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MEMORANDUM TO CLIENTS

Re: **<u>Round-Up of Legislative and Regulatory Relief For Plan Sponsors, Administrators, and Participants and Beneficiaries Affected by Hurricanes Katrina and Rita</u>**

In the wake of Hurricanes Katrina and Rita,

- the Internal Revenue Service (the "Service"), Department of Labor ("DOL") and the Pension Benefit Guaranty Corporation ("PBGC") have issued guidance extending numerous deadlines for specific acts related to pension and employee benefit plans affected by Hurricanes Katrina and Rita, along with certain acts otherwise required to be met by plan participants and beneficiaries adversely affected by both Hurricanes.

- the Service and the DOL announced liberalized hardship procedures and allowed plans that currently do not permit hardship distributions and loans to make such distributions to participants directly affected by Hurricane Katrina.

- the Service issued guidance intended to encourage taxpayers to donate paid leave to charities assisting victims of Hurricane Katrina through employer-provided leave-based donation programs, and

- the President signed into law targeted tax relief measures for those businesses and individuals located in the Hurricane Katrina disaster area, including some pension provisions.

It is important to note that, to date, the majority of guidance issued by the Service, DOL, and PBGC, along with the recently enacted tax relief package, has been limited to

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individuals and businesses affected by Hurricane Katrina. In response to the devastation caused by Hurricane Rita, however, the Service, DOL, and PBGC have recently issued guidance relating exclusively to Rita victims. It is unclear whether any legislative proposals will be advanced extending the relief granted to Katrina victims to those victims of Hurricane Rita.

This memo updates our September 23 memo that focused exclusively on Agency and Congressional activity relating to Hurricane Katrina by detailing Agency guidance relating to Hurricane Rita and clarifying various pieces of Katrina-related guidance that has been issued to date. This memo will also further distinguish the Katrina-related guidance with various provisions included in the Katrina Emergency Tax Relief Act of 2005 ("KETRA"), which was signed into law by the President on September 23 (Pub. L. No. 109-73).

A. Background – Code Section 7508A

1. In General

Generally, Code section 7508A gives the Service the authority to postpone the deadlines for specified acts otherwise required to be met under the Code for taxpayers affected by a Presidentially declared disaster (as defined under Code section 1033(h)(3)). More specifically, Code section 7508A(b) allows the Service to postpone the date on which certain acts by a pension or other employee benefit plan – or by a plan sponsor, administrator, participant, beneficiary or other person – would otherwise be required to be completed. Such specified acts may be postponed for up to 1 year. In addition, a plan is not treated as failing to be operated under the terms of the plan solely as a result of disregarding any period designated by the Service. The DOL and the PBGC have parallel authority to postpone similar deadlines for acts relating to pension and employee benefit plans and plan participants and beneficiaries under ERISA sections 518 and 4002(i).[1]

The legislative history of Code section 7508A(b) lists a number of acts that Congress believed could be postponed by the Service, DOL, and PBGC. Such acts include:

- the filing of a form with the Service, DOL or the PBGC;
- an employer's contribution to the plan of required quarterly amounts for the current year or the prior year minimum funding amounts;
- the filing of an application for a waiver of the minimum funding standard;
- the payment of premiums to the PBGC;
- a participant's election of a form of benefits under a plan;
- the plan administrator's distribution of benefits in accordance with a participant's election;
- notice to an employee of eligibility for continuation coverage under a group health plan (i.e., COBRA coverage); and
- an employee's election of COBRA coverage.

2. <u>Regulations Under Code Section 7508A</u>

The final regulations under Code section 7508A set forth, among other things, a list of certain acts that may be postponed by the Service (Treasury Regulation section

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1 The Department of Health and Human Services ("HHS") was not given statutory authority to extend certain deadlines or waive other administrative or reporting requirements. However, on September 26, Sens. Enzi (R-WY) and Kennedy (D-MA) introduced the "Public Health and Health Insurance Emergency Act" (S. 1769) which would, among other things, allow HHS to waive certain reporting or administrative requirements. Timing of the Act's passage remains unclear.

301.7508A-1). Specifically, Treasury Regulation section 301.7508A-1(c)(1)(iii) permits the Service to postpone the deadline for:

- making contributions to a qualified retirement plan;
- returning contributions made to an individual retirement account ("IRA") to a taxpayer;
- recharacterizing Roth IRA contributions; and
- making rollovers to a tax-qualified retirement plan, a tax-deferred annuity under Code sections 403(a) and 403(b), and an IRA.

