



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9875]

RIN-1545-BO82

Hardship Distributions of Elective Contributions, Qualified Matching Contributions, Qualified Nonelective Contributions, and Earnings

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that amend the rules relating to hardship distributions from section 401(k) plans. The final regulations reflect statutory changes affecting section 401(k) plans, including changes made by the Bipartisan Budget Act of 2018. The regulations affect participants in, beneficiaries of, employers maintaining, and administrators of plans that include cash or deferred arrangements or provide for employee or matching contributions.

DATES: *Effective Date:* These regulations are effective **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability Date: For dates of applicability, see §1.401(k)-1(d)(3)(v).

FOR FURTHER INFORMATION CONTACT: Roger Kuehnle at (202) 317-4148 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1669. The collection of information in these final regulations is in §1.401(k)-1(d)(3)(iii)(B). The collection of information relates to the certification by participants in section 401(k) plans that they have insufficient cash or other liquid assets reasonably available to cover expenses resulting from a hardship and, thus, will need a distribution from the plan to meet the expenses. The collection of information is required to obtain a benefit.

The likely recordkeepers are individuals.

Estimated total annual reporting burden: 101,250 hours.

Estimated average annual burden per respondent: 45 minutes.

Estimated number of respondents: 135,000.

Estimated frequency of responses: On occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Background

Section 401(k)

Section 401(k)(1) of the Internal Revenue Code (Code) provides that a profit-sharing, stock bonus, pre-ERISA money purchase, or rural cooperative plan will not fail to qualify under section 401(a) merely because it includes a cash

or deferred arrangement (CODA) that is a qualified CODA. Under section 401(k)(2), a CODA (generally, an arrangement providing for an election by an employee between contributions to a plan or payments directly in cash) is a qualified CODA only if it satisfies certain requirements. Section 401(k)(2)(B) provides that contributions made pursuant to a qualified CODA (referred to as “elective contributions”) may be distributed only on or after the occurrence of certain events, including death, disability, severance from employment, termination of the plan, attainment of age 59-1/2, hardship, or, in the case of a qualified reservist distribution, the date a reservist is called to active duty. Section 401(k)(2)(C) requires that elective contributions be nonforfeitable at all times.

Section 401(k)(3)(A)(ii) requires that elective contributions satisfy the actual deferral percentage (ADP) test set forth in section 401(k)(3). Sections 401(k)(11), 401(k)(12), and 401(k)(13) each provide an alternative method of meeting the ADP test. Under section 401(k)(3)(D), qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs), as described in sections 401(m)(4)(C) and 401(k)(3)(D)(ii)(I), respectively, are permitted to be taken into account under the ADP test. Among other requirements, QNECs and QMACs must satisfy the distribution limitations of section 401(k)(2)(B) and the nonforfeitability requirements of section 401(k)(2)(C). Similarly, employer contributions that are made pursuant to the safe harbor plan designs of section 401(k)(12) or (13) must meet the distribution limitations of section 401(k)(2)(B).

Section 401(m)(2)(A) requires that matching contributions and employee contributions satisfy the actual contribution percentage (ACP) test set forth in section 401(m)(2). Sections 401(m)(10), 401(m)(11), and 401(m)(12) each provide an alternative method of meeting the ACP test with respect to matching contributions. As with contributions made to section 401(k) plans pursuant to safe harbor plan designs, employer contributions made pursuant to the safe harbor plan designs of section 401(m)(11) or (12) must meet the distribution limitations of section 401(k)(2)(B).

Existing Regulations Under Section 401(k)

The Department of the Treasury (Treasury Department) and the IRS issued comprehensive regulations under sections 401(k) and 401(m) on December 29, 2004 (TD 9169, 69 FR 78143). Since that time, the regulations have been updated to reflect certain subsequent changes to the applicable statute (see TD 9237, 71 FR 6, and TD 9324, 72 FR 21103, providing guidance on designated Roth contributions under section 402A; and TD 9447, 74 FR 8200, providing guidance on section 401(k)(13)). Although the regulations have not been updated to reflect other statutory changes, they have been amended to address certain discrete issues unrelated to statutory changes (see TD 9319, 72 FR 16878, relating to the definition of compensation; TD 9641, 78 FR 68735, relating to mid-year amendments to safe harbor plan designs; and TD 9835, 83 FR 34469, relating to whether QNECs and QMACs must be nonforfeitable when contributed to the plan).

Section 1.401(k)-1(d)(3) provides rules for determining whether a distribution is made on account of an employee's hardship. Under those rules, a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need and the amount of the distribution is not in excess of the amount necessary to satisfy that need (plus any amounts necessary to pay any taxes or penalties reasonably anticipated to result from the distribution). These determinations must be made on the basis of all the relevant facts and circumstances and in accordance with nondiscriminatory and objective standards set forth in the plan.

Section 1.401(k)-1(d)(3)(iv)(B) provides that a distribution is not treated as necessary to satisfy an immediate and heavy financial need of an employee to the extent the need may be relieved from other resources that are reasonably available to the employee (including assets of the employee's spouse and minor children that are reasonably available to the employee). Under §1.401(k)-1(d)(3)(iv)(C), in determining whether the need can be relieved from other resources that are reasonably available to an employee, the employer may rely on the employee's representation (unless the employer has actual knowledge to the contrary) that the need cannot reasonably be relieved from resources specified in §1.401(k)-1(d)(3)(iv)(C).

