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Legal Alert: Broader Access To Hardship Distributions And Loans From Retirement Funds For Victims Of Hurricane Katrina

September 20, 2005

On September 15, the IRS issued Announcement 2005-70, which expands the availability of hardship distributions and loans from specified qualified retirement plans, such as 401(k) plans, for victims of Hurricane Katrina and, in certain cases, their family members. The Department of Labor has indicated that distributions and loans made in accordance with the terms of the Announcement will not constitute a violation of Title I of ERISA.

The Announcement (1) allows hardship distributions to satisfy any need arising from Hurricane Katrina, (2) allows plans to make hardship distributions and loans available even if the plan does not provide for such disbursements, provided the plan is later amended, and (3) provides administrative relief with respect to certain documentation requirements. The plans, participants and circumstances to which these rules apply are described in more detail below. All requirements otherwise applicable to hardship withdrawals and loans continue to apply.

What types of retirement plans can take advantage of the hardship distribution and loan relief in the Announcement?

A "qualified employer plan" may take advantage of the hardship distribution and loan relief provided in the Announcement. A "qualified employer plan" means (1) an Internal Revenue Code ("Code") section 401(a) plan, including a 401(k), a profit-sharing or pension plan, (2) a Code section 403(a) plan, (3) a Code section 403(b) plan, or (4) a governmental Code section 457(b) plan.

A plan is a qualified employer plan only if the plan could make in-service hardship distributions if the plan terms allowed for such distributions. For example, a 401(k) plan may allow certain hardship distributions of pre-tax deferrals (exclusive of earnings) but may not make in-service distributions of qualified non-elective contributions (QNECs) or qualified matching contributions (QMACs). Similarly, defined benefit and money purchase pension plans may make in-service distributions only from separate employee contribution and rollover accounts. The Announcement does not lift these or other similar in-service distribution restrictions.

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Which participants are eligible for this relief?

The relief under the Announcement applies to the needs of current or former employees arising from Hurricane Katrina, if

- on August 29, 2005, the participant had a principal residence in a county or parish in Alabama, Mississippi or Louisiana that is declared a disaster area eligible for Individual Assistance from the Federal Emergency Management Agency as a result of Hurricane Katrina,

- the Participant's place of employment was in such county or parish on August 29, 2005, or

- the participant's spouse, child, grandchild, parent, grandparent or dependent had a principal residence or place of employment in one of these counties or parishes on August 29, 2005.

An up-to-date list of the applicable counties and parishes is available at http://www.fema.gov/news/disasters.fema

What additional types of hardship distributions does the Announcement authorize?

Qualified employer plans can make a hardship distribution to satisfy any need arising from Hurricane Katrina. For example, the 401(k) plan hardship rules do not expressly allow a hardship withdrawal so that a participant displaced from his home can pay for temporary lodging. Pursuant to the Announcement, however, the 401(k) plan could, if the hardship distribution satisfies the other applicable hardship distribution rules, make a distribution for this reason.

The plan administrator may rely on representations from the participant as to the need for and amount of the distribution unless the administrator has actual knowledge to the contrary. Although not required, the plan administrator may consider having the participant sign a short representation document when that is possible. A distribution made in accordance with the Announcement is treated as a hardship withdrawal for all purposes under the Code and regulations. For instance, the plan administrator would be required to send the distribution notice required by Code section 402(f), and the distribution would generally be subject to the 10% penalty tax under Code section 72(t) if it was made before age 59-1/2.

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Does the Announcement address the reasons for which a plan can make a loan related to Hurricane Katrina?

Except as described below with respect to the timing of amendments and procedural requirements, the Announcement does not change the generally applicable rules.

What if a qualified employer plan does not contain hardship distribution or loan provisions?

A qualified employer plan can take advantage of the relief in the Announcement even if its terms do not provide for hardship distributions or loans. The plan must, however, be amended to provide for such hardship distributions or loans no later than the last day of the first plan year beginning after December 31, 2005.

Are there time limits for taking advantage of the relief in the Announcement?

To qualify for relief under the Announcement, a hardship distribution must be made between August 29, 2005 and March 31, 2006. There is no time limitation on loans.

Is the amount of a hardship distribution or loan limited in any way?

The dollar limits on hardships and loans under the Internal Revenue Code continue to apply. For instance, the amount of the hardship distribution cannot exceed the amount necessary to satisfy the financial need. A plan may rely on a participant’s representation regarding the amount necessary to satisfy the financial need.

Do the post-distribution 401(k) contribution restrictions apply?

A 401(k) plan is not required to suspend a participant’s pre-tax contributions for the six-month period following a hardship distribution made pursuant to the Announcement.

Does the Announcement provide any relief from procedural requirements related to plan distributions and loans?

With respect to any plan distribution or loan to an individual who qualifies for the relief under the Announcement, a “retirement plan” (excluding IRAs for purposes of the loan rules) will not be treated as having violated any procedural requirements set out in the plan merely because it disregards such requirements for the period from August 29, 2005 through March 31, 2006. To take advantage of this administrative relief, the plan administrator (which includes an institutional trustee of an IRA for these purposes) must make a good-faith effort to comply with the relevant plan procedures and, as soon as practical, must take reasonable action to obtain any forgone documentation.

For example, if a plan requires a death certificate as evidence that spousal consent cannot be obtained, the plan administrator can authorize the distribution to be made (no later than March 31, 2006) if it reasonable to believe that the spouse is deceased, and, as soon as practical, the plan administrator takes reasonable steps to obtain the death certificate.

What is a "retirement plan" for purposes of the relief from procedural requirements?

For purposes of the relief from procedural requirements described above, a retirement plan includes (1) a Code section 401(a) plan, including a 401(k), a profit-sharing or pension plan, (2) a Code section 403(a) plan, (3) a Code section 403(b) plan, (4) a governmental section 457(b) plan, (5) an individual retirement account described in Code section 408(a), (6) an individual retirement annuity described under Code section 408(b), and (7) in certain cases, designated Roth accounts and Roth IRAs.

What additional relief relating to retirement plans is available or can be expected?

The IRS has announced that a number of tax filing and payment deadlines have been extended for affected plans, including an extension for minimum funding contributions under Code section 412 pursuant to Notice 2005-60. The Department of Labor announced an extension until October 31, 2005 for filing Forms 5500 and 5500-EZ, and the PBGC has announced extensions for certain filings, reports, and notices. The IRS and Department of Labor have also jointly announced an extension of certain deadlines relating to health and welfare plans, including relief relating to COBRA and HIPAA notices.

In addition, the House of Representatives and the Senate each passed very similar Hurricane Katrina relief bills late last week. Among other things, these bills provide relief from the 10% penalty tax under Code section 72(t) for Hurricane Katrina-related distributions and permit the income tax on such distributions to be spread over three years. The bills also increase the loan limits to $100,000 or 100% of the participant's account balance. It is anticipated that the House and Senate will reach agreement on and pass a final bill in the near future.

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