The regulations also define several types of "affected taxpayers" eligible for relief under Code section 7508A (Treasury Regulation section 301.7508A-1(d)(1)). Among others, these taxpayers include:

- any individual whose principal residence is located in the covered disaster area;
- any business entity whose principal place of business is located in the covered disaster area;
- any individual whose principal residence, and any business entity whose principal place of business, is not located in the covered disaster area, but whose records necessary to meet a filing or paying deadline are maintained in the covered disaster area;
- any estate or trust that has tax records necessary to meet a filing or paying deadline in a covered disaster area; and
- any other person determined by the IRS to be affected by a Presidentially declared disaster.

3. **Revenue Procedure 2005-27**

Generally, Revenue Procedure 2005-27 expands the list of acts that the Service has determined may be postponed under Code section 7508A. (Revenue Procedure 2005-27 does not, by itself, provide any postponements under Code section 7508A, but supplements the list of acts that may be postponed under Treasury Regulation section

301.7508A-1(c)(1)). It provides that, in the event of a Presidentially declared disaster, the Service, in its discretion, will issue a Notice (or other applicable guidance) authorizing the postponement. Such guidance will describe the acts postponed, the duration of the postponement, and the location of the covered disaster area. The following are employee benefit-related acts that may be postponed (see Section 8 of Revenue Procedure 2005-27):

- plan loan repayments;
- 83(b) elections;
- cafeteria plan elections under Code section 125;
- written requirement for establishing preestablished performance goals under Code section 162(m);
- rollovers to an eligible governmental 457 plan, a Code section 529 plan, a Coverdell Educational Saving Account, or a Medical Savings Account;
- required minimum distribution under Code section 401(a)(9);
- distribution of excess deferrals;
- remedial amendment period;
- distribution of nondeductible contributions in order to avoid 10 percent penalty under Code section 4972;
- filing Form 5500s.

B. Guidance Extending Deadlines In Response to Hurricanes Katrina and Rita

Pursuant to the authority under Code section 7508A and ERISA sections 518 and 4002(i), the Service, DOL, and PBGC have recently issued the following guidance.

1. Extension of Deadlines for Acts Listed Under Treasury Regulation Section 301.7508A-1(c)(1) and Revenue Procedure 2005-27

a. Hurricane Katrina – Deadline and Covered Areas

As reported in our September 23rd memo,[2] the Service has issued a number of IRS news releases extending the deadlines for filing tax returns and submitting tax payments that would otherwise be required to be met on or after August 29, 2005 for taxpayers located in the areas struck by Hurricane Katrina (see IRS News Release 2005-84 (8/30/2005), IRS News Release 2005-91 (9/6/2005), IRS News Release 2005-96 (9/8/2005), and IRS News Release 2005-109 (9/21/2005)). More specifically, these news releases extended the deadlines for all of the employee benefit-related acts listed in Treasury Regulation section 301.7508A-1(c)(1) and Section 8 of Revenue Procedure 2005-27 (see IRS News Release 2005-84 (8/30/2005) and related link at, <http://www.irs.gov/newsroom/article/0,,id=147055,00.html> and <http://www.irs.gov/newsroom/article/0,,id=141489,00,html>).[3]

Most recently, the Service issued IRS News Release 2005-112 (9/28/2005) which extends the deadline for these acts to February 28, 2006, implementing the Katrina Tax Relief legislation summarized below. In other words, the due date for the employee

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2 See, http://www.groom.com/_library/downloads/memotoclients-katrinareliefv4.pdf.

3 IRS News Release 2005-84 was the first public announcement extending these deadlines. Although subsequent news releases do not explicitly refer to the acts listed in Treasury Regulation section 301.7508A-1(c)(1) and Section 8 of Revenue Procedure 2005-27, the extensions announced in these releases concurrently apply to such acts.

benefit-related acts listed in the treasury regulations and revenue procedure is February 28, 2006 (i.e., those acts otherwise required to be met on or after August 29, 2005 must now be met by February 28, 2006 (for Florida affected taxpayers, the period is August 24, 2005 to February 28, 2006)).

