

## **In Response to Recent Hurricanes, Retirement and Welfare Plan Requirements Are Relaxed For Affected Plans and Individuals**

**September 30, 2005**

On September 23, 2005, President Bush signed the Katrina Emergency Tax Relief Act of 2005 (KETRA) into law. As it relates to employee benefit plans, KETRA gives individuals affected by Hurricane Katrina easier access to retirement plan funds and provides relief with respect to certain healthcare-related coverage period issues. This LawFlash summarizes the provisions of KETRA, as well as relevant, ongoing administrative relief provided by the Internal Revenue Service (IRS), the Department of Labor (DOL), and the Pension Benefit Guaranty Corporation (PBGC) for plans and participants affected by Hurricane Katrina and, most recently, Hurricane Rita.

### **KETRA**

KETRA makes it easier for individuals affected by Hurricane Katrina to receive retirement funds, either through distributions or loans.

Distributions: Under KETRA, an individual who receives a so-called “Qualified Hurricane Katrina Distribution” has the following tax relief:

- Distributions are not subject to a 10% penalty that would otherwise be applicable to early withdrawals.
- Distributions are treated as non-rollover distributions. Therefore, they are exempt from the automatic 20% tax withholding, and the recipient may elect out of the 10% tax withholding applicable to non-rollover distributions.
- Distributions are included in the individual’s income ratably over a three-year period, instead of entirely in the year of the distribution.
- Distributions may be repaid within three years to any retirement plan that accepts rollovers. To the extent a distribution is repaid within that period, that amount is not subject to tax, and the individual is entitled to a refund of any tax previously paid.

A “Qualified Hurricane Katrina Distribution” is a distribution or series of distributions of up to \$100,000 from an eligible retirement plan (i.e., a qualified plan, a 403(a) or 403(b) annuity, a governmental 457(b) plan, or an IRA) made between August 25, 2005 and December 31, 2006. The distribution(s) must be to an individual who, on August 28, 2005, had a primary residence in a Hurricane Katrina disaster area and who suffered an economic loss because of Hurricane Katrina.

Loans: KETRA provides two ways to give “qualified individuals” easier access to retirement funds via loans.

- First, the maximum amount available for loans (after taking into account the outstanding balance of other loans) is increased to the lesser of \$100,000 or 100% of the participant’s account, from the current general limit of \$50,000 or 50% of the participant’s account. Note that KETRA does not affect the rule, applicable to ERISA-covered plans (e.g., 401(k) plans), that limits loan security to 50% of the participant’s account balance. Unless the DOL relaxes this rule, plans subject to ERISA will need to obtain security outside of the plan for loans in excess of 50% of an individual’s vested account balance.
- Second, any loan repayment otherwise due from August 25, 2005 through December 31, 2006 is delayed for one year. After the one-year delay, loan repayments will be adjusted to reflect the delayed repayments and unpaid interest, and the loan-repayment term will be extended by one year.

For loan purposes, a “qualified individual” is someone who, on August 28, 2005, had a primary residence in a Hurricane Katrina disaster area and who suffered a loss as a result of Hurricane Katrina.

Distributions for Home Purchase in an Affected Area: KETRA permits individuals to repay all or part of certain distributions received after February 28, 2005 but before August 29, 2005 from a retirement plan for a home purchase or home construction that was not finalized because it was in an area affected by Hurricane Katrina. Repayments are permitted until February 28, 2006.

Amendment Period for KETRA: Retirement plans that operate in compliance with KETRA do not need to be amended until the end of the plan year beginning on or after January 1, 2007 (e.g., for calendar-year plans, amendments are required by December 31, 2007).

