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Hardship Withdrawals from Employer-Sponsored Retirement Plans

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In general

Hardship withdrawals are a type of "discretionary" distribution available from certain employer-sponsored retirement plans. Retirement plans aren't required to allow employees to take hardship withdrawals while they are still working for the employer. Consult your plan administrator or your employer's benefits department to find out if hardship withdrawals are available from your plan. If your plan allows this type of withdrawal, to qualify you'll need to clearly demonstrate a financial hardship (as defined below) to justify the withdrawal.

Eligibility requirements for a hardship withdrawal

So, what exactly qualifies as a hardship withdrawal? In a 401(k) plan, you can withdraw your own elective contributions (pre-tax and Roth) if you, your spouse, your dependents, or your plan beneficiary, have an "immediate and heavy financial need."

Whether you have an immediate and heavy financial need depends on the facts and circumstances. However, IRS regulations provide that the following expenses are deemed to satisfy this requirement:

- Certain medical bills for you, your spouse, your children, your other dependents, or your plan beneficiary
- Costs directly related to the purchase of a principal residence for yourself (excluding mortgage payments)
- Post-secondary tuition for you, your spouse, your children, your other dependents, or your plan beneficiary
- Payments necessary to prevent an eviction from or foreclosure of your principal residence
- Burial and funeral expenses for a parent, your spouse, your children, your other dependents, or your plan beneficiary
- Expenses for the repair of damage to your principal residence after certain casualty losses
- Income taxes and/or penalties due on the hardship withdrawal itself

Caution: Your plan does not have to allow hardship distributions on account of all of these events.

A distribution is not considered necessary to satisfy an immediate and heavy financial need if you, your spouse, or your minor children have other resources reasonably available to meet that need. Again, this is a facts and circumstances determination. However, a 401(k) plan is not required to inquire about your other (non-plan) assets if the plan's terms:

- require that you obtain all other available distributions and nontaxable loans under all plans maintained by your employer before you're eligible to take a hardship withdrawal, and
- provide that your ability to contribute to the 401(k) plan, and all other deferred compensation plans maintained by your employer, is suspended for at least six months.

Tip: Most 401(k) plans follow this "safe harbor" rule, and do not require you to disclose your other assets to the plan administrator.

Section 403(b) plans generally follow the same rules as 401(k) plans. Somewhat different rules apply to Section 457(b) and nonqualified deferred compensation plans. Under these plans, a hardship distribution can occur only if you are faced with an unforeseeable emergency. An unforeseeable emergency is a severe financial hardship resulting from an illness or accident, loss of property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of you or your beneficiary. Examples of unforeseeable emergencies include imminent foreclosure on, or eviction from, your home, medical expenses, and funeral expenses. A distribution is not on account of an unforeseeable emergency to the extent your need can be relieved through insurance reimbursement, liquidation of your assets, or by stopping deferrals to the plan.

> **Tip:** Some 401(k) plans allow you to withdraw your elective deferrals and earnings after you attain age 59½. In this case, you would not need to comply with these hardship rules. Review your summary plan description (SPD) or check with your plan administrator.

> **Caution:** Defined benefit and money purchase pension plans can't permit hardship withdrawals.

How much can be distributed as a hardship withdrawal?

You can only withdraw the amount necessary to satisfy your financial need.

In a 401(k) plan, the amount available for hardship withdrawal is equal to the sum or your own elective contributions, pre-tax and Roth, minus any prior hardship withdrawals. Your plan may also allow you to withdraw earnings on your elective contributions that accrued prior to 1989, but earnings that accrued after 1988 are not available for hardship withdrawal.

Your plan may also allow you to withdraw your employer's regular matching contributions and profit-sharing contributions on account of hardship. However, the rules governing these hardship withdrawals may be different from the rules governing the withdrawal of your elective deferrals.

> **Caution:** "Qualified nonelective contributions" and "qualified matching contributions" (special contributions made by an employer to help meet 401(k) plan nondiscrimination requirements) are not available for hardship withdrawal.

Advantages of taking a hardship withdrawal

If you are in a difficult financial situation and have nowhere else to turn, a hardship withdrawal may be your only source of available funds.

Disadvantages of taking a hardship withdrawal

A hardship withdrawal is generally treated as a taxable distribution to you and, if you aren't age 59½ or older, the 10 percent federal premature distribution tax (and perhaps a state penalty) may also apply (certain exceptions are available). See "Income tax consequences of a hardship withdrawal" below.

As indicated earlier, when you take a hardship distribution of your elective contributions from a 401(k) plan, you generally can't make an additional elective contribution (pre-tax or Roth) or after-tax contribution to your 401(k) plan, or to any other deferred compensation plan maintained by your employer (qualified and nonqualified) for a minimum of six months after the hardship withdrawal is taken, depending on the specific provisions of your plan.

The funds you withdraw from your plan account are no longer part of your tax-deferred retirement plan. This hardship withdrawal will reduce the size of your plan balance, and the funds you withdraw will miss out on further tax-deferred growth in the plan. This means that a large hardship withdrawal could jeopardize your ability to reach your retirement goals.

You can't roll over hardship withdrawals.

How hardship withdrawals differ from plan loans

If you are eligible to take a loan from your retirement plan, there is generally an easy qualification process (in fact, qualification is often automatic). With a hardship withdrawal, though, you must establish that you have an immediate and heavy financial need, and meet the specific requirements set out in your employer's plan. Some plans don't permit hardship withdrawals (or loans) at all.

Plan loans have to be repaid to avoid income tax and possible penalties on the amount borrowed. A hardship withdrawal is generally subject to federal (and possibly state) income tax for the year in which you receive the distribution. In addition, the distribution may be subject to a 10 percent federal penalty (and perhaps a state penalty) if you are under age 59½. You are generally not permitted to repay a hardship withdrawal to avoid taxes and/or penalties on it.

How to get a hardship withdrawal

There are five main steps that you must follow to take a hardship withdrawal:

1. Determine how much money you need, and whether there is any other reasonable source available to meet your need.
2. Check with your plan administrator to find out if your plan allows hardship withdrawals, the requirements to qualify for such a withdrawal, and the maximum amount you can withdraw.
3. Request a hardship withdrawal from your plan administrator. The procedure varies from plan to plan, so check with your plan administrator on how to apply for a hardship withdrawal from your plan.
4. Get your spouse's consent, if necessary. Ask your plan administrator if your spouse's consent is required for you to take a hardship withdrawal from your plan.
5. Pay any income tax and/or penalties due on the hardship withdrawal. You will typically do this when you file your federal and state income tax returns for the year of the withdrawal.

Income tax consequences of a hardship withdrawal

As discussed, a hardship withdrawal is generally treated as taxable income to you for federal (and possibly state) income tax purposes. In addition, if you aren't at least age 59½, the 10 percent federal premature distribution tax (and perhaps a state penalty) may apply (certain exceptions are available). The tax consequences of a hardship withdrawal from a Roth 401(k) or Roth 403(b) account depend on whether your distribution is qualified or nonqualified. Before taking a hardship withdrawal, it's best to consult a tax advisor regarding the income tax implications.

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