The multiple news releases issued by the Service not only extended the deadlines for certain acts, but also expanded the areas to which the extensions apply. The most detailed pieces of guidance that identify the areas covered by the relief are Notice 2005-73 and IRS News Releases 2005-109, each issued on September 21 (see also, IRS News Release 2005-112 (9/28/2005)). The Notice and the news releases distinguish between the areas that will receive automatic relief and those areas where persons are required to identify themselves as Hurricane victims before they may be afforded such relief.

Specifically, the Service indicated that those areas hardest hit by Hurricane Katrina have been designated "Individual Assistance" areas by FEMA.[4] These areas will receive automatic tax relief, including the automatic postponement of all employee benefit-related acts listed in Treasury Regulation section 301.7508A-1(c)(1)(iii) and Section 8 of Revenue Procedure 2005-27. In those areas where damage from Katrina is more isolated (i.e., those areas designated for "Public Assistance" by FEMA),[5] taxpayers

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[4] Areas designated by FEMA for "Individual Assistance" include 31 parishes in Louisiana, 47 counties in Mississippi, and 10 counties in Alabama. See IRS News Releases 2005-109 and 2005-112 and Notice 2005-73 for a comprehensive list.

[5] Areas designated by FEMA for "Public Assistance" include 33 parishes in Louisiana, 35 counties in Mississippi, 12 counties in Alabama, and 11 counties in

will need to identify themselves as Hurricane victims if and when the Service questions whether they are subject to any penalty taxes or interest for failure to meet the otherwise required employee benefit-related deadlines. Significantly, while the Service has not explicitly granted relief for taxpayers located outside of the affected areas but whose books, records, or tax professionals are located in areas affected by Katrina, the Service indicated that it will work with such taxpayers in determining whether they would be eligible for relief (i.e., whether they will be able to disregard the employee benefit-related deadlines identified by the Service). The Service has publicly stated that it may grant other relief under appropriate circumstances for affected taxpayers or affected areas. For example, the Service has extended relief to all workers assisting in the relief activities in the covered areas regardless of whether or not they are affiliated with, among others, the government or a charity (see IRS News Release 2005-103 (9/14/2005)).

The following maps (which are located as links at the end of the electronic version of IRS News Release 2005-109 located on the Service's web site) illustrate the areas that have been designated "Individual Assistance" and "Public Assistance" areas.

- Louisiana - <http://www.irs.gov/pub/irs-utl/louisiana.pdf>
- Mississippi - <http://www.irs.gov/pub/irs-utl/mississippi.pdf>
- Alabama - <http://www.irs.gov/pub/irs-utl/alabama.pdf>
- Florida - <http://www.irs.gov/pub/irs-utl/florida.pdf>'

Florida. See IRS News Releases 2005-109, 2005-112 and Notice 2005-73 for a comprehensive list.

b. Hurricane Rita – Deadline and Covered Areas

In response to Hurricane Rita, the Service issued IRS News Release 2005-110 (9/26/2005), updated 10/3/2005)). The news release, in similar form and style, extends the deadline for taxpayers located in the areas struck by Hurricane Rita who are otherwise required to file tax returns and submit tax payments on or after September 23, 2005, to February 28, 2006. The news release also lists the areas to which the extensions apply and articulates that those areas designated for "Individual Assistance"[6] will have automatic relief, while taxpayers located in areas eligible for "Public Assistance," and taxpayers outside of the area whose books, records or tax professionals are located in the affected areas, are required to identify themselves as Hurricane Rita victims. Significantly, the news release explicitly states that all of the acts listed under Treasury Regulation section 301.7508A-1(c)(1) and Revenue Procedure 2005-27 are extended. In other words, similar to the extensions for Hurricane Katrina, the deadlines for all of the employee-benefit related acts listed in the treasury regulations and the revenue procedure are extended to February 28, 2006.

2. Extension of Deadline for Filing Form 5500s for Entities Affected By Hurricanes Katrina and Rita

The DOL recently extended the deadline for filing Form 5500s for those plan sponsors and plan administrators affected by Hurricanes Katrina and Rita who are

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[6] Areas designated by FEMA for "Individual Assistance" include 22 counties in Texas and 18 parishes in Louisiana. See IRS News Release 2005-110 for a comprehensive list.

otherwise required to file a Form 5500 to February 28, 2006. This extension also applies to entities located outside of the affected areas who are unable to obtain information from service providers, banks, or insurance companies directly affected by Katrina or Rita (see DOL Release 05-1732-NAT (9/20/2005) and DOL Release 05-1848-DAL (9/29/2005)). The areas covered by this relief include those areas identified in the most recent IRS news release as "Individual Assistance" *and* "Public Assistance" areas. In other words, the areas eligible for "Individual" and "Public" Assistance, as indicated in IRS News Releases 2005-110 and 2005-112, are eligible for this extension.

