Hardship Withdrawal Provisions

You can remember the potentially eligible hardship withdrawal expenses by the saying, "**My disastrously faulty emergency fund**." "My" for **M**edical and funeral expenses (unreimbursed). "Disastrously" for federally declared **D**isasters. "Faulty" for "**F**irst home buying" in the sense of purchasing a primary residence. This is NOT the same definition as a first-time home buyer for exceptions to the 10% early withdrawal penalty for IRAs. Also hardship withdrawals can only be used for a primary/first residence - never a second home. "Emergency" for **E**ducation (higher education) expenses. These higher education expenses can be for the employee, the spouse, the employee's children, the employee's dependents or a beneficiary. The qualified educational expenses include tuition and related educational fees plus room and board. These educational expenses must occur within 12 months of the distribution. "Fund" for **F**oreclosure of the primary home. Foreclosures on a second/vacation home do not count.

Hardship withdrawals can be thought of as "**My disastrously faulty emergency fund**" because they should not be thought of as the emergency fund at all. However, hardship withdrawals are often used when a true emergency fund had not been established. Hardship withdrawals are not a proper emergency fund because they are taxed and penalized. Worst still, the principal and the forgone earnings will not be available for retirement.

Hardship withdrawals are limited to the amount needed to pay the applicable expense plus the income taxes on the withdrawal.

Next, unreimbursed medical expenses are not exactly the same as deductible medical expenses. Hardship withdrawals are available for unreimbursed medical expenses whether or not they rise to the amount relative to AGI that allows some of the expenses to be deducted. On the other hand, the requirement that a financial need be "immediate and heavy" means low level, routine unreimbursed medical expenses do not qualify. The plan administrator should say no to a hardship withdrawal for only a $100 deductible payment or a $20 copay. In other words, a small expense or two is not an immediate and heavy financial need. However, a lot of small expenses could add with large expenses to make the overall unreimbursed medical expenses an immediate and heavy financial need.

Next, hardship withdrawals are actually a plan document issue. Retirement plans are not required by law to offer hardship withdrawals. In fact, if hardship withdrawals are allowed, the plan has the ability to include or exclude any of the four reasons. These four reasons are simply withdrawal methods the IRS has permitted in the past and therefore should be thought as being like safe harbor provisions for hardship withdrawals.

Finally, disaster withdrawals have several unique aspects. First, the employee must be a qualified individual for COVID-19. That means the person must meet one of these rules:

1. He was diagnosed with SARSCoV-2 or COVID-19 by a test approved by the Center for Disease Control and Prevention.

2. Whose spouse or dependent was diagnosed by such a test.

3. Who has experienced adverse financial consequences as a result of being quarantined, furloughed or laid off or having work hours reduced due to