

## KETRA Provides Additional Relief For Hurricane Katrina Victims

**WHO'S AFFECTED** This relief is available to sponsors of qualified plans, ERISA 403(b) plans, and governmental section 457 plans whose participants were directly affected by Hurricane Katrina. It is also available to affected participants in non-ERISA 403(b) programs.

**BACKGROUND AND SUMMARY** On September 23, 2005, President Bush signed into law the Katrina Emergency Tax Relief Act of 2005 (KETRA). This law provides individuals who were directly affected by Hurricane Katrina with additional access to their retirement savings to alleviate hardships caused by the arrival of this hurricane on the Gulf Coast at the end of August. It also lessens the tax burdens related to these special hardship distributions.

It is important to note that this relief is *in addition to* the relief previously provided by the federal regulatory agencies, as discussed in our September 2005, *Pension Analyst* titled "Hurricane Katrina Affects Retirement Plan Administration." KETRA relief is not available to victims of Hurricane Rita.

**ACTION AND NEXT STEPS** Plan sponsors with employees or former employees in Louisiana, Mississippi, Alabama, or Florida should review this publication to become familiar with the additional relief available to these individuals. Plan sponsors that wish to make this relief available under their plans or programs should contact their Prudential Retirement representatives.

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## Recontribution of Withdrawals Taken for Home Purchases

KETRA contains a special recontribution provision for individuals who took hardship distributions from a 401(k) plan or 403(b) arrangement to purchase a home in the Hurricane Katrina disaster, if that home was not purchased or built due to Hurricane Katrina. By its nature, this provision applies

to both individuals who resided in a Hurricane Katrina disaster area and those who did not yet reside there when Katrina came ashore.

If the home purchase distribution was taken after February 28, 2005, but before August 29, 2005, the participant may re contribute the funds to a retirement plan in which he is participating provided:

- The plan accepts rollover contributions; and
- The re contribution is made before March 1, 2006.

The re contribution does not have to be made to the plan that made the original distribution. It may be made to any traditional IRA, qualified plan, governmental section 457 plan, or 403(b) arrangement in which the individual participates. The re contribution may be made in the form of one or more contributions, but total re contributions cannot exceed the amount of the original distribution.

Re contributions are treated as direct rollovers. As a result, the original distribution is not treated as a taxable distribution. We expect the IRS to issue guidance on the tax-reporting of such distributions, especially since the distributing plan may not be aware of the nature of the distribution or that a re contribution has been made. The IRS may place the burden of documenting this type of transaction on the individual taxpayer.

## Qualified Hurricane Katrina Distributions

In its pre-KETRA guidance, the IRS allowed plan sponsors to make hardship distributions available on a broader basis to individuals affected by Hurricane Katrina. Under these rules, described in our September 2005, *Pension Analyst* titled [“Hurricane Katrina Affects Retirement Plan Administration.”](#) “Katrina victims” included individuals whose lineal ascendants, descendants, dependents, or spouse were directly affected by the hurricane. These special hardship distribution provisions still apply.

In addition, KETRA permits individuals who were directly affected by Hurricane Katrina to take “qualified Hurricane Katrina distributions” from their retirement plans. Unlike the special Katrina hardship distributions, qualified Hurricane Katrina distributions are eligible for special tax treatment. Plan sponsors may permit such distributions immediately, as long as they eventually amend their plans to provide for them.

A qualified Hurricane Katrina distribution is a distribution made on or after August 25, 2005, to an individual:

- Whose principal place of residence on August 28, 2005, was in the [“Hurricane Katrina disaster area:”](#) and
- Who sustained an economic loss from Hurricane Katrina.

Qualified Hurricane Katrina distributions can be made from profit sharing plans (including section 401(k) plans), stock bonus plans, 403(b) arrangements, governmental section 457 plans, and traditional IRAs. It is not entirely clear whether defined benefit plans and money purchase pension plans may make this type of distribution. However, based on the guidance provided in IRS Announcement 2005-70, we suspect the IRS will not allow this much liberalization of the distribution rules that apply to these types of plans.

An individual's total qualified Hurricane Katrina distributions, taken from all eligible plans, cannot exceed \$100,000. When applying this limit, plan sponsors are responsible only for tracking distributions from all plans that they or other members of their controlled group sponsor.

Qualified Hurricane Katrina distributions are subject to the following special rules:

- They are exempt from the 10% federal income tax penalty on early distributions.
- If made from a qualified plan or a governmental section 457 plan, they are not eligible for rollover and therefore, are not subject to mandatory 20% federal tax withholding.
- They are included in the individual's gross income ratably over a three-taxable year period, beginning with the year in which the distribution occurred, unless the individual elects otherwise.
- They may be repaid within three years to an "eligible retirement plan" (i.e., an IRA, a qualified plan, a governmental section 457 plan, or a 403(b) arrangement) in which the individual is participating, which is eligible to receive a rollover contribution. The repayment does not have to be made to the same plan or IRA from which the distribution was made.

