and update their safe harbor notice, as applicable.

Authors