### **Other Administrative Relief**

- Relaxed Hardship Distribution and Loan Procedures: The IRS and DOL have made it easier for retirement plans to make hardship distributions and loans on account of Hurricane Katrina. This relief is expansive and is broader than the “qualified individual” concept. It applies to individuals who either principally resided or worked in an area affected by Hurricane Katrina, as well as those whose lineal descendants, spouses, or dependants principally resided in or worked in an affected area. In particular, this relief deems distributions on account of Hurricane Katrina as distributions on account of a hardship (or, for governmental 457(b) plans, on account of an unforeseeable emergency). The relief also suspends the six-month ban on new contributions after a hardship distribution, permitting participants who receive a hardship distribution to resume making new contributions immediately. A plan that does not currently permit loans or hardship distributions can now permit either or both – even if the plan does not currently so provide – so long as the plan is amended by December 31, 2005. *IRS Announcement 2005-70*.
- Minimum Funding Extension: The date for a pension plan affected by Hurricane Katrina to make minimum funding payments (or apply for waivers) has been extended until February 28, 2006. This relief also applies to plans whose provider (e.g., record-keeper or actuary) is located in a disaster area. *KETRA; IRS Notice 2005-60*.

- Claims Procedure Extension: For ERISA-covered plans, the period from August 29, 2005 through January 3, 2006 is disregarded when determining the period during which individuals directly affected by Hurricane Katrina can file claims or appeal adverse benefit determinations. *70 Fed. Reg. 55,500*. The DOL is considering further extending the disregarded period, through February 28, 2006.
- Extension of Deadlines for Those Affected by Both Hurricanes Katrina and Rita: IRS, DOL, and PBGC deadlines are extended for taxpayers affected by Hurricanes Katrina and Rita. This relief most notably applies to:
  - *5500 Filing Extension*: During the applicable relief period, plans in affected areas may postpone filing forms 5500 without penalty until February 28, 2006. This relief also applies to employers unable to obtain information to file because their service providers, banks, or insurance companies were in affected areas. *IR-2005-110; Rev. Proc. § 8 (Item 29)*.
  - *Employment and Excise Taxes*: The deadline for filing employment and excise tax returns and associated payments has been extended until February 28, 2006. This extension does not apply to the filing of information returns in the W-2 or 1099 series. *IR-2005-110; IR-2005-112*.
  - *PBGC Relief*: The PBGC is waiving certain penalties and extending certain deadlines (including premium payments, which will be considered timely if paid on January 3, 2006 for plans affected by Hurricane Katrina, and February 28, 2006 for plans affected by Hurricane Rita). *PBGC Disaster Relief (Hurricane Katrina, Hurricane Rita)*.
- COBRA and HIPAA Relief: The IRS and DOL have issued Katrina-related relief extending certain regulatory time frames with respect to plan participants, beneficiaries and qualified beneficiaries. The period between August 29, 2005 and January 3, 2006 is disregarded with respect to the:
  1. 63-day break in coverage rule under HIPAA;
  2. 30-day period for adding newborn children to health coverage without a preexisting condition exclusion;
  3. 30-day HIPAA special enrollment rule;
  4. 60-day COBRA election period;
  5. due date for COBRA premiums; and
  6. employee notification of a COBRA qualifying event or disability determination.

Related extensions have been granted to group health plans, sponsors, and administrators for distributing HIPAA certificates of creditable coverage and COBRA election notices.

- Leave Donation Programs: IRS Notice 2005-68 allows employees to donate unused vacation, sick, or personal time in exchange for cash payments made by their employer to organizations assisting in the relief of Hurricane Katrina victims. Donated leave does not trigger income to the employee, nor can the employee claim a charitable deduction for the donation. Donations must be made before January 1, 2007.

For more information about KETRA tax relief, click on the link below to read our Law Flash from the Morgan Lewis Tax-Exempt Organizations practice at [www.morganlewis.com/pubs/KatrinaTE.pdf](http://www.morganlewis.com/pubs/KatrinaTE.pdf).

New relief for victims affected by this year's hurricanes is released almost daily. For information about how your benefit plans or participants may be affected, contact the Morgan Lewis attorney with whom you regularly consult or any of the following:

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