401(k) Financial Hardship Withdrawals

What is a 401(k) financial hardship provision?
Your 401(k) plan, through its financial hardship provision, allows an employee to withdraw money from their 401(k) plan for specific reasons defined by the IRS as financial hardships. While each person may have their own definition of what a financial hardship is for them, federal law narrowly defines financial hardship as it relates to your 401(k) plan. Any violation of these federal laws could result in severe tax penalties for the person taking the illegal financial hardship withdrawal and even possible disqualification of the entire 401(k) plan.

What specific events qualify as a "financial hardship?"
The events that qualify under IRS rules as a financial hardship include:

- College education (you or your dependents)
- Medical expenses (you or your dependents)
- Purchase of a primary home
- Prevent foreclosure on your primary home
- Funeral expenses
- Natural catastrophe

Will I have to provide supporting documentation of my hardship?
Yes. Examples of these include but are not limited to copies of escrow instructions, unpaid medical bills, copies of college tuition payments and eviction/foreclosure notices.

Are there any tax consequences for taking a financial hardship withdrawal?
You owe at least three and possibly four different types of taxes on your financial hardship, including federal and state income tax, a 10% federal excise (penalty) tax and possibly a state excise (penalty) tax. Your financial hardship must be added to your annual income for federal and state income reporting purposes. Failure to do so could result in further penalty taxes by the IRS.

How much may I withdraw?
Your withdrawal, if approved, will be limited to the total of the documentation furnished plus the 10% federal excise (penalty) tax. For example, if you qualify for a $10,000 financial hardship withdrawal, you may withdraw $10,000 + $1,000 that will be used to pay the 10% federal excise (penalty) taxes. Only your vested account balance is eligible to be withdrawn for a financial hardship. Stated differently, any employer contributions to your 401(k) plan that are not yet vested are not eligible for a financial hardship withdrawal.

May I still participate in the 401(k) plan after taking a financial hardship withdrawal?
You are suspended from participating (making your own contributions) in the 401(k) plan for six months after receiving a financial hardship withdrawal.

What is the process to request a financial hardship withdrawal?
Before an employee may request a financial hardship withdrawal, you must first attempt to obtain a loan through the loan provision in the 401(k) plan (if applicable). If your plan does not have a loan provision or you already have an outstanding loan or you do not qualify for a loan under the terms of your 401(k) plan, you may then pursue a financial hardship withdrawal. The process to complete a financial hardship application varies with each plan.

Is there anything else I should consider before taking a financial hardship withdrawal?
Although the IRS allows 401(k) financial hardship withdrawals for certain specific reasons, the extremely severe tax ramifications and six-month suspension from the 401(k) plan, should make a financial hardship withdrawal the last resort to obtain money. You are strongly encouraged to consider other methods of borrowing, including bank loans, credit card cash advances, equity home loans and even the 401(k) loan provision (if applicable). Please consult your tax advisor or financial planning professional for advice about the most cost effective way to access money that you need for purposes of meeting your financial hardship needs.