Refer to the ["Special Hurricane Katrina Distributions" chart](#) appearing at the end of this publication for a comparison of the types of special distributions available to Hurricane Katrina victims.

## Special Plan Loan Provisions

The IRS pre-KETRA relief also allowed plan sponsors to make plan loans available to individuals who were directly or indirectly affected by Hurricane Katrina, as described in our [September 2005, Pension Analyst](#), even if their plans did not normally permit loans. However, these loans remained subject to the standard loan limits of the lesser of \$50,000 or 50% of the participant's vested account balance.

Under KETRA, plans may allow individuals who are eligible to take qualified Hurricane Katrina distributions to take larger loans from qualified plans, 403(b) arrangements, and governmental section 457 plans. In addition, any of these individuals who had an outstanding plan loan on or after August 25, 2005, may delay payments without causing the loan to become taxable

The maximum loan amount available to these individuals for loans taken on or after September 23, 2005, and before January 1, 2007 (when added to the outstanding balance of all other loans from the plan), generally cannot exceed the lesser of \$100,000, or 100% of the participant's vested account balance.

In addition, an individual with an outstanding plan loan on or after August 25, 2005, may delay for one year any loan repayments due after August 24, 2005, and before January 1, 2007.

*For example, a repayment originally due on September 1, 2005, may be delayed to September 1, 2006.*

This delay will not cause the loan to become a taxable deemed distribution. After the one-year period ends, the loan must be reamortized to adjust payments for the new due date and accrued interest. The one year postponement period will be ignored with respect to the term of the loan.

It is important to note that while KETRA increased the limit on nontaxable loans to \$100,000 or 100% of the participant's vested account balance, it did not similarly increase the ERISA loan limit. As a result, a plan loan equal to 100% of a participant's vested account balance would not be considered a taxable distribution but could easily be a prohibited transaction, if the plan administrator does not obtain additional security for the loan outside the plan. So far, the Department of Labor has not provided any special relief from the adequate security rule for these situations. However, we would expect forthcoming guidance to address this issue.

The "[Special Hurricane Katrina Plan Loans](#)" chart appearing at the end of this publication for a comparison of the types of the plan loans available to Hurricane Katrina victims.

## **Plan and Contract Amendments**

In general, the deadline for KETRA plan amendments is the last day of the first plan year beginning on or after January 1, 2007. For governmental plans, KETRA amendments must be adopted by the last day of the first plan year beginning on or after January 1, 2009. Naturally, the effective dates specified in these amendments must be retroactive to the date the provisions were first made effective. The IRS may establish different amendment deadlines, if they perceive a need to do so.

## **Next Steps**

We understand that the IRS is on a very fast track to publish KETRA regulations. Those regulations will be explained in a future issue of the *Pension Analyst*. In the meantime, if you have questions regarding the availability of KETRA relief to your plan or participants, please contact your Prudential Retirement representative.

State	Hurricane Katrina Individual Disaster Assistance Areas	Hurricane Katrina Disaster Areas
<b>Louisiana</b>	Parishes of: Acadia, Ascension, Assumption, Calcasieu, Cameron, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson, Jefferson Davis, Lafayette, Lafourche, Livingston, Orleans, Pointe Coupee, Plaquemines, St. Bernard, St. Charles, St. Helena, St. James, St. John, St. Mary, St. Martin, St. Tammany, Tangipahoa, Terrebonne, Vermilion, Washington, West Baton Rouge, and West Feliciana.	Parishes of: Acadia, Allen, Ascension, Assumption, Avoyelles, Beauregard, Bienville, Bossier, Caddo, Calcasieu, Caldwell, Cameron, Catahoula, Claiborne, Concordia, Desoto, East Baton Rouge, East Carroll, East Feliciana, Evangeline, Franklin, Grant, Iberia, Iberville, Jackson, Jefferson, Jefferson Davis, Lafayette, Lafourche, LaSalle, Lincoln, Livingston, Madison, Morehouse, Natchitoches, Orleans, Ouachita, Pointe Coupee, Plaquemines, Rapides, Red River, Richland, Sabine, St. Bernard, St. Charles, St. Helena, St. James, St. John, St. Landry, St. Mary, St. Martin, St. Tammany, Tangipahoa, Tensas, Terrebonne, Union, Vermilion, Vernon, Washington, Webster, West Baton Rouge, West Carroll, West Feliciana, and Winn.
<b>Mississippi</b>	Counties of: Adams, Amite, Attala, Claiborne, Choctaw, Clarke, Copiah, Covington, Forrest, Franklin, George, Greene, Hancock, Harrison, Hinds, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lauderdale, Lawrence, Leake, Lincoln, Lowndes, Madison, Marion, Neshoba, Newton, Noxubee, Oktibbeha, Pearl River, Perry, Pike, Rankin, Scott, Simpson, Smith, Stone, Walthall, Warren, Wayne, Wilkinson, Winston, and Yazoo.	Counties of: Adams, Alcorn, Amite, Attala, Benton, Bolivar, Calhoun, Carroll, Chickasaw, Claiborne, