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Employee Benefit Plan Review

Ask the Experts

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Recent Changes to Hardship Distribution Rules

Q My company sponsors a 401(k) plan that permits employees to take hardship distributions from their elective deferrals, using the "safe harbor" rules in the Internal Revenue Service (IRS) regulations. I heard that recent legal changes relax some of the hardship distribution requirements. Is this true? If so, have any new regulations been issued, and will plan amendments be required?

A Yes, this is true. Changes under the Bipartisan Budget Act of 2018 (the Budget Act) relaxed certain requirements related to 401(k) plan hardship distributions, generally effective for plan years beginning on or after January 1, 2019. Some of the recent changes made by the Budget Act are as follows:

- Under the prior IRS "safe harbor" regulations on hardship distributions, there was a six-month prohibition on future plan contributions for participants who take a hardship distribution. The Budget Act directed the Secretary of the Treasury to delete the six-month prohibition on contributions following a hardship distribution.
- Under the prior IRS "safe harbor" regulations on hardship distributions, before taking a hardship distribution, a participant was required to take all available distributions and nontaxable plan loans available under the employer's plans. The Budget Act amended the Code to provide that a distribution is not treated as failing to be made upon the hardship of an employee solely because the employee does not take any available loan under the plan.
- Under the prior rules, hardship distributions were limited to a participant's elective deferrals, and could not be taken from a participant's qualified non-elective contributions (QNECs), qualified matching contributions (QMACs), or earnings on elective deferrals, QNECs, or QMACs credited after 1988. The Budget Act amended these rules so that hardship distributions may now be taken from QNECs, QMACs, and earnings on these contributions.

On November 9, 2018, the Department of the Treasury and Internal Revenue Service issued a Notice of Proposed Rulemaking to amend IRS regulations applicable to hardship distributions. In addition to addressing changes made by the Budget Act, these proposed regulations also address hardship distribution issues implicated by the 2017 Tax Cuts and Jobs Act (the TCJA). The proposed IRS regulations would adopt the changes under the Budget Act described above, including eliminating the six-month prohibition on contributions following a hardship distribution, eliminating the requirement that a participant must take any available loans prior to requesting a hardship distribution, and providing that participants may take hardship distributions from QNECs, QMACs, and earnings on these contributions, regardless of when contributed or earned. However, plans may limit the type of contributions available for hardship distributions and whether earnings on those contributions are included. The proposed regulations also eliminate the rules in

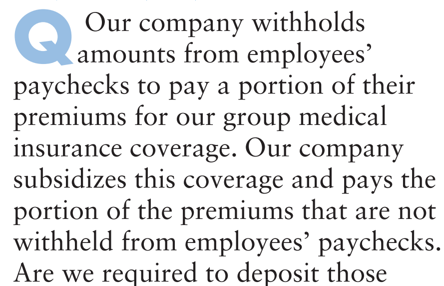
the current IRS regulations under which the determination of whether a distribution is necessary to satisfy a financial need is based on all of the relevant facts and circumstances, and instead provides one general standard for determining whether a distribution is necessary. Under this proposed general standard, a hardship distribution may not exceed the amount of the employee's need, the employee must have obtained other available distributions under the employer's plans, and the employee must represent that he or she has insufficient cash or other liquid assets to satisfy the financial need. A plan administrator may rely on such a representation unless the plan administrator has actual knowledge to the contrary.

The proposed regulations also modify the "safe harbor" list of expenses in the current IRS regulations that are deemed to be incurred on account of an immediate and heavy financial need, by:

(1) Providing that qualifying medical, educational, and funeral expenses of a participant's primary beneficiary under the plan may be incurred as a permissible expense;
(2) Clarifying that the TCJA's new limitations (which limit deductions for personal casualty losses to losses attributable to federally declared disasters for taxable years 2018 through 2025) do not apply to the meaning of "casualty loss" to a principal residence that would qualify for a hardship distribution; and
(3) Adding a new, seventh, safe harbor item to the list in the IRS regulations, relating to expenses and losses incurred as a result of a disaster declared by the Federal Emergency Management Agency (FEMA), provided that the employee's principal place of residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for individual assistance with respect to the disaster (meaning that plans could offer hardship distributions to affected participants without having to wait for Congress or the IRS to take specific action in response to a particular disaster).

