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Hardship Distributions Made Easier in 2019

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Well over half of the corporate sponsored retirement plans administered by Greenleaf Trust include hardship withdrawal provisions for participants facing immediate and heavy financial need. While no one ever desires to be in a situation where they, or someone they know, are facing a financial challenge that necessitates a hardship withdrawal, it is important to be aware of the increased flexibility the IRS is providing for hardships processed after December 31, 2018. On February 9, 2018, the Bipartisan Budget Act of 2018 was passed into law, which ended the government shutdown by raising the debt ceiling for the next two years. However, also buried in the new law were changes to ease the rules that govern hardship distributions in qualified retirement plans [not IRAs].

We often refer to hardship distributions as the "option of last resort." This is due to the taxes and penalties that are incurred in conjunction with the withdrawal. Unlike a 401(k) loan which does not trigger immediate taxation, hardship distributions are a taxable event and cannot be repaid to the plan. To make matters worse, if you are under the age of 59½, you are also subject to a 10% early withdrawal excise tax penalty.

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For background, hardship distribution provisions within retirement plans are not required by law, but such distributions are permitted as an option that is elected by the plan sponsor. The amount of the hardship is limited to the amount necessary to satisfy the financial need. Some of the key hardship distribution rule changes follow.

Future Contributions Now Permitted

Previously, once a participant received a hardship distribution, he/she was prohibited from making future contributions to the qualified plan for the next six (6) months. The purpose of the 6-month wait was to deter employees from taking a hardship distribution. In addition, it was a silent way of implying that "if things are bad enough financially that you have to take a distribution from your retirement account, you probably should not be making contributions to your 401(k) plan for the next few months." The new law removes the 6-month contribution prohibition, which means the participant will lose less ground on saving for retirement and still be eligible to receive the employer's matching contributions.

No More 'Last Resort' Rule

Previously the law required that a participant take all available plan loans, prior to being eligible for a hardship distribution. But there was no reporting mechanism to enforce this last resort rule, rendering it somewhat superfluous. Consequently, the new law eliminates this last resort rule, so where applicable, a plan loan no longer needs to be utilized before a hardship distribution. We are happy to see this requirement go away for multiple reasons. For example, if you have an employee whose primary residence is going into foreclosure, why would you make them take a loan which then requires loan payments to be made via deductions from their paycheck? It seems reasonable to assume that additional payroll deductions would actually put them in a worse financial position.

Expanded Source of Funds

Previously, participants could receive a hardship distribution of their own elective deferrals to the qualified plan, and they could not include growth or investment gains on the

participant's own contributions or employer contributions. With the change in law, hardship distributions will now include earnings on participant contributions, non-elective contributions, and qualified matching contributions.

More Qualified Plans Authorized to Permit Hardship Distributions

Currently, not all qualified retirement plans can permit hardship distributions. With the recent changes, more types of plans will be authorized to permit the withdrawal type.

It is important to note that the Budget Act will impact 403(b) plans differently. The changes described above will only impact 403(b) plans using the 401(k) regulations, safe harbor hardship withdrawal requirements. Additional guidance from Treasury is expected to clarify the application of the Budget Act to 403(b) plans. None of the changes directly impact the rules for unforeseeable emergency withdrawals from 457(b) plans. Plan Sponsors with individually drafted documents will be required to update their plan document by the last day of the plan year that begins in 2019. For those companies with plan documents provided by Greenleaf Trust, our team will be working on amendments during the 2019 and 2020 plan years. However, plans sponsors should immediately implement the new hardship rules. Fear not, our Greenleaf Trust team will reiterate the changes to any participants and/or plan sponsors that request a hardship in 2019.

Eligibility Conditions Include a New Addition

While the eligibility conditions surrounding hardship distributions have largely remained constant, it is important to be aware of one new qualifying reason. Participants with principal homes or employment locations in federally declared disaster areas can now take a hardship distribution to cover expenses incurred as a result. The requirements typically include:

- Unreimbursed medical care expenses for the employee, the employee's spouse, dependents or beneficiary.
- Costs directly related to the purchase of an employee's principal residence (excluding mortgage payments).
- Tuition, related educational fees and room and board expenses for the next 12 months of postsecondary education for the employee or the employee's spouse, children, dependents or beneficiary.
- Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence.
- Funeral expenses for the employee, the employee's spouse, children, dependents, or beneficiary.
- Certain expenses to repair damage to the employee's principal residence that would qualify for the casualty deduction under the Internal Revenue Code.
- New in 2019: Expenses (including loss of income) incurred on account of a federally declared disaster, if the participant's principal residence or place of employment is in a FEMA-designated area.

Overall, we are pleased with the increased flexibility provided for hardship withdrawals from qualified plans. The modifications will allow participants to continue saving for retirement uninterrupted and potentially prevent them from missing out on employer matching contributions. The changes also streamline some requirements that have been previously difficult for plan sponsors to administer. While the changes will operationally impact participants and plan sponsors, we at Greenleaf Trust have also been revising our internal processes and procedures. Although there are still some unanswered questions about the changes, Greenleaf Trust is confident that we will be able to help navigate the changes smoothly with our plan sponsors and over 20,000 participants.

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