Pursuant to the extension of the deadline for filing Form 5500s, questions have been raised as to whether the deadline for filing summary annual reports ("SARs") is extended as well. Labor officials have informally stated that, under the Labor regulations, if the deadline for filing a Form 5500 is extended, furnishing a SAR to participants need not take place until two months after the extended due date (see DOL Regulation section 2520.104b-10(c)(2)). As a result, by operation, entities located in the areas affected by Hurricanes Katrina and Rita, or those entities located outside of the affected areas who are unable to obtain information from service providers, banks, or insurance companies directly affected by the Hurricanes, have until the end of April 2006 to furnish SARs to participants.

3. **<u>Extension of PBGC-Related Deadlines for Entities Affected by Hurricanes Katrina and Rita</u>**

The PBGC recently granted relief for persons responsible for meeting PBGC-related deadlines who are either located in areas affected by Hurricanes Katrina and Rita (as identified by the Service in IRS News Release 2005-109 (for Hurricane Katrina) and IRS News Release 2005-110 (for Hurricane Rita)), or who are unable to obtain needed information or other assistance from a service provider, bank, or other person with operations directly affected by Katrina and Rita. More specifically, this relief is extended to persons located in all of the counties or parishes eligible for "Individual Assistance" *and* "Public Assistance." Among other deadlines, the announcement extends the deadline for (i) making premium payments, (ii) meeting certain requirements related to standard and distress terminations (e.g., filing termination notices and distributing plan assets), and (iii) providing certain notices (e.g., participant and reportable event notices). These deadlines are extended to January 3, 2006 for those entities affected by Hurricane Katrina (see PBGC Disaster Relief Announcement 05-10 (8/31/2005), updated (9/14/2005)) and February 28, 2006 for those entities affected by Rita (see PBGC Disaster Relief Announcement 05-11 (9/29/2005)). However, pursuant to Section 8, Paragraph 30 of Revenue Procedure 2004-13, whatever date is permitted by the Service under Code section 7508A will also be permitted by the PBGC. As a result, the deadlines for entities affected by Hurricane Katrina would also be extended to February 28, 2006. The PBGC is expected to officially extend the deadline in the coming weeks.

4. <u>Extension of Deadline for Making Minimum Funding Contributions for Plan Sponsors Affected by Katrina</u>

The Service, DOL, and PBGC provided relief for plans required to make minimum funding contributions (or to apply for a waiver) between the dates of August 29, 2005 and October 30, 2005 by initially extending the due date for such contributions to October 31, 2005. The extension applies to plans whose (i) principal place of business of the employer that maintains the plan, (ii) the principal place of business of employers that employ more than 50 percent of the active participants covered by the plan, (iii) the office of the plan or the plan administrator, (iv) the office of the primary recordkeeper serving the plan, or (v) the office of the plan's enrolled actuary, was located in one of the areas designated for "Individual Assistance" by FEMA (Notice 2005-60 (9/2/2005)). The Treasury Department has made it clear that this relief applies only to plans located in the areas designated for "Individual Assistance" by FEMA (see Treasury Department Press Release JS-2715 (9/13/2005)) and that this relief is limited to entities affected by Hurricane Katrina.

On September 23, the Katrina Emergency Tax Relief Act of 2005 ("KETRA") was signed into law by the President (see below for a detailed discussion of pension-related provisions included in KETRA). Among other tax-related provisions, the bill extended all of the deadlines previously extended by the Service under Code section 7508A to February 28, 2006. In other words, all of the extensions that were publicly announced by the Service in the form of notices and news releases were further extended to February 28. Therefore, the deadline for making minimum required contributions is currently extended to February 28, 2006.

