February 7, 2018

Hardship Availability Due to Modification of Deduction for Personal Casualty Losses Under the Tax Cuts and Jobs Act

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In general, the Internal Revenue Service's hardship distribution regulations provide that a hardship distribution may only be made on account of a participant's immediate and heavy financial need. This "immediate and heavy financial need" for hardship withdrawals has certain requirements that include medical, education, funeral, home purchase, foreclosure prevention and casualty loss. Previously, casualty loss allowed for *"Expenses for the repair of damage to the employee's principal residence that would qualify for the casualty deduction under section 165"* (this generally included property losses that were not covered by insurance for storms, fires and other like casualties).

The recently enacted tax reform legislation, commonly referred to as the Tax Cut and Jobs Act, made a change to the types of personal casualty losses that qualify for a casualty deduction under Section 165 of the Internal Revenue Code. This temporary change, applicable to tax years 2018-2025, affects plans that permit hardship distributions to their participants as they are no longer allowed hardship withdrawals unless the casualty loss is credited to a disaster area declared by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

It is still unclear as to whether or not that this provision was meant to affect hardship withdrawals from 401(k) plans or if it was a consequence not intended. However, the existing regulations and statute language indicate that the previous qualification for principal residence casualty damage has been excluded unless in a disaster area declared by the federal government. Plan Sponsors need to look for future guidance and developments regarding this type of withdrawal provision.

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