

403(b) Tax Sheltered Annuities Administrative Policy Regarding Hardship Withdrawals

Quoting from the answer to Question 10:55 in the 403(b) Answer Book, Fifth Edition, 2000, Panel Publishers:

“There are no regulations or other guidance dealing with hardship distributions from Section 403(b) contracts. However, legislative history expressed the intent that hardship be the same for Sections 403(b) and 401(k) plans, so the standards in the Section 401(k) regulations should apply. Under these rules, two tests must be met before a hardship distribution may be made. The participant must have an immediate and heavy financial need and the distribution must be necessary to satisfy the financial need.”

All citations in the **Hardship Distributions** section of the above reference text are to Treas. Reg. 1.401(k)-1(d), the complete text of which appears below. However, especially pertinent explanations from the reference text are quoted first:

“*Test 1.* The hardship distribution must result from an immediate and heavy financial need of the participant.

Test 2. The distribution must be necessary to satisfy the financial need. This requires a showing that (a) the amount of the distribution does not exceed the amount required to relieve the participant’s financial need and (b) such need may not be satisfied from other resources reasonably available to the participant. This test can be met in one of two ways at the employer’s option.

Employee’s Representation. The employee represents that the need cannot be satisfied from certain resources [Treas. Reg. 1.401(k)-1(d)(2)(iii)(B)]. The representation would usually take the form of a certification, with the employee attesting to the facts.

Safe Harbor. The employer relies on the safe harbor for distributions deemed necessary to satisfy financial need [Treas. Reg. 1.401(k)-1(d)(iv)(B)].”

The policy of this District is to assume that the employee will use the Employee’s Representation approach to demonstrating that a hardship distribution is justified, submitting the associated certification directly to the Service Provider that is to make the hardship distribution. Hence, a plan participant must submit a signed certification to the Service Provider in accord with Treas. Reg. 1.401(k)-1(d)(2)(iii)(B). The employee’s representation must state that the need cannot be relieved by: insurance; reasonable liquidation of the employee’s assets; cessation of elective deferrals to the plan; or other distributions or loans from the employer’s plan(s) or a commercial loan.

Treas. Reg. 1.401(k)-1(d)(2)

(2) Rules applicable to hardship distributions -- (i) Distribution must be on account of hardship. A distribution is treated as made after an employee's hardship for purposes of paragraph (d)(1)(ii) of this section only if it is made on account of the hardship. For purposes of this rule, a distribution is made on account of hardship only if the distribution both is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the financial need. The determination of the existence of an immediate and heavy financial need and of the amount necessary to meet the need must be made in accordance with nondiscriminatory and objective standards set forth in the plan. See section 411(d)(6) and the regulations thereunder.

(ii) Limit on distributable amount. For plan years beginning after December 31, 1988, a distribution on account of hardship must be limited to the distributable amount. The distributable amount is equal to the employee's total elective contributions as of the date of distribution, reduced by the amount of previous distributions on account of hardship. If the plan so provides, the employee's total elective contributions used in determining the distributable amount may be increased by income allocable to elective contributions, by amounts treated as elective contributions under paragraph (b)(5) of this section, and by income allocable to amounts treated as elective contributions. The distributable amount may only include amounts that were credited to the employee's account as of a date specified in the plan that is no later than December 31, 1988, or if later, the end of the last plan year ending before July 1, 1989 (or such later date provided in paragraph (h) of this section).

(iii) General hardship distribution standards -- (A) Immediate and heavy financial need. Whether an employee has an immediate and heavy financial need is to be determined based on all relevant facts and circumstances. Generally, for example, the need to pay the funeral expenses of a family member would constitute an immediate and heavy financial need. A distribution made to an employee for the purchase of a boat or television would generally not constitute a distribution made on account of an immediate and heavy financial need. A financial need may be immediate and heavy even if it was reasonably foreseeable or voluntarily incurred by the employee.

(B) Distribution necessary to satisfy financial need. A distribution is not treated as necessary to satisfy an immediate and heavy financial need of an employee to the extent the amount of the distribution is in excess of the amount required to relieve the financial need or to the extent the need may be satisfied from other resources that are reasonably available to the employee. This determination generally is to be made on the basis of all relevant facts and circumstances. For purposes of this paragraph, the employee's resources are deemed to include those assets of the employee's spouse and minor children that are reasonably available to the employee. Thus, for example, a vacation home owned by the employee and the employee's spouse, whether as community property, joint tenants, tenants by the entirety, or tenants in common, generally will be deemed a resource of the employee. However, property held for the employee's child under an irrevocable trust or under the Uniform Gifts to Minors Act is not treated as a resource of the employee. The amount of an immediate and heavy financial need may include any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution. A distribution generally may be treated as necessary to satisfy a financial need if the employer relies upon the employee's written representation, unless the employer has actual knowledge to the contrary, that the need cannot reasonably be relieved:

- (1) Through reimbursement or compensation by insurance or otherwise;
- (2) By liquidation of the employee's assets;
- (3) By cessation of elective contributions or employee contributions under the plan; or
- (4) By other distributions or nontaxable (at the time of the loan) loans from plans maintained by the employer or by any other employer, or by borrowing from commercial sources on reasonable commercial terms, in an amount sufficient to satisfy the need. For purposes of this paragraph (d)(2)(iii)(B), a need cannot reasonably be relieved by one of the actions listed above if the effect would be to increase the amount of the need. For example, the need for funds to purchase a principal residence cannot reasonably be relieved by a plan loan if the loan would disqualify the employee from obtaining other necessary financing.

(iv) Deemed hardship distribution standards -- (A) Deemed immediate and heavy financial need. A distribution is deemed to be on account of an immediate and heavy financial need of the employee if the distribution is for:

- (1) Expenses for medical care described in section 213(d) previously incurred by the employee, the employee's spouse, or any dependents of the employee (as defined in section 152) or necessary for these persons to obtain medical care described in section 213(d);
- (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 the next 12 months of post-secondary education for the employee, or the employee's spouse, children, or dependents (as defined in section 152); or
- (4) Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence.

(B) Distribution deemed necessary to satisfy financial need. A distribution is deemed necessary to satisfy an immediate and heavy financial need of an employee if all of the following requirements are satisfied:

- (1) The distribution is not in excess of the amount of the immediate and heavy financial need of the employee. The amount of an immediate and heavy financial need may include any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution.
- (2) The employee has obtained all distributions, other than hardship distributions, and all nontaxable (at the time of the loan) loans currently available under all plans maintained by the employer.
- (3) The plan and all other plans maintained by the employer limit the employee's elective contributions for the next taxable year to the applicable limit under section 402(g) for that year minus the employee's elective contributions for the year of the hardship distribution.
- (4) The employee is prohibited, under the terms of the plan or an otherwise legally enforceable agreement, from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 6 months after receipt of the hardship distribution. For this purpose the phrase "all other plans maintained by the employer" means all qualified and nonqualified plans of deferred compensation maintained by the employer. The phrase includes a stock option, stock purchase, or similar plan, or a cash or deferred arrangement that is part of a cafeteria plan within the meaning of section 125. However, it does not include the mandatory employee contribution portion of a defined benefit plan. It also does not include a health or welfare benefit plan, including one that is part of a cafeteria plan within the meaning of section 125. See § 1.401(k)-1(g)(4)(i) for the continued treatment of suspended employees as eligible employees.

(C) Commissioner may expand standards. The Commissioner may expand the list of deemed immediate and heavy financial needs and may prescribe additional methods for distributions to be deemed necessary to satisfy an immediate and heavy financial need only in revenue rulings, notices, and other documents of general applicability, and not on an individual basis.