

Clarification on Hardships

A Segment in Our Retirement Rescue Series

The Internal Revenue Service issued guidance on hardship withdrawals in the form of memo to IRS employees who audit employer-sponsored retirement plans. While this memo is not directed at Plan Sponsors, it clarifies what is expected of them with regard to hardship withdrawals.

Does your Plan need to be rescued?

Memo to Employee Plans Auditors

In the memo, the IRS gives audit employees guidelines to use in employee plan examination where a hardship withdrawal is being reviewed. In the examination, the auditor will examine whether the hardship distribution is “deemed to be on account of an immediate and heavy financial need”, as dictated by Internal Revenue Code. This memo is not changing the current law but providing clarification where there previously was none.

Immediate & Heavy Financial Need

If allowed by the Plan, hardship withdrawals are given to meet an employee’s immediate and heavy financial need when relief cannot be obtained using other sources reasonably available to the employee. Many times, hardship distributions are limited for specific reasons such as unforeseen medical expenses, the purchase of the employee’s primary residence, or funeral expenses.

Refer to our [401\(k\) Rescue Series](#) for the full list of Safe Harbor reasons for Hardship Withdrawals.

Hardship Distribution Records

The memo directs auditors to take specific steps when determining whether a hardship distribution was made based on an immediate and heavy need. First, the auditor will request source documents, such as contracts or bills, used by the Plan Sponsor when initially determining if a hardship withdrawal is warranted. If source documents are not readily available, the auditor will request a summary of the source documents and determine if the employee was properly notified that he or she must retain the original source documents used. The auditor may request the original source documents from the employee. Using these records, the auditor will determine if the hardship was warranted or if further information is needed.

To further assist auditors in determining if the hardship distribution was needed to fulfill an immediate and heavy need, the IRS included with the [memo](#) a summary of substantiation information based on the reason for the hardship. For Plan Sponsors, this should be seen as a welcome clarification and guideline for future hardship withdrawals.

Iacurci, Greg. IRS guidance on 401(k) hardship withdrawals clarifies uncertain terrain. Investment News. 1 March 2017.
Memorandum for Employee Plans Examination Employees. Department of the Treasury. Internal Revenue Service. 23 February 2017.