

MEMO# 30606

February 27, 2017

IRS Issues Exam Guidelines for Substantiation of 401(k) Plan Hardship Distributions

[30606] February 27, 2017 TO: ICI Members SUBJECTS: Pension RE: IRS Issues Exam Guidelines for Substantiation of 401(k) Plan Hardship Distributions

The IRS has posted new [guidance](#), in the form of a memorandum to examiners, setting forth substantiation guidelines for determining whether a 401(k) plan hardship distribution is on account of an immediate and heavy financial need (pursuant to the safe harbor standards in Treas. Reg. §1.401(k)-1(d)(3)(iii)(B)).^[1] The guidance stems from plan sponsor and service provider concerns over prior informal statements by the IRS that plan sponsors should keep documentation substantiating immediate and heavy financial need, and that electronic self-certification (by the participant) of the nature of a hardship is not sufficient.^[2] In light of these concerns, the ICI previously asked the IRS to clarify the status of this informal guidance.^[3] More recently, ICI and other organizations met with representatives from the IRS and Treasury Department and submitted a letter explaining our concerns and recommending that certain commonly-used substantiation practices be permitted in any forthcoming guidance.^[4]

The new exam guidelines are helpful in that they clarify that examiners are not required to ask for copies of source documentation to substantiate the hardship. The guidelines describe as an acceptable practice for the employer or “third-party administrator” (presumably referring to any service provider administering hardship distributions) to obtain either source documentation or a summary of the information contained in source documents. Such a summary could be in paper format, electronic format, or telephone records.

An attachment to the memorandum outlines specific information the IRS examiner should look for if the employer or third-party administrator relies on a summary of the information in source documents, including information required for all hardship requests and specific information relevant for particular types of hardships. The attachment also states that an employer or administrator relying on a summary (instead of source documents) must provide the employee with the following notifications:

- The hardship distribution is taxable and additional taxes could apply.
- The amount of the distribution cannot exceed the immediate and heavy financial need.

- Hardship distributions cannot be made from earnings on elective contributions or from QNEC or QMAC accounts, if applicable.
- The recipient agrees to preserve source documents and to make them available at any time, upon request, to the employer or administrator.

If the examiner finds that the information in the summary or employee notification is incomplete, the examiner may ask for source documents from the employer or third-party administrator.

In addition, the guidelines specify that if a third-party administrator relies on a summary of information from source documents, the examiner should determine whether the third-party administrator provides a report or other access to data to the employer, at least annually, describing the hardship distributions made during the plan year.

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endnotes

[1] The memorandum is available here:
<https://www.irs.gov/pub/foia/ig/spder/tege-04-0217-0008.pdf>. It will be published in the Internal Revenue Manual at section 4.72.2.

[2] These statements appeared in a 2015 newsletter (see https://www.irs.gov/pub/irs-tege/eptn_2015_4.pdf) despite a lack of formal guidance on the topic.

[3] See ICI Memorandum No. 29913, dated May 16, 2016. *Available at* https://www.ici.org/my_ici/memorandum/memo29913.

[4] See ICI Memorandum No. 30463, dated December 7, 2016. *Available at* https://www.ici.org/my_ici/memorandum/memo30463.