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NEW RETIREMENT DISTRIBUTION RULES FOR HARDSHIP CASES

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IRS recently relaxed rules on payouts for **hardship or unforeseen financial emergency**, as mandated by the Pension Protection Act of 2006.

Background on hardship distributions. Distributions from a qualified cash or deferred arrangement (CODA) such as a 401(k) plan, a Code Sec. 403(b) tax-sheltered annuity, a Code Sec. 457 plan, or a nonqualified deferred compensation plan under Code Sec. 409A cannot be made before the occurrence of one or more specified events. For Code Sec. 401(k) plans or Code Sec. 403(b) tax-sheltered annuities, one of these events is a **hardship**. For Code Sec. 457 plans and nonqualified deferred compensation plans subject to Code Sec. 409A, one of these events is an **unforeseeable emergency**. Under regs issued before the enactment of the Pension Protection Act, a hardship or unforeseeable emergency sometimes includes a hardship or unforeseeable emergency of a participant's spouse or dependent.

A distribution is made on account of **hardship** only if the distribution is both

1. Made on account of an **immediate and heavy financial** need of the employee (participant) and
2. Is necessary to satisfy the financial need.

A distribution is on account of an **immediate and heavy financial need if made for:**

1. Expenses for **medical care** which includes expenses for the care of a spouse or dependent;
2. Costs directly related to the **purchase of a principal residence** (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, or the employee's spouse, children, or dependents;
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, children or dependents; or
6. Expenses for the **repair of damage to the employee's principal residence** that would qualify for casualty deduction.

Hardship distributions of elective contributions are permitted for medical, tuition, and funeral expenses for a **primary beneficiary**. For this purpose, a "primary beneficiary" under the plan is someone who:

1. Is named as a beneficiary under the plan; and
2. Has an unconditional right to all or part of the participant's account balance under the plan upon the participant's death.

New law changes. The new law provides that hardship or unforeseeable emergency rules also cover participant's **spouse or dependent**. Beneficiaries could include relatives of the participant who are not his dependents, e.g., **nephews, nieces, cousins**, etc. They could also include individuals who are not related to the participant at all.