To simplify administration, the regulations provide certain safe harbors that may be used to determine whether a distribution is made on account of an employee's hardship. Specifically, §1.401(k)-1(d)(3)(iii)(B) provides a safe harbor under which distributions for six types of expenses are deemed to be

made on account of an immediate and heavy financial need. One of the six types is “expenses for the repair of damage to the employee’s principal residence that would qualify for the casualty deduction under section 165 (determined without regard to whether the loss exceeds 10% of adjusted gross income).”

In addition, §1.401(k)-1(d)(3)(iv)(E) provides a safe harbor under which a distribution is deemed necessary to satisfy an immediate and heavy financial need. Under that safe harbor, an employee must first obtain all currently available distributions (including distributions of employee stock ownership plan (ESOP) dividends under section 404(k), but not hardship distributions), and nontaxable plan loans from the plan and any other plan maintained by the employer. Under the safe harbor, an employee’s ability to make elective contributions and employee contributions to the plan (and any other plan maintained by the employer) must be suspended for at least 6 months after receipt of the hardship distribution. Pursuant to §1.401(k)-3(c)(6)(v)(B), in the case of a safe harbor plan described in section 401(k)(12) or (13), the suspension period may not exceed 6 months.

Under §1.401(k)-1(d)(3)(ii), the maximum amount that may be distributed on account of hardship is the total of the employee’s elective contributions that have not previously been distributed (plus earnings, QNECs, and QMACs credited before a specified grandfather date that generally is before 1989). Thus, the maximum amount that may be distributed on account of hardship does not include earnings, QNECs, or QMACs that are not grandfathered.

Section 403(b)

Section 403(b)(7)(A)(ii) provides distribution limitations on amounts contributed to a custodial account that is treated as a section 403(b) annuity contract. Section 403(b)(11) provides that contributions made pursuant to a salary reduction agreement (within the meaning of section 402(g)(3)(C)) (generally referred to in the regulations under section 403(b) as “section 403(b) elective deferrals”) may be distributed only on or after the occurrence of certain events, one of which is the employee’s hardship. Section 403(b)(11) also provides that no income attributable to these contributions may be distributed on account of hardship.

Section 1.403(b)-6 provides rules for applying these distribution limitations. Section 1.403(b)-6(b) applies to distributions of amounts that are neither attributable to section 403(b) elective deferrals nor made from custodial accounts, §1.403(b)-6(c) applies to distributions from custodial accounts that are not attributable to section 403(b) elective deferrals, and §1.403(b)-6(d) applies to distributions of amounts attributable to section 403(b) elective deferrals. Section 1.403(b)-6(d)(2) provides that a hardship distribution of section 403(b) elective deferrals is subject to the rules and restrictions set forth in §1.401(k)-1(d)(3) and is limited to the aggregate dollar amount of a participant’s section 403(b) elective deferrals, without earnings thereon.

Statutory Changes Relating to Section 401(k)

Section 41113 of the Bipartisan Budget Act of 2018, Pub. L. 115-123 (BBA 2018), directs the Secretary of the Treasury to modify §1.401(k)-1(d)(3)(iv)(E) to (1) delete the 6-month prohibition on contributions following a hardship

distribution and (2) make any other modifications necessary to carry out the purposes of section 401(k)(2)(B)(i)(IV). Section 41114 of BBA 2018 modified the hardship distribution rules under section 401(k)(2)(B) by adding section 401(k)(14)(A) to the Code, which states that the maximum amount available for distribution upon hardship includes (1) contributions to a profit-sharing or stock bonus plan to which section 402(e)(3) applies, (2) QNECs, (3) QMACs, and (4) earnings on these contributions. Section 41114 of BBA 2018 also added section 401(k)(14)(B) to the Code, which provides 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.

Section 11044 of the Tax Cuts and Jobs Act, Pub. L. 115-97 (TCJA), added section 165(h)(5) to the Code. Section 165(h)(5) provides that, for taxable years 2018 through 2025, the deduction for a personal casualty loss generally is available only to the extent the loss is attributable to a federally declared disaster (as defined in section 165(i)(5)).

Section 826 of the Pension Protection Act of 2006, Pub. L. 109-280 (PPA '06), directs the Secretary of the Treasury to modify the rules relating to hardship distributions to permit a section 401(k) plan to treat a participant's beneficiary under the plan the same as the participant's spouse or dependent in determining whether the participant has incurred a hardship. Notice 2007-7, 2007-5 I.R.B. 395, provides guidance for applying this provision.

Section 827(a) of PPA '06 added to the Code section 72(t)(2)(G), which exempts certain distributions from the application of the section 72(t) additional

income tax on early distributions. These distributions, made during the period that a reservist has been called to active duty, are referred to as “qualified reservist distributions,” and could include distributions attributable to elective contributions. Section 827(b)(1) of PPA '06 added section 401(k)(2)(B)(i)(V) to the Code, which permits qualified reservist distributions to be made from a section 401(k) plan.¹

Section 105(b)(1)(A) of the Heroes Earnings Assistance and Relief Tax Act of 2008, Pub. L. 110-245 (HEART Act), added section 414(u)(12) to the Code. Section 414(u)(12)(B)(ii) provides for a 6-month suspension of elective contributions and employee contributions after certain distributions to individuals performing service in the uniformed services.

