



Will We Soon See A New Form of 'Hardship Withdrawal' Exception?

Qualified accounts in any form have financial consequences of taking money out of a plan 'too soon'. For example, the magic age of age 59 and ½ has long been the attained age after which a withdrawal from a traditional IRA no longer triggers a possible 10% penalty. For active participants in employer 401k plans, age limitations also exist. The 'too-young' penalty exists to strongly discourage raiding retirement funds for purposes other than retirement.

The clear message from US Treasury to the saver is: find your immediate needs for money elsewhere.

The penalty scenario makes sense when there is viable ability to find funds elsewhere. But in the case of extended periods of unemployment, the need for money continues and a 401k plan or an IRA may be the only asset available to a person when unemployment compensation runs out.

Following the financial crisis back in 2008, when unemployment rose sharply, millions of Americans suffered long periods of unemployment. Many were unemployed for more than two years or more. If the individual was 'too young' and 401k or IRA money was withdrawn, a new type of additional pain was experienced at tax filing time — a 10% penalty. Complaints and appeals to US Treasury provided no relief. The message is clear — economic hardship is no excuse for withdrawing retirement funds without penalty consequences.

Barack Obama's 2016 Budget proposal includes a provision to remedy this harsh penalty treatment resulting from unemployment.

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Under the proposed new form of hardship withdrawal, an unemployed person may withdraw money from an IRA or a 401k plan in the same year or the year after having received 26 weeks of unemployment compensation. The proposal is to allow a withdrawal amount calculated as half the account balance up to a maximum of \$50,000 penalty free. For example, if the 401k plan balance is \$45,000 then \$22,500 may be withdrawn under the proposed exception. To get the full \$50,000 allowed, the account balance must be at least \$100,000.

While this is an Obama proposal, the concept appears to have bi-partisan support in Congress as well.

So what rules will be required to manage this new exception? The rules will need to be defined. The details will undoubtedly require a minimum request amount, what form of documentation is needed to prove compliance of unemployment, whether or not multiple requests may be made over time and how to correct withdrawal requests made in error that need to be later restored – perhaps a grace period concept. At minimum, expect a new code required on 1099R reporting.

This humane and reasonable idea is long overdue. It will, however, have administrative processing and reporting consequences for 401k recordkeeping. So be prepared to plan for this in the near future.

*Visit: HamiltonSmithassociates.com or contact:
Dan Smith, President
email: Dan.Smith@hamiltonsmithassociates.com*