TRANSAMERICA CENTER
FOR RETIREMENT STUDIES℠

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TCRS 2005-03: HURRICANE KATRINA RELIEF

Background

On September 15, the Treasury Department and the Internal Revenue Service (IRS) issued Announcement 2005-70 providing relief to individuals and plan sponsors affected by Hurricane Katrina by relaxing loan and hardship distribution rules and procedures. On the same date, the Department of Labor (DOL) issued additional relief relating to blackout notices and the timing of contributions, withholdings and loan repayments. On September 23, President Bush signed into law the Katrina Emergency Tax Relief Act of 2005 (KETRA) providing much needed relief to individuals, employers, fiduciaries and participants directly affected by Hurricane Katrina in a number of areas, such as employment, taxes, charitable giving and employee benefits. Additionally, Transamerica Retirement Services (TRS) is offering special services and fee waivers to its affected customers. The following are highlights of these three pieces of guidance which affect employee retirement plans and TRS' relief program.

IRS Relief - Announcement 2005-70

This guidance covers counties or parishes in Louisiana, Mississippi or Alabama that have been or are later designated as disaster areas eligible for individual assistance by the Federal Emergency Management Agency (FEMA) because of the devastation caused by Hurricane Katrina.

The relief in the IRS guidance applies to the following plans and arrangements:

- Section 401(a) (including 401(k)), 403(a), 403(b) and 457(b) plans.
- Separate accounts containing after-tax employee contributions or rollover contributions maintained within a money purchase or defined benefit plan.
- IRAs (for distributions only).

Individuals entitled to relief are:

- Employees or former employees whose principal residence and/or place of employment on August 29, 2005 was located in the disaster area.
- Employees or former employees whose lineal ascendant or descendant, dependent or spouse had a principal residence or place of employment on August 29, 2005 located in the disaster area.

Relief for Loans and Hardship Distributions made after August 28, 2005 and before April 1, 2006:

- Plan administrators may rely on an employee's or former employee's representation as to the need for and the amount of the hardship distribution, unless the plan administrator has actual knowledge to the contrary.
- A hardship distribution may be made for any reason resulting from Hurricane Katrina, not just for the reasons listed in the current IRS regulations.
- The amount of a hardship or loan is limited to the maximum amount that would be permitted under current IRS regulations.
- If a plan does not provide for loans or hardship distributions, but would have been permitted to do so under the law, the loan or hardship distribution may nevertheless be made; however, the plan must be amended by the last day of the 2006 plan year.
- The six-month ban from making employee contributions following a hardship distribution is not applicable.
- Certain procedural requirements are disregarded, provided the plan administrator or financial institution (in the case of an IRA distribution) makes a good-faith effort to comply with such procedural requirements and, as soon as practical, makes a reasonable attempt to assemble any forgone documentation.
- Hardship distributions may not be made from Qualified Nonelective Contribution and Qualified Matching Contribution Accounts or from earnings on elective contributions.

DOL Relief

The DOL, in a statement made by EBSA Assistant Secretary Ann L. Combs, provided relief for Hurricane Katrina victims in the following areas:

- Participant Contributions and Loan Repayments; and
- Blackout Notices.

The DOL recognized that some employers and service providers acting on employers' behalf located in the disaster areas will not be able to forward participant payments, contributions and withholdings to the plan within the regulatory prescribed time. In such instances, the DOL will not seek to enforce the deposit requirements with respect to a temporary delay in the forwarding of loan repayments or contributions to the plan. In addition, the DOL will not allege a violation of the blackout notice requirements. However, appropriate efforts must be made by plan sponsors, fiduciaries and service providers to act reasonably, prudently and in the interest of workers and their families under the circumstances.

Katrina Emergency Tax Relief Act of 2005 ("KETRA")

The following is a summary of the employee benefit-related provisions contained in KETRA:

- The 10% early distribution tax penalty for a Qualified Hurricane Katrina Distribution (Qualified Katrina Distribution) is waived.
- A Qualified Katrina Distribution is a distribution from an eligible retirement plan that is made:
    - After August 24, 2005 and before January 1, 2007 **(Note that IRS relief expires on March 31, 2006);**
    - To an individual whose principal abode on August 28, 2005 is located in the Hurricane Katrina disaster area and who has sustained an economic loss as a result of Hurricane Katrina.

    Note that, unlike the IRS relief that allows family members of affected individuals to take hardship distributions, KETRA does not permit family members of affected individuals to take distributions to help a family member located in a disaster area. In addition, KETRA relief is limited to an individual's principal abode in the affected area.
- The maximum Qualified Katrina Distribution that an individual can receive from all plans and IRAs in the aggregate is $100,000.
- Any distribution in excess of $100,000 is not a Qualified Katrina Distribution.
- Income tax liability on a Qualified Katrina Distribution may be spread ratably over the three-year period beginning with the year of distribution.
- Any portion of a Qualified Katrina Distribution may be re-contributed to a plan or IRA during the three-year period after distribution was made. Taxpayers making a re-contribution may file amended returns to claim a refund of the taxes paid.
- Any amounts re-contributed will be treated as a rollover to a plan or IRA.
- Mandatory 20% withholding and distribution notices do not apply to a Qualified Katrina Distribution.
- Loan limits are increased to the lesser of $100,000 or 100% of an individual's vested account balance, but only for loans made after August 24, 2005 and before January 1, 2007.
- Loan repayments due after August 24, 2005 and before January 1, 2007 can be suspended for one year on a new or existing loan. Interest will continue to accrue during the period of suspension.
- Hardship distributions received after February 28, 2005 and before August 29, 2005 for the purchase/construction of a principal residence in the disaster area not completed as a result of Hurricane Katrina can be re-contributed during the period August 25, 2005 through February 28, 2006 to a qualified plan or IRA. The amount re-contributed will be treated as a rollover.
- Plan amendments are generally required by the end of the 2007 plan year, unless extended by the Secretary of the Treasury. In the meantime, plans must comply in operation.

There are a number of issues that require clarification from the IRS, including the mechanics of the re-contribution relief. IRS interpretive guidance on KETRA is expected, which hopefully will address the inconsistencies and overlaps between the IRS guidance and KETRA. Relief similar to KETRA is also expected for victims of Hurricane Rita.

TRS' Response

TRS has identified its customers located in the Hurricane Katrina disaster areas eligible for individual assistance as designated by FEMA. TRS is doing its part to provide relief to affected plan sponsors and participants by offering special services and concessions, and by waiving all billed fees at the plan sponsor and participant level, including quarterly administrative fees and distribution / loan processing fees. TRS is also offering ACH deposit services to those participants requesting emergency funds via hardship or loan withdrawal. These concessions and special services will be in place for a minimum of 6 months.

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