On November 14, 2018, the Treasury Department and the IRS published proposed regulations (REG-107813-18) under section 401(k) and (m) in the **Federal Register** (83 FR 56763). No public hearing was requested or held. Seven comments on the proposed regulations were received during the comment period. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

Summary of Comments and Explanation of Provisions

Overview

The final regulations update the section 401(k) and (m) regulations to reflect: (1) the enactment of (a) sections 41113 and 41114 of BBA 2018, (b) sections 826 and 827 of PPA '06, and (c) section 105(b)(1)(A) of the HEART Act;

¹ While section 827(b)(2) and (3) of PPA '06 amended section 403(b)(7)(A)(ii) and (b)(11) to permit qualified reservist distributions to be made from a section 403(b) plan, the regulations under section 403(b) have not yet been updated to reflect these statutory amendments.

and (2) the application of the hardship distribution rules in light of the modification to the casualty loss deduction rules made by section 11044 of the TCJA. The final regulations are substantially similar to the proposed regulations, and plans that complied with the proposed regulations will satisfy the final regulations.

Deemed Immediate and Heavy Financial Need

The final regulations, like the proposed regulations, modify the safe harbor list of expenses in existing §1.401(k)-1(d)(3)(iii)(B) for which distributions are deemed to be made on account of an immediate and heavy financial need by: (1) adding “primary beneficiary under the plan” as an individual for whom qualifying medical, educational, and funeral expenses may be incurred; (2) modifying the expense listed in existing §1.401(k)-1(d)(3)(iii)(B)(6) (relating to damage to a principal residence that would qualify for a casualty deduction under section 165) to provide that for this purpose the limitations in section 165(h)(5) (added by section 11044 of the TCJA) do not apply; and (3) adding a new type of expense to the list, relating to expenses incurred as a result of certain disasters.

Several commenters observed that this new safe harbor expense, which is described in the preamble to the proposed regulations as similar to relief provided by the IRS after certain major federally declared disasters, is narrower in certain respects than this past IRS relief and asked for confirmation that the narrowing is intentional. Some commenters also raised the concern that the new safe harbor expense would lead the IRS to discontinue its practice of issuing announcements providing such relief. The effect of the new safe harbor expense differs from the disaster-relief announcements in three main respects.

First, only disaster-related expenses and losses of an employee who lived or worked in the disaster area will qualify for the new safe harbor expense, and not, as under the disaster-relief announcements, expenses and losses of the employee's relatives and dependents. The Treasury Department and IRS have concluded that limiting distributions only to those employees directly affected by a disaster is consistent with the purposes underlying the Code's hardship distribution provisions and better aligns with the relief given to affected individuals under section 7508A for similar disasters.

Second, unlike under the disaster-relief announcements, there is no specific deadline by which a request for a disaster-related hardship distribution must be made and no specific authority to relax certain procedural requirements established by the plan administrator or plan terms (although it is expected that plan administrators will be flexible in interpreting plan terms requiring documentation relating to the hardship when processing hardship distribution requests during the difficult circumstances following a disaster).

Third, unlike under the disaster-relief announcements, there is no extended deadline for plan sponsors to add disaster-related distribution or loan provisions to the plan. In the absence of such an extended deadline, a plan sponsor that does not choose to add disaster-related hardship distribution provisions as part of an amendment reflecting the final regulations but instead chooses to wait until a disaster occurs to add those provisions (or to add a loan provision) would need to adopt a plan amendment by the end of the plan year the amendment is first effective.

Making expenses related to certain disasters a safe harbor expense is intended to eliminate any delay or uncertainty concerning access to plan funds that might otherwise occur following a major disaster. Accordingly, the Treasury Department and IRS expect that no more disaster-relief announcements will be needed. However, the Treasury Department and IRS are considering separate guidance to address delayed amendment deadlines when the new safe harbor expense or loan provisions are added to a plan at a later date in response to a particular disaster.

Distribution Necessary to Satisfy Financial Need

Pursuant to sections 41113 and 41114 of BBA 2018, the final regulations, like the proposed regulations, modify the rules for determining whether a distribution is necessary to satisfy an immediate and heavy financial need by eliminating (1) any requirement that an employee be prohibited from making elective contributions and employee contributions after receipt of a hardship distribution and (2) any requirement to take plan loans prior to obtaining a hardship distribution. In particular, the final regulations, like the proposed regulations, eliminate the safe harbor in existing §1.401(k)-1(d)(3)(iv)(E), under which a distribution is deemed necessary to satisfy the financial need only if elective contributions and employee contributions are suspended for at least 6 months after a hardship distribution is made and, if available, nontaxable plan loans are taken before the hardship distribution is made.

The proposed regulations eliminate the rules in existing §1.401(k)-1(d)(3)(iv)(B) (under which the determination of whether a distribution

is necessary to satisfy a financial need is based on all the relevant facts and circumstances) and provide one general standard for determining whether a distribution is necessary. Under this general standard, a hardship distribution may not exceed the amount of an employee's need (including any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution), the employee must have obtained other available, non-hardship distributions under the employer's plans, and the employee must provide a representation that he or she has insufficient cash or other liquid assets available to satisfy the financial need. A hardship distribution may not be made if the plan administrator has actual knowledge that is contrary to the representation. These modifications are adopted in the final regulations with the changes described later in this preamble relating to employee representations and the type of plans subject to the prohibition on suspensions.

Two commenters asked that ESOP dividends under section 404(k) be excepted from the requirement that an employee must first obtain other currently available distributions under the employer's plans. Alternatively, they asked that plans be permitted to disregard that distribution requirement with respect to those dividends if the dividends are less than a specified dollar amount. The comments appear to reflect a misinterpretation of the breadth of the distribution requirement. Under both the existing regulations and the proposed regulations, the distribution requirement applies only to distributions that are "currently available," which significantly limits the ESOP dividends subject to the rule.

