



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
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MEMORANDUM FOR EMPLOYEE PLANS (EP) EXAMINATIONS EMPLOYEES

FROM: Thomas J. Petit /s/ *Thomas J. Petit*
Acting Director, EP Examinations

SUBJECT: Substantiation Guidelines for Safe-Harbor Hardship Distributions from
Section 401(k) Plans

This memorandum sets forth substantiation guidelines for EP Examinations employees examining whether a section 401(k) plan hardship distribution is “deemed to be on account of an immediate and heavy financial need” under safe-harbor standards set out in § 1.401(k)-1(d)(3)(iii)(B) of the Income Tax Regulations. This memorandum does not address substantiation of non-safe-harbor distributions under § 1.401(k)-1(d)(3)(iii)(A) of the Income Tax Regulations.

This is not a pronouncement of law and is not subject to use, citation, or reliance as such. Nothing herein shall affect the operation of any other provision of the Internal Revenue Code, regulations, or guidance thereunder.

Background

Generally, section 401(k) plans may provide that an employee can receive a distribution of elective contributions from the plan on account of hardship. A distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the financial need. § 1.401(k)-1(d)(3)(i) of the Income Tax Regulations.

“A distribution is deemed to be on account of an immediate and heavy financial need” under § 1.401(k)-1(d)(3)(iii)(B) of the Income Tax Regulations if it is for one or more of the following:

1. Expenses for medical care deductible under section 213(d) for the employee or the employee’s spouse, children or dependents (as defined in section 152) or primary beneficiary under the plan;
2. Costs directly related to the purchase of a principal residence;

3. Payment of tuition, related educational fees, 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 (as defined in section 152) or primary beneficiary under the plan;
4. Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure of the mortgage on that residence;
5. Payments for burial or funeral expenses for the employee's deceased parents, spouse, children or dependents (as defined in section 152) or primary beneficiary under the plan; or
6. Expenses for the repair of damages to the employee's principal residence that would qualify for the casualty deduction under section 165.

Substantiation that a distribution is for one of the above items is required to determine that a hardship distribution is deemed to be on account of an immediate and heavy financial need.

Administrative Guidelines

If during an examination, you are reviewing distributions to determine whether they are made on account of a deemed immediate and heavy financial need, you should take the steps described below.

Step 1.

- (i) Determine whether the employer or third-party administrator, prior to making a distribution, obtains: (a) source documents (such as estimates, contracts, bills and statements from third parties); or (b) a summary (in paper, electronic format, or telephone records) of the information contained in source documents.
- (ii) If a summary of information on source documents is used, determine whether the employer or third-party administrator provides the employee notifications required on Attachment I prior to making a hardship distribution.

Step 2.

- (i) If the employer or third-party administrator obtains source documents under Step 1(i)(a), review the documents to determine if they substantiate the hardship distribution.
- (ii) If the employer or third-party administrator obtains a summary of information on source documents under Step 1(i)(b), review the summary to determine whether it contains the relevant items listed on Attachment I.
- (iii) If the notification provided to employees in Step 1(ii) or the information reviewed in Step 2(ii) is incomplete or inconsistent on its face, you may

ask for source documents from the employer or third-party administrator to substantiate that a hardship distribution is deemed to be on account of an immediate and heavy financial need.

- (iv) If the summary of information reviewed in Step 2(ii) is complete and consistent but you find employees who have received more than 2 hardship distributions in a plan year, then, in the absence of an adequate explanation for the multiple distributions and with managerial approval, you may ask for source documents from the employer or third-party administrator to substantiate the distributions. Examples of an adequate explanation include follow-up medical or funeral expenses or tuition on a quarterly school calendar.
- (v) If a third-party administrator obtains a summary of information contained in source documents under Step 1(i)(b), 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.

If you determine that all applicable requirements in Step 1 and Step 2 are satisfied, the plan should be treated as satisfying the substantiation requirement for making hardship distributions deemed to be on account of an immediate and heavy financial need.

Effect on Other Documents

This guidance will be incorporated into IRM 4.72.2 by February 23, 2019.

Effective Date

This memo is effective upon the date of issuance, and should be applied to examinations open on the effective date.

For questions regarding this memo, contact Steven Shearer at (615) 250-5069.

Distribution:

<https://www.irs.gov/uac/part-4-examining-process-continued>

Attachment I

HARDSHIP SUBSTANTIATION INFORMATION AND NOTIFICATIONS FOR SUMMARY OF SOURCE DOCUMENTS

I. Notifications that the Employer/Administrator Must Provide to the Employee

- 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.

II. General Information for All Hardship Requests

- Participant's name
- Total cost of the event causing hardship (for example, total cost of medical care, total cost of funeral/burial expenses, payment needed to avoid foreclosure or eviction)
- Amount of distribution requested
- Certification by the participant that the information provided is true and accurate

III. Specific Information on Deemed Hardships

A. Medical Care

- Who incurred the medical expenses (name)?
- What is the relationship to the participant (self, spouse, dependent, or primary beneficiary under the plan)?
- What was the purpose of the medical care (not the actual condition but the general category of expense, for example, diagnosis, treatment, prevention, associated transportation, long-term care)?
- Name and address of the service provider (hospital, doctor/dentist/chiropractor/other, pharmacy)
- Amount of medical expenses not covered by insurance

B. Purchase of Principal Residence

- Will this be the participant's principal residence?
- Address of the residence
- Purchase price of the principal residence
- Types of costs and expenses covered (down-payment, closing costs and/or title fees)
- Name and address of the lender

- Date of the purchase/sale agreement
- Expected date of closing

C. Educational Payments

- Who are the educational payments for (name)?
- What is the relationship to the participant (self, spouse, child, dependent, or primary beneficiary under the plan)?
- Name and address of the educational institution
- Categories of educational payments involved (post-high school tuition, related fees, room and board)
- Period covered by the educational payments (beginning/end dates of up to 12 months)

D. Foreclosure/Eviction from Your Principal Residence

- Is this the participant's principal residence?
- Address of the residence
- Type of event (foreclosure or eviction)
- Name and address of the party that issued the foreclosure or eviction notice
- Date of the notice of foreclosure or eviction
- Due date of the payment to avoid foreclosure or eviction

E. Funeral and Burial Expenses

- Name of the deceased
- Relationship to the participant (parent, spouse, child, dependent, or primary beneficiary under the plan)
- Date of death
- Name and address of the service provider (cemetery, funeral home, etc.)

F. Repairs for Damage to Principal Residence

- Is this the participant's principal residence?
- Address of the residence that sustained damage
- Briefly describe the cause of the casualty loss (fire, flooding, type of weather-related damage, etc.), including the date of the casualty loss
- Briefly describe the repairs, including the date(s) of repair (in process or completed)