5. Extension of Deadlines Under HIPAA, COBRA, and ERISA Claims Procedures for Individuals and Businesses Affected by Katrina

On September 21, the Service and the DOL announced the extension of certain time frames under HIPAA, COBRA, and ERISA's claims procedures (see 70 Fed. Reg. 55500; 29 C.F.R. Parts 2560 and 2590). Specifically, the extension relates to certain acts that must otherwise be completed by plan participants and beneficiaries and group health plans, disability and other welfare plans, pension plans, and group health insurance issuers located in Hurricane Katrina disaster areas. Significantly, plan sponsors and plan administrators are required to disregard the deadlines that fall within the extension period granted in the notice (see below for the dates of the extension). In other words, disregarding the due dates for acts otherwise required to be completed is mandatory.

The Hurricane Katrina disaster areas, for the purposes of the notice, include the counties and parishes in Louisiana, Mississippi, or Alabama that have been or are later designated as disaster areas eligible for "Individual Assistance" by FEMA. Therefore, this relief is not extended to, among others, areas in Florida that are eligible for "Public Assistance." This relief is also not yet available for individuals and businesses affected by Hurricane Rita.

a. Extension for Plan Participants and Beneficiaries

Plan participants and beneficiaries who lived and worked in the Hurricane Katrina disaster areas may disregard the deadlines for the acts enumerated below. Although the notice initially extended these deadlines to January 3, 2006, DOL and Treasury officials have informally stated that the deadlines for the enumerated acts will be treated as being extended to February 28, 2006 until further guidance is issued. In other words, the following deadlines generally do not begin to run until February 28, 2006:[7]

- the 63-day break in coverage period for determining a whether a group health plan may disregard a period of creditable coverage. Generally, if an individual has a 63-day break in health coverage, the individual's new group health plan may disregard his or her creditable coverage under any prior plan for purposes of reducing the preexisting condition exclusion period.

- the 30-day period to secure creditable coverage without a preexisting condition exclusion for certain children. Generally, a newborn, adopted child, or child placed for adoption may not be subject to a preexisting condition exclusion period if covered under creditable coverage within 30 days of birth, adoption, or placement for adoption.

- the 30-day period to request special enrollment in a group health plan. Generally, ERISA and the Code allow certain individuals who have lost coverage to be eligible for special enrollment in other plans.

[7] The extensions under the notice differ from the extensions discussed above in that a time period that falls within the extension period (i.e., August 29, 2005 and February 28, 2006) is postponed until February 28 at which time the period will once again begin to run (see Section IV of the notice for examples), whereas the due dates applicable to, for example, the employee benefit-related acts listed in Treasury Regulation section 301.7508A-1(c)(1) and section 8 of Revenue Procedure 2005-27, are only extended to February 28, 2006.

- the 60-day period to elect COBRA coverage. Generally, an individual has 60 days to elect COBRA coverage under a group health plan.

- the date for making COBRA premium payments. Generally, an individual electing COBRA coverage must pay COBRA premiums within 45 days of making an initial COBRA election (with a 30-day grace period after the expiration of 45 days) and no later than 30 days after the first day in the period for which payment is being made.

- the date for individuals to notify the plan of certain qualifying events or determination of disability. Generally, a participant is required to notify the plan of certain qualifying events (e.g., a divorce) or determination of disability within 60 days.

- the date within which individuals may file a benefit claim under the plan's claims procedures. Generally, plans may require claims for benefits to be filed within a specified period of time after a specified event (e.g., the receipt of medical treatment), but plans are prohibited from having provisions that unduly inhibit or hamper the initiation of processing of claims for benefits.

- the date within which individuals may file an appeal of a denied benefits claim. Generally, a participant may appeal a denied benefits claim within a specified period of time following the receipt of the adverse determination (i.e., within 60 days in the case of a pension plan and 180 days in the case of a group health or disability plan).

b. **Extension for Plans**

Group health plans, disability and other welfare plans, pension plans, and group health insurance issuers directly affected by Hurricane Katrina must disregard certain acts otherwise required to be completed between August 29, 2005 and February 28, 2006. Such acts include:

- the date for providing a certificate of creditable coverage. Generally, a certificate of creditable coverage must be provided within a reasonable period of time after an individual ceases to be covered under a group health plan.

- the date for providing a COBRA election notice. Generally, a group health plan must send a COBRA election notice to a participant ceasing coverage under the plan within 14 days after being informed of a qualifying event.