Specifically, the only ESOP dividends that must be distributed under this rule are those that, at the time of the employee's hardship withdrawal request, both (1) have been paid to the plan and (2) are available for the employee to elect to receive in cash. Thus, for example, if an ESOP requires a participant to make an irrevocable election whether to receive a dividend by a deadline that is in advance of the dividend payment date, then a participant who does not elect to receive the dividend by that deadline and who later requests a hardship distribution has no dividends currently available. Although in some instances these ESOP dividend amounts may be small and, if distributed, would have a minimal impact on alleviating a hardship, the Treasury Department and IRS have concluded that ESOP dividends should not be treated differently than any other nonhardship distributions that are currently available under the plan. Accordingly, no changes were made in response to these comments.

One commenter was concerned that the requirement for an employee to make a representation regarding the unavailability of cash or other liquid assets to satisfy the financial need would be a problem if the employee has those assets but has another immediate need for them. In response to the comment, the final regulations provide that the employee representation only relates to whether the employee has cash or other liquid assets that are "reasonably available" to satisfy the need. Thus, an employee could make a representation that he or she has insufficient cash or other liquid assets reasonably available to satisfy a financial need even if the employee did have cash or other liquid assets on hand,

provided those assets were earmarked for payment of an obligation in the near future (for example, rent).

The proposed regulations provide that the employee representation may be made “in writing, by an electronic medium, or in such other form as may be prescribed by the Commissioner.” One commenter asked for clarification that a verbal representation via telephone could be used if it is recorded. The final regulations clarify that this method is acceptable, by referencing the definition of “electronic medium” at §1.401(a)-21(e)(3).

Two commenters asked for clarification of the requirement that a plan administrator not have “actual knowledge” that is contrary to an employee’s representation or, alternatively, they asked that the requirement be eliminated. The requirement does not impose upon plan administrators an obligation to inquire into the financial condition of employees who seek hardship distributions. Rather, the rule is limited to situations in which the plan administrator already possesses sufficiently accurate information to determine the veracity of an employee representation. The Treasury Department and IRS believe the requirement helps ensure the integrity of the procedures used to determine whether a distribution is necessary to satisfy an employee’s financial need. Accordingly, the final regulations retain the actual-knowledge requirement.

The final regulations, like the proposed regulations, provide that a plan generally may provide for additional conditions, such as those described in 26 CFR 1.401(k)-1(d)(3)(iv)(B) and (C) (revised as of April 1, 2019), to demonstrate that a distribution is necessary to satisfy an immediate and heavy financial need

of an employee. However, like the proposed regulations, the final regulations do not permit a plan to provide for a suspension of elective contributions or employee contributions as a condition of obtaining a hardship distribution. This is responsive to Congress' concern in enacting section 41113 of BBA 2018 that a suspension impedes an employee's ability to replace distributed funds. See the Ways and Means Committee description of section 1503 of H.R. 1,² which became section 41113 of BBA 2018.

One commenter asked what conditions, besides those listed in existing §1.401(k)-1(d)(3)(iv)(B) and (C) (other than a suspension of contributions), could be imposed on a hardship distribution, suggesting that completing a plan's application process and providing required documentation should be permissible conditions. The Treasury Department and IRS agree that these two conditions are permissible. The Treasury Department and IRS also note that plan sponsors have available a broad range of conditions that may be imposed on a hardship distribution; for example, a plan could provide for a nondiscriminatory, minimum dollar amount for a hardship distribution.

Another commenter recommended that the prohibition on suspensions of elective contributions and employee contributions in the proposed regulations be eliminated and plan sponsors be given the flexibility to impose a suspension. However, in light of Congress' expressed concern that a suspension impedes an employee's ability to replace distributed funds, the final regulations retain the prohibition on suspensions.

² H.R. Rep. No. 115-409, at 196 (2017).

Another commenter requested guidance on which other plans of the employer, besides the plan making the hardship distribution, are subject to the prohibition on suspensions. Although the existing safe harbor in §1.401(k)-1(d)(3)(iv)(E)(2) imposes a mandatory suspension with respect to all qualified and nonqualified plans maintained by the employer, the proposed regulations do not specify the plans to which the prohibition on suspensions applies. The Treasury Department and IRS have concluded that Congress' concerns underlying section 41113 of BBA 2018 have little relevance to unfunded nonqualified plans. Accordingly, the final regulations provide that the prohibition on suspensions applies only to a qualified plan, a section 403(b) plan, and an eligible deferred compensation plan described in section 457(b) maintained by an eligible employer described in section 457(e)(1)(A). Thus, a plan subject to section 409A may retain its suspension provisions (or, to the extent consistent with section 409A and the regulations thereunder, the plan may be amended to remove them).

Another commenter requested guidance on the continuing applicability of revenue rulings that require a "substantial limitation" on the right of a participant to withdraw matched employee contributions, such as a suspension of contributions. See, for example, Rev. Rul. 74-56, 1974-1 C.B. 90. Under the final regulations, if, on or after January 1, 2020, matched employee contributions

are distributed in conjunction with a hardship distribution of elective contributions, a suspension of employee contributions is not permitted.³

Expanded Sources for Hardship Distributions

Pursuant to section 41114 of BBA 2018, the final regulations, like the proposed regulations, modify existing §1.401(k)-1(d)(3) to permit hardship distributions from section 401(k) plans of elective contributions, QNECs, QMACs, and earnings on these amounts, regardless of when contributed or earned.