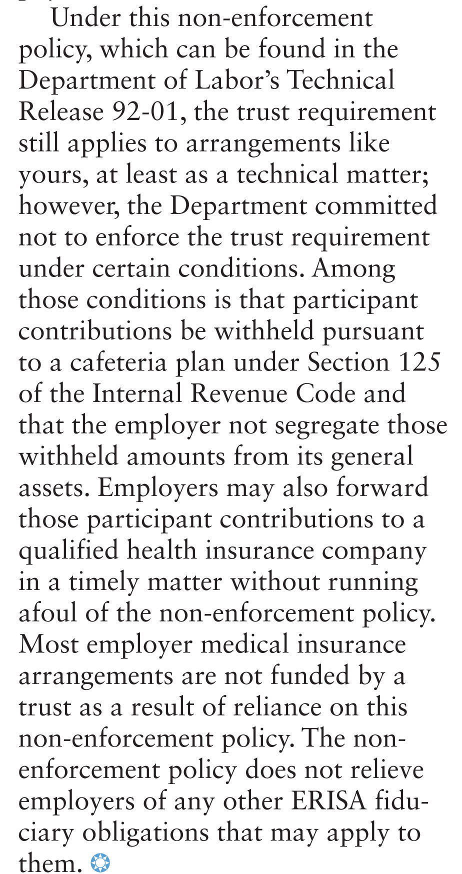
The IRS has requested comments on the proposed regulations by January 14, 2019. The Treasury Department and IRS have stated that, if these regulations are finalized as they have been proposed, all plan sponsors with hardship provisions will need to amend their plans' hardship distribution provisions. This will be the case even if plan sponsors are not making any plan design changes, because the proposed regulations clarify that certain changes will be mandatory. For example, on and after January 1, 2020, plans will not be permitted to impose a six-month prohibition on contributions following a hardship distribution, and plan administrators will need to implement the requirement for obtaining representations from participants under the newly proposed "general standard." Once the proposed regulations are finalized, mandatory amendments will need to be adopted by the end of the second calendar year that begins after the issuance of the IRS Required Amendments List reflecting the new rules (which date has not yet been determined). For changes that are optional design changes, plan sponsors may want to consider whether, and when, to adopt optional changes under the proposed regulations.[1]

Trust Requirement for Medical Plan



Q Our company withholds amounts from employees' paychecks to pay a portion of their premiums for our group medical insurance coverage. Our company subsidizes this coverage and pays the portion of the premiums that are not withheld from employees' paychecks. Are we required to deposit those withheld amounts into a trust the same way we do for 401(k) plan deferrals that we withhold from employees' paychecks?

A The deferrals that you are withholding from employees' paychecks to pay for group medical insurance coverage are technically "plan assets" that are subject to the trust requirement under ERISA, in the same way that amounts withheld for 401(k) plan contributions are. However, many years ago, the Department of Labor issued a non-enforcement policy whereby it would treat welfare plans as not being subject to ERISA's trust requirement if the only reason that the plan would otherwise be required to have a trust is because the employer withheld premium contributions from employees' paychecks.



Under this non-enforcement policy, which can be found in the Department of Labor's Technical Release 92-01, the trust requirement still applies to arrangements like yours, at least as a technical matter; however, the Department committed not to enforce the trust requirement under certain conditions. Among those conditions is that participant contributions be withheld pursuant to a cafeteria plan under Section 125 of the Internal Revenue Code and that the employer not segregate those withheld amounts from its general assets. Employers may also forward those participant contributions to a qualified health insurance company in a timely matter without running afoul of the non-enforcement policy. Most employer medical insurance arrangements are not funded by a trust as a result of reliance on this non-enforcement policy. The non-enforcement policy does not relieve employers of any other ERISA fiduciary obligations that may apply to them. ❂

Note

1. For more information, and additional provisions addressed by the proposed regulations, see 83 FR 56763 (November 14, 2018).

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