Plans are considered "directly affected" by the Hurricane if (i) the principal place of business of the employer that maintains the plan, (ii) the principal place of business of employers that employ more than 50 percent of the active participants covered by the plan, (iii) the office of the plan or the plan administrator, or (iv) the office of the primary recordkeeper serving the plan, was located in one of the Hurricane Katrina disaster areas (i.e., those areas eligible for "Individual Assistance").

C. Guidance Relating to Hardship Distribution and Loan Rules for Individuals and Businesses Affected by Hurricane Katrina

On September 15, the Service, in conjunction with the DOL, released Announcement 2005-70 (9/14/2005) permitting certain hardship or emergency withdrawals and loans from tax-favored retirement plans to employees or former employees whose principal residence or place of employment on August 29, 2005 was located in one of the counties or parishes in Louisiana, Mississippi, or Alabama that have been or are later designated as disaster areas eligible for "Individual Assistance" by FEMA. Thus, this relief is not extended to, among others, areas in Florida that are eligible for "Public Assistance." This relief is also not available for individuals and businesses affected by Hurricane Rita.

Under the Announcement, plans may make loans to affected employees or former employees whether or not the plan documents allow for such loans to be made, so long as the requirements of Code section 72(p) are met. In addition, the relief essentially allows plans to rely on representations from affected employees or former employees as to the need for an amount of a hardship distribution, unless the plan administrator has actual knowledge to the contrary. Similar to the treatment of plan loans, this relief applies whether or not the plan otherwise provides for hardship distributions (except that money purchase pension plans would not qualify), but such relief is limited to amounts that could otherwise be distributed under a qualified 401(k), 403(b), or 457(b) hardship or emergency distribution.

While the Announcement provides that plans are not required to suspend contributions for up to 6 months for participants receiving a hardship distribution (i.e., the Announcement states that this "safe harbor" condition need not be followed), it is unclear whether a plan sponsor or plan administrator must consider whether a participant can take a plan loan before a hardship distribution can be made (consideration of whether a loan can be taken is another "safe harbor" condition under the 401(k) regulations). Informal discussions with Treasury officials indicate that if a plan allows loans to participants, the plan administrator must make the participant take a loan before a hardship distribution can be made. If, however, the plan does not allow loans, the plan administrator does not appear to be required to determine whether other sources may satisfy the need, and the plan administrator may make a hardship distribution pursuant to the good-faith relief under the Announcement. Future guidance may clarify this issue.

In addition to distributions and loans to affected participants, the Announcement extends the relief to Katrina-related hardships of lineal ascendants or descendents of participants as well as spouses and dependents. In other words, a person who lives in another part of the country can assist a son, daughter, parent, grandparent or other dependent who lived and worked in the affected areas by taking out a plan loan or hardship withdrawal. Plans that do not currently provide for loans or hardship distributions may be amended to do so by the end of the 2006 plan year. The Announcement also allows administrators to follow good faith compliance procedures in administering their loan and hardship procedures in these respects through March 2006.

Contemporaneous with the Announcement, Assistant DOL Secretary Ann Combs issued a statement announcing a reasonable good faith approach to DOL enforcement in areas such as transmitting elective deferrals or loan repayments and giving blackout notices (see DOL Release 05-1728-NAT (9/15/2005)). This guidance applies to employers, plan sponsors and service providers located in areas that have been or are later designated as disaster areas eligible for "Individual Assistance" by FEMA.

D. Employer Leave-Based Donation Programs and Tax-Free Qualified Disaster Relief Payments

1. Notice 2005-68

The Service recently issued Notice 2005-68 (9/8/2005) allowing employers to adopt leave-based donation programs. Specifically, Notice 2005-68 provides that amounts an employee elects to forego which are otherwise payable as vacation, sick, or personal leave and which are subsequently paid to a charitable organization involved in relief efforts for victims of Hurricane Katrina will not be taxable to the employee. (This guidance is not yet applicable to relief efforts for Hurricane Rita). Employees making the donations will not be able to claim a charitable deduction on their tax return. Employers may take a deduction for the contributions under Code section 162 (i.e., the limitations on corporate charitable donations under Code section 170 do not apply). The Notice extends this favorable tax treatment to donations made before January 1, 2007. Notice 2005-68 thus establishes a leave-based donation program similar to the one established under Notice 2001-69 (issued in response to the 9/11 terrorist attacks).