Several commenters asked how the new distribution rules apply to safe harbor contributions made to a plan described in section 401(k)(12). Because safe harbor contributions made to a plan described in section 401(k)(12) are either QNECs or QMACs, amounts attributable to these contributions may be distributed on account of hardship. As noted in the preamble to the proposed regulations, safe harbor contributions made to a plan described in section 401(k)(13) may also be distributed on account of an employee's hardship (because these contributions are subject to the same distribution limitations applicable to QNECs and QMACs). See §1.401(k)-3(k)(3)(i). However, a plan may limit the type of contributions available for hardship distributions and may exclude earnings on those contributions from hardship distribution eligibility.

Section 403(b) Plans

Section 1.403(b)-6(d)(2) provides that a hardship distribution of section 403(b) elective deferrals is subject to the rules and restrictions set forth in §1.401(k)-1(d)(3); accordingly, the preamble to the proposed regulations states

³ Issues relating to the applicability of prior revenue rulings to distributions of matched employee contributions not made in conjunction with a hardship distribution of elective contributions are beyond the scope of these regulations.

that the new rules relating to a hardship distribution of elective contributions from a section 401(k) plan generally apply to section 403(b) plans. Two commenters asked whether, in light of historical concerns about employee self-certification in section 403(b) plans, the employee-representation requirement applies to section 403(b) plans. Because this requirement is retained in the final regulations, at §1.401(k)-1(d)(3)(iii)(B), it applies to section 403(b) plans.

The preamble to the proposed regulations addresses other issues related to hardship distributions under section 403(b) plans, and states that because Code section 403(b)(11) was not amended by section 41114 of BBA 2018, income attributable to section 403(b) elective deferrals continues to be ineligible for distribution on account of hardship. As also stated in that preamble, amounts attributable to QNECs and QMACs may be distributed from a section 403(b) plan on account of hardship only to the extent that, under §1.403(b)-6(b) and (c), hardship is a permitted distributable event for amounts that are not attributable to section 403(b) elective deferrals. Thus, QNECs and QMACs in a section 403(b) plan that are not in a custodial account may be distributed on account of hardship, but QNECs and QMACs in a section 403(b) plan that are in a custodial account continue to be ineligible for distribution on account of hardship.

Applicability Dates

The changes to the hardship distribution rules made by BBA 2018 are effective for plan years beginning after December 31, 2018. The final regulations provide plan sponsors with a number of applicability-date options. Although presented differently in the proposed regulations, the options available to plan

sponsors under the final regulations are the same as those available under the proposed regulations.

In response to a comment on the proposed regulations requesting clarity regarding which rules apply during 2019, the final regulations provide that §1.401(k)-1(d)(3) applies to distributions made on or after January 1, 2020 (rather than, as in the proposed regulations, to distributions made in plan years beginning after December 31, 2018). However, §1.401(k)-1(d)(3) may be applied to distributions made in plan years beginning after December 31, 2018, and the prohibition on suspending an employee's elective contributions and employee contributions as a condition of obtaining a hardship distribution may be applied as of the first day of the first plan year beginning after December 31, 2018, even if the distribution was made in the prior plan year. Thus, for example, a calendar-year plan that provides for hardship distributions under the pre-2019 safe harbor standards may be amended to provide that an employee who receives a hardship distribution in the second half of the 2018 plan year will be prohibited from making contributions only until January 1, 2019 (or may continue to provide that contributions will be suspended for the originally scheduled 6 months).

If the choice is made to apply §1.401(k)-1(d)(3) to distributions made before January 1, 2020, the new rules requiring an employee representation and prohibiting a suspension of contributions may be disregarded with respect to those distributions. To the extent early application of §1.401(k)-1(d)(3) is not chosen, the rules in §1.401(k)-1(d)(3), prior to amendment by this Treasury

decision, apply to distributions made before January 1, 2020, taking into account statutory changes effective before 2020 that are not reflected in that regulation.

In addition, the revised list of safe harbor expenses may be applied to distributions made on or after a date that is as early as January 1, 2018. Thus, for example, a plan that made hardship distributions relating to casualty losses deductible under section 165 without regard to the changes made to section 165 by the TCJA (which, effective in 2018, require that, to be deductible, losses must result from a federally declared disaster) may be amended to apply the revised safe harbor expense relating to casualty losses to distributions made in 2018, so that plan provisions will conform to the plan's operation. Similarly, a plan may be amended to apply the revised safe harbor expense relating to losses (including loss of income) incurred by an employee on account of a disaster that occurred in 2018, provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by the Federal Emergency Management Agency for individual assistance with respect to the disaster.

Plan Amendments

The Treasury Department and IRS expect that plan sponsors will need to amend their plans' hardship distribution provisions to reflect the final regulations, and any such amendment must be effective for distributions beginning no later than January 1, 2020. The deadline for amending a disqualifying provision is set forth in Rev. Proc. 2016-37, 2016-29 I.R.B. 136. For example, with respect to an individually designed plan that is not a governmental plan, the deadline for

amending the plan to reflect a change in qualification requirements is the end of the second calendar year that begins after the issuance of the Required Amendments List (RAL) described in section 9 of Rev. Proc. 2016-37 that includes the change; if the final regulations are included in the 2019 RAL, the deadline will be December 31, 2021.

