# The Hardship Distribution

*When plan participants are hard-pressed for money, sometimes they'll turn to their retirement savings. What will that mean come retirement?*

There are countless reasons why a plan participant would feel they need to take money out of their retirement savings – funeral expenses, emergencies, children defaulting on college loans, they can't get loans at affordable rates, they don't qualify for loans … the list goes on.

Yet what may seem like a good option at the time will most likely become a very bad decision when those same plan participants head off to retirement. A withdrawal from a retirement savings account can be fraught with caveats that could cost your plan participant more in the long run, particularly at retirement time when the money is sorely needed.

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Also, what many plan participants don't understand is that retirement plans are not required to provide hardship distributions. If the plan provides for elective deferrals, hardship distributions are allowed; a 401(k) plan is an example of a plan that allows for withdrawals under a hardship claim.

In fact, the Pension Protection Act of 2006 provides that employee's needs could also include needs of a non-spouse or non-dependent beneficiary. Even so, plan participants must meet the criteria for such a distribution, particularly under 401(k), 403(b) and 457(b) plans.

According to the IRS website, a hardship is defined as "certain expenses are deemed to be immediate and heavy, including: (1) certain medical expenses; (2) costs relating to the purchase of a principal residence; (3) tuition and related educational fees and expenses; (4) payments necessary to prevent eviction from, or foreclosure on, a principal residence; (5) burial or funeral expenses; and (6) certain expenses for the repair of damage to the employee's principal residence."

Even if your plan participant qualifies, such a distribution is subject to taxes as the amount is considered earnings.  Also, there could be additional 10% tax on early distributions depending on the plan.

Yet the most important point for your plan participants to understand is this: hardship distributions are not repaid. If your participant takes a distribution, it reduces permanently the employee's retirement balance.

**Other Options**

When your plan participant asks about hardship distributions, you as a plan sponsor can discuss alternatives with them. For instance, if your company offers it, a 401(k) loan might be a better solution. Participants can borrow from their own plan with interest, which is also added to the participant's plan. In essence, your participant can pay himself interest on his loan.

Another suggestion might be for participants to seek a personal loan. Repaying a personal loan will keep the retirement fund intact and allow the participant to cover most hardship expenses.

A less attractive option would be for the participant to consider bankruptcy protection. If the need is dire and significant, this could be an option that would preserve the participant's retirement accounts.

Another option is for the participant to withdraw from a Roth IRA, which is a tax-free, penalty-free alternative. While it's still not *continued ...*

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addressing the underlying issue of not having enough for retirement, it will be a less-expensive option than to withdraw from a fund that attaches taxes and penalties.

What may seem like a good option at the time will most likely become a very bad decision when those same plan participants head off to retirement. Plan sponsors can educate participants on the very real consequences of borrowing from their future, and help them determine if the hardship is viable enough to consider other options.