2. Code Section 139

Employers and other entities may provide direct tax-free relief to employees and individuals affected by a Presidentially declared disaster by making "qualified disaster relief payments" to such affected employees or individuals. Specifically, Code section 139 provides that qualified disaster relief payments are not taxable to the recipient. In addition, the payments are not subject to withholding or employment taxes. Moreover, such payments made by an employer or related entity are deductible despite the excludability of the payments by the recipients. This relief, however, does not include payments for any expenses compensated by insurance or otherwise.

A "qualified disaster relief payment" generally includes any amount paid to an individual:

- to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a "qualified disaster";
- to reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence (including a rented residence) or repair or replacement of its contents to the extent that the need for that repair, rehabilitation, or replacement results from a "qualified disaster";
- by a person who provides or sells transportation as a common carrier because of the death or personal physical injuries arising from a "qualified disaster"; or
- if the amount is paid by a federal, state, or local government, or an agency or instrumentality of those governments, in connection with a "qualified disaster" in order to promote the general welfare.

A "qualified disaster" means, among others, a Presidentially declared disaster (as defined under Code section 1033(h)(3)).

E. The Katrina Emergency Tax Relief Act of 2005

The following is a summary of the principal pension-related provisions included in the Katrina Emergency Tax Relief Act ("KETRA"). The tax relief provisions are available to taxpayers located in areas declared as major disaster areas by the President on account of Hurricane Katrina. It is unclear from the legislative language whether such tax relief is available to taxpayers located in areas eligible for "Individual Assistance" *and* "Public Assistance," but a Joint Committee on Taxation report (JCX-69-05 (9/22/2005)) provides that the States for which such a disaster has been declared are Louisiana, Mississippi, Alabama, and Florida. It is also unclear whether a similar tax package for victims of Hurricane Rita will be considered. To date, no proposals have been introduced.

1. Qualified Hurricane Katrina Distributions

Generally, a 10 percent penalty tax is imposed on participants who receive a distribution from an individual retirement account ("IRA") or tax-favored retirement plan (e.g., Code sections 401(a) or 403(b) plans) before attaining age 59-1/2. Distributions from a governmental 457(b) plan are also subject to the 10 percent penalty if such distributions are attributable to rollovers from a 401(a) or 403(b) plan, or an IRA. Amounts distributed are taxable to the participant in the year in which they are received.

KETRA waives the 10 percent penalty tax if a distribution from these arrangements is considered a qualified Hurricane Katrina distribution ("QHKD"). A distribution is considered a QHKD if it is made on or after August 25, 2005 and before January 1, 2007 and is made to an individual whose principal residence on August 28, 2005 is located in a Hurricane Katrina disaster area and who sustained an economic loss by reason of Katrina. It is unclear whether an affected individual is required to "show" or "certify" whether they sustained an "economic loss" on account of the Hurricane (or the extent of such "economic loss"). Other principal features include the following –

- The waiver is limited to amounts up to $100,000. Therefore, distributions in excess of $100,000 may still be made, but those amounts will not receive favorable tax treatment.
- The mandatory withholding rules applicable to eligible rollover distributions would not apply. Thus, a QHKD would be subject to the

elective withholding rules which require 10 percent of the distribution to be withheld unless the participant elects for withholding not to apply.

- Participants receiving a QHKD would be permitted to spread the income tax resulting from receipt of the distribution ratably over three years.

- Amounts distributed may be re-contributed to the plan over a three-year period following the distribution and such re-contributions would be treated as tax-free rollovers. In other words, amounts that are re-contributed (within the three-year period) would not be includible in income in the tax year in which the distribution was made (e.g., if a participant received an "early" distribution in 2005 and subsequently re-contributed the distribution amount in 2007, the participant may file an amended return requesting a refund for the amount taxable in 2005).

A QHKD is a new and separate distribution allowed under a Code section 401(k), 403(b), or 457(b) plan. For example, a QHKD is treated as meeting the requirements of Code section 401(k)(2)(B)(i) (which enumerates the types of permissible distributions under a 401(k) plan). Therefore, a QHKD would be treated the same as a distribution made upon, among others, a severance from employment, death or disability (i.e., a permissible distribution). As a result, it appears that a QHKD may be made out of any source that is otherwise available as a permissible distribution under a 401(k) plan (e.g., it appears that a QHKD may be made out of vested employer contributions (including matching contributions, QNECs or QMACs), so long as the plan combines elective and nonelective contributions for testing purposes). Because a QHKD would be treated as a new distribution under a 401(k) plan, a QHKD would not be considered a "hardship" distribution, and therefore, a QHKD may be made without running through the "hardship" distribution rules. For example, if a plan already allows loans to participants, the plan sponsor is not required to make the individual take a loan before a QHKD may be made. This appears to be in contrast to the "hardship" relief provided under Announcement 2005-70, and purportedly makes a QHKD more attractive than a hardship distribution (e.g., a hardship distribution made before age 59-1/2 is still subject to a 10 percent penalty). However, lineal descendants and ascendants may take a hardship distribution, whereas a QHKD is limited to individuals located in the affected areas.

2. <u>Re-Contribution of Withdrawals for Home Purchases</u>

Generally, a participant may receive a hardship distribution under a Code section 401(k) or 403(b) plan (if the plan permits hardship distributions) for costs directly relating to the purchase of a principal residence. If such amounts are distributed before the participant attains age 59-1/2, such amounts are includible in income and subject to a 10 percent penalty tax. In addition, distributions from IRAs for first-time homebuyers are generally subject to the 10 percent penalty to the extent the distributions exceed $10,000.

KETRA allows distributions for home purchases that were made after February 28, 2005 and before August 29, 2005 and that were not finalized because of Hurricane Katrina to be re-contributed to the plan tax-free (i.e., the re-contributions would be treated as rollovers). Amounts must be re-contributed by February 28, 2006 in order to receive favorable tax treatment. In other words, a participant who received a hardship distribution (or IRA distribution) to purchase or construct a principal residence, but was unable to purchase or construct the principal residence on account of Hurricane Katrina, would not be required to include the amounts in income (nor would the 10 percent penalty apply), so long as amounts are re-contributed to the plan by February 28, 2006.

3. **Plan Loans**

Generally, if a tax-favored retirement plan allows loans to plan participants, the loan cannot exceed $50,000 or 50 percent of the participant's total vested accrued benefit. The plan loan must be amortized in substantially level payments over the term of the loan, generally limited to 5 years.

KETRA effectively doubles the limitation on plan loans by allowing participants located in the Hurricane Katrina disaster area and who sustained economic loss by reason of the Hurricane to receive loans up to the lesser of $100,000, or 100 percent of the vested accrued benefit for loans made after the date of enactment and before January 1, 2007. As discussed above, it is unclear whether a participant must "certify" that he or she sustained an "economic loss" (or the extent of such "economic loss"). In addition, outstanding loan payments due on or after August 25, 2005 and before January 1, 2007 may be deferred an additional 12 months (which is similar to the time period in which loan repayments may be suspended for participants on a bona fide leave of absence), with appropriate adjustments for interest, etc.[8]

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[8] KETRA effectively moots the extension of the deadline for loan repayments under IRS guidance. For example, if a loan repayment was due on October 10, 2005, the loan may be repaid (or face default) on October 10, 2006 instead of February 28, 2006.

KETRA, however, does not address ERISA's requirement that 50 percent of a participant's account balance must be used as security for a plan loan. DOL officials have recently indicated that so long as the plan loan is made in accordance with Code section 72(p) (as amended by KETRA), the DOL will not seek enforcement of the requirement. Future guidance on this issue is expected. In addition, future guidance is expected on how to re-amortize scheduled loan repayments under section 72(p) if a loan repayment is deferred 12 additional months.

4. Plan Amendments

The legislation allows certain retroactive plan amendments to effectuate the pension-related provisions included in the tax relief package. For example, plans that do not currently provide for loans may be amended retroactive to the effective date of the legislation to allow such loans to be made, up to the maximum loan amount and limited to the time period set forth under the legislation (see the discussion on Plan Loans, above). In addition, plans that do not currently accept rollovers may be amended retroactively to accept such rollovers. More specifically, because re-contributions of an "early" distribution or distributions to purchase or construct a principal residence are treated a "rollovers" under the legislation, plans that do not otherwise accept rollovers must be amended to accommodate any re-contributions to the plan. Generally, plans must be amended by December 31, 2007 (for calendar year plans) (which is later than the deadline in IRS Announcement 2005-70). Governmental plans must be amended by December 31, 2009.

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We hope this information is helpful. Please call Lou Mazawey or Chris Condeluci with any questions.