A plan provision that does not result in the failure of the plan to satisfy the qualification requirements, but is integrally related to a qualification requirement that has been changed in a manner that requires the plan to be amended, may be amended by the same deadline that applies to the required amendment. The Treasury Department and IRS have determined that a plan amendment modifying a plan's hardship distribution provisions that is effective no later than the required amendment, including a plan amendment reflecting one or more of the following, will be treated as amending a provision that is integrally related to a qualification requirement that has been changed: (1) the change to section 165 (relating to casualty losses); (2) the addition of the new safe harbor expense (relating to expenses incurred as a result of certain federally declared disasters); and (3) the extension of the relief under Announcement 2017-15, 2017-47 I.R.B. 534, to victims of Hurricanes Florence and Michael that was provided in the preamble to the proposed regulations. Thus, in the case of an individually designed plan, the deadline for such an integrally related amendment will be the same as the deadline for the required amendment (described in the preceding paragraph), even if some of the amendment provisions have an earlier effective date.

Several commenters requested guidance on amendment deadlines for pre-approved plans. The deadline for adopting a required amendment (as well as any integrally related amendment) to a pre-approved plan is set forth in section 15 of Rev. Proc. 2016-37, and varies depending on several factors, including the type of entity sponsoring the plan and the period used for the plan year. For example, under Rev. Proc. 2016-37, in the case of an employer with a calendar-year tax year that maintains a pre-approved plan with a calendar-year plan year and that chose to apply the new safe harbor expense for certain disasters in 2018, the deadline to adopt such an interim amendment for the new expense would be the tax-filing deadline (plus extensions) for 2018. The Treasury Department and IRS recognize that, for an employer using a pre-approved plan, the interim amendment deadline under Rev. Proc. 2016-37 that applies for an amendment to a plan provision that is integral to the qualification requirement that has been changed may be earlier than the interim amendment deadline for the required amendment. Accordingly, the Treasury Department and IRS are extending the deadline for an interim amendment related to the hardship distribution provisions. Under this extension, for an employer using a pre-approved plan, the interim amendment deadline for the required amendment to the hardship distribution provisions of the plan will also be the deadline for all amendments integrally related to the hardship distribution provisions (rather than the earlier deadline that might otherwise apply under Rev. Proc. 2016-37 to those integrally related amendments). Thus, if the employer in the example in this paragraph were to implement the prohibition on suspensions

effective for distributions made on or after January 1, 2020, the interim amendment deadline to add the new safe harbor expense would be the same as the deadline for the required amendment (that is, the tax-filing deadline (plus extensions) for 2020), even if the new safe harbor expense is effective in an earlier year.

Several commenters also requested guidance on the amendment deadlines for pre-approved and individually designed section 403(b) plans. Under Rev. Proc. 2017-18, 2017-5 I.R.B. 743, the remedial amendment deadline for a section 403(b) plan is March 31, 2020. The Treasury Department and IRS are considering providing for a later amendment deadline for the amendments relating to the final regulations in separate guidance.

Other Issues

Several commenters requested that the Internal Revenue Manual (IRM) be updated to reflect the new hardship distribution rules. The IRS intends to update the IRM to reflect the new rules in the final regulations after publication of the final regulations.

Two commenters asked whether a plan must include every one of the seven expenses in the §1.401(k)-1(d)(3)(ii)(B) list of deemed immediate and heavy financial needs and cover every individual described in the list (for example, a primary beneficiary under the plan, in the case of certain expenses) in order to be considered as using the safe harbor standards for hardship distributions. Under the IRS's pre-approved plan program for qualified plans, certain section 401(k) plans that provide for hardship distributions will not be

approved unless the distributions are made under circumstances described in the safe harbor standards in the regulations under section 401(k). For this purpose, a plan making hardship distributions for some but not all the safe harbor expenses, or for expenses of some but not all the categories of individuals described in §1.401(k)-1(d)(3)(ii)(B), is considered to be using the safe harbor standards for hardship distributions.

One commenter asked whether the proposed regulations' prohibition on suspensions of elective contributions and employee contributions applies to pre-approved section 403(b) plans in light of the fact that the IRS's rules for pre-approved section 403(b) plans require that a participant's elective deferrals be suspended for 6 months following a hardship distribution. The prohibition on suspensions is retained in the final regulations, and the rule applies to section 403(b) plans, including pre-approved section 403(b) plans.

Also, one commenter asked for relief relating to the notice requirements for safe harbor plans described in sections 401(k)(12) and 401(k)(13). Because a description of withdrawal provisions is required to be included in the notice provided to eligible employees (see §1.401(k)-3(d)(2)(ii)(G)), if a description of the new hardship withdrawal provisions was not already included in a notice, employees must be provided an updated notice reflecting the new hardship withdrawal provisions and must be given a reasonable opportunity to change their cash or deferred election. See section III.C of Notice 2016-16, 2016-7 I.R.B. 318, for the notice-timing and election-opportunity requirements with respect to mid-year amendments to safe harbor plans.

Special Analyses

These regulations are not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that employers with section 401(k) plans that permit hardship withdrawals must already maintain records relating to an employee's application for a hardship withdrawal, and the incremental cost due to the new certification requirement in final regulations §1.401(k)-1(d)(3)(iii)(B)(2) will be minimal. In addition, some employers, including some small entities, use a hardship withdrawal procedure available under the existing regulations that requires an employee certification almost identical to that in the final regulations. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses, and no comment was received.

Drafting Information

The principal author of these regulations is Roger Kuehnle of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and

Employment Taxes). However, other personnel from the IRS and Treasury Department participated in their development.

Statement of Availability of IRS Documents

The IRS notices, revenue procedures and other guidance cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 401(m)(9) and 26 U.S.C. 7805.

* * * * *

Par. 2. Section 1.401(k)-0 is amended under the heading §1.401(k)-1 by revising the entries for (d)(3)(ii) and (d)(3)(ii)(A) and (B), adding an entry for (d)(3)(ii)(C), revising the entries for (d)(3)(iii) and (d)(3)(iii)(A) and (B), adding an entry for (d)(3)(iii)(C), revising the entry for (d)(3)(iv), removing the entries for (d)(3)(iv)(A) through (F), revising the entry for (d)(3)(v), and adding the entries for (d)(3)(v)(A) through (C) to read as follows:

§1.401(k)-0 Table of contents.

* * * * *

§1.401(k)-1 Certain cash or deferred arrangements.

* * * * *

- (d) * * *
- (3) * * *
- (ii) Immediate and heavy financial need.
 - (A) In general.
 - (B) Deemed immediate and heavy financial need.
 - (C) Primary beneficiary under the plan.
- (iii) Distribution necessary to satisfy financial need.
 - (A) Distribution may not exceed amount of need.
 - (B) No alternative means reasonably available.
 - (C) Additional conditions.
- (iv) Commissioner may expand standards.
- (v) Applicability date.
 - (A) General rule.
 - (B) Options for earlier application.
 - (C) Certain rules optional in 2019.

* * * * *

Par. 3. Section 1.401(k)-1 is amended by:

1. Revising paragraphs (d)(1)(ii) and (iii) and adding new paragraph (d)(1)(iv).
2. Removing paragraph (d)(3)(ii) and redesignating paragraphs (d)(3)(iii), (iv), and (v) as paragraphs (d)(3)(ii), (iii), and (iv).
3. Revising newly redesignated paragraph (d)(3)(ii)(B) and adding new paragraph (d)(3)(ii)(C).
4. Revising newly redesignated paragraphs (d)(3)(iii) and (iv) and adding new paragraph (d)(3)(v).
5. In paragraph (d)(6), removing Examples 3, 4, and 5, redesignating Example 6 as Example 3, and designating Examples 1 through 3 as paragraphs (d)(6)(i) through (iii).
6. In newly designated paragraph (d)(6)(ii), redesignating paragraphs (d)(6)(ii)(i) and (ii) as paragraphs (d)(6)(ii)(A) and (B).

The additions and revisions read as follows:

§1.401(k)-1 Certain cash or deferred arrangements.

* * * * *

(d) * * *

(1) * * *

(ii) In the case of a profit-sharing, stock bonus or rural cooperative plan—

(A) The employee's attainment of age 59 ½; or

(B) In accordance with section 401(k)(14), the employee's hardship;

(iii) In accordance with section 401(k)(10), the termination of the plan; or

(iv) In the case of a qualified reservist distribution defined in

section 72(t)(2)(G)(iii), the date the reservist was ordered or called to active duty.

* * * * *

(3) * * *

(ii) * * *

(B) *Deemed immediate and heavy financial need.* A distribution is

deemed to be made on account of an immediate and heavy financial need of the employee if the distribution is for--

(1) Expenses for (or necessary to obtain) medical care that would be deductible under section 213(d), determined without regard to the limitations in section 213(a) (relating to the applicable percentage of adjusted gross income and the recipients of the medical care) provided that, if the recipient of the medical care is not listed in section 213(a), the recipient is a primary beneficiary under the plan;

(2) Costs directly related to the purchase of a principal residence for the employee (excluding mortgage payments);

(3) Payment of tuition, related educational fees, and room and board expenses, for up to the next 12 months of post-secondary education for the employee, for the employee's spouse, child or dependent (as defined in section 152 without regard to section 152(b)(1), (b)(2) and (d)(1)(B)), or for a primary beneficiary under the plan;

(4) Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence;

(5) Payments for burial or funeral expenses for the employee's deceased parent, spouse, child or dependent (as defined in section 152 without regard to section 152(d)(1)(B)), or for a deceased primary beneficiary under the plan;

(6) Expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under section 165 (determined without regard to section 165(h)(5) and whether the loss exceeds 10% of adjusted gross income); or

(7) Expenses and losses (including loss of income) incurred by the employee on account of a disaster declared by the Federal Emergency Management Agency (FEMA) under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, Pub. L. 100-707, provided that the employee's principal 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.

(C) *Primary beneficiary under the plan.* For purposes of paragraph (d)(3)(ii)(B) of this section, a “primary beneficiary under the plan” is an individual who is named as a beneficiary under the plan and has an unconditional right, upon the death of the employee, to all or a portion of the employee’s account balance under the plan.

(iii) *Distribution necessary to satisfy financial need—(A) Distribution may not exceed amount of need.* A distribution is treated as necessary to satisfy an immediate and heavy financial need of an employee only to the extent the amount of the distribution is not in excess of the amount required to satisfy the financial need (including any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution).

(B) *No alternative means reasonably available.* A distribution is not treated as necessary to satisfy an immediate and heavy financial need of an employee unless each of the following requirements is satisfied—

(1) The employee has obtained all other currently available distributions (including distributions of ESOP dividends under section 404(k), but not hardship distributions) under the plan and all other plans of deferred compensation, whether qualified or nonqualified, maintained by the employer;

(2) The employee has provided to the plan administrator a representation in writing (including by using an electronic medium as defined in §1.401(a)-21(e)(3)), or in such other form as may be prescribed by the Commissioner, that

he or she has insufficient cash or other liquid assets reasonably available to satisfy the need; and

(3) The plan administrator does not have actual knowledge that is contrary to the representation.

(C) *Additional conditions.* A plan generally may provide for additional conditions, such as those described in 26 CFR 1.401(k)-1(d)(3)(iv)(B) and (C) (revised as of April 1, 2019), to demonstrate that a distribution is necessary to satisfy an immediate and heavy financial need of an employee. For example, a plan may provide that, before a hardship distribution may be made, an employee must obtain all nontaxable loans (determined at the time a loan is made) available under the plan and all other plans maintained by the employer. However, a plan may not provide for a suspension of an employee's elective contributions or employee contributions under any plan described in section 401(a) or 403(a), any section 403(b) plan, or any eligible governmental plan described in §1.457-2(f) as a condition of obtaining a hardship distribution.

(iv) *Commissioner may expand standards.* The Commissioner may prescribe additional guidance of general applicability, published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter), expanding the list of distributions deemed to be made on account of immediate and heavy financial needs and setting forth additional methods to demonstrate that a distribution is necessary to satisfy an immediate and heavy financial need.

(v) *Applicability date—(A) General rule.* Except as otherwise provided in this paragraph (d)(3)(v), the rules in this paragraph (d)(3) apply to distributions

made on or after January 1, 2020. For distributions made before January 1, 2020, the rules in 26 CFR 1.401(k)-1(d)(3) (revised as of April 1, 2019) apply.

(B) *Options for earlier application.* The rules in this paragraph (d)(3) may be applied to distributions made in plan years beginning after December 31, 2018, and the last sentence of paragraph (d)(3)(iii)(C) of this section (prohibiting the suspension of contributions as a condition of obtaining a hardship distribution) may be applied as of the first day of the first plan year beginning after December 31, 2018, even if the distribution was made in the prior plan year. Thus, for example, a calendar-year plan that provides for hardship distributions under the rules in 26 CFR 1.401(k)-1(d)(3)(iv)(E) (revised as of April 1, 2019) may be amended to provide that an employee who receives a hardship distribution in the second half of the 2018 plan year will be prohibited from making contributions only until January 1, 2019 (or may continue to provide that contributions will be suspended for the originally scheduled 6 months). In addition, paragraph (d)(3)(ii)(B) of this section (listing distributions deemed to be made on account of an immediate and heavy financial need) may be applied to distributions made on or after a date that is as early as January 1, 2018.

(C) *Certain rules optional in 2019.* If, in accordance with paragraph (d)(3)(v)(B) of this section, the rules in this paragraph (d)(3) are applied to distributions made before January 1, 2020, then the rules in paragraphs (d)(3)(iii)(B)(2) and (3) of this section (relating to an employee representation) and the last sentence of paragraph (d)(3)(iii)(C) of this section (prohibiting the

suspension of contributions as a condition of obtaining a hardship distribution) may be disregarded with respect to such distributions.

* * * * *

Par. 4. Section 1.401(k)-3 is amended by:

1. Revising paragraph (c)(6)(v).

2. Removing the language “, and, in the case of a hardship distribution, suspends an employee’s ability to make elective contributions for 6 months in accordance with §1.401(k)-1(d)(3)(iv)(E)” in the fifth sentence in paragraph (c)(7), *Example 1(i)*.

3. Removing the second sentence in paragraph (j)(2)(iv).

The revision reads as follows:

§1.401(k)-3 Safe harbor requirements.

* * * * *

(c) * * *

(6) * * *

(v) *Restrictions due to limitations under the Internal Revenue Code.* A

plan may limit the amount of elective contributions made by an eligible employee under a plan--

(A) Because of the limitations of section 402(g) or 415;

(B) Due to a suspension under section 414(u)(12)(B)(ii); or

(C) Because, on account of a hardship distribution made before January 1, 2020, an employee's ability to make elective contributions has been suspended for 6 months.

* * * * *

§1.401(k)-6 [Amended]

Par. 5. Section 1.401(k)-6 is amended by:

1. Removing the fourth sentence in paragraph (2) of the definition of *Eligible employee*.
2. Removing the language “, except as provided otherwise in §1.401(k)-1(c) and (d),” in the definitions of *Qualified matching contributions (QMACs)* and *Qualified nonelective contributions (QNECs)*.

Par. 6. Section 1.401(m)-3 is amended by revising paragraph (d)(6)(v) to read as follows:

§1.401(m)-3 Safe harbor requirements.

* * * * *

(d) * * *

(6) * * *

(v) *Restrictions due to limitations under the Internal Revenue Code.* A plan may limit the amount of contributions made by an eligible employee under a plan-

(A) Because of the limitations of section 402(g) or section 415;

(B) Due to a suspension under section 414(u)(12)(B)(ii); or

(C) Because, on account of a hardship distribution made before January 1, 2020, an employee's ability to make contributions has been suspended for 6 months.

* * * * *

Kirsten Wielobob,
Deputy Commissioner for Services and Enforcement.

Approved: September 5, 2019.

David J. Kautter,
Assistant Secretary of the Treasury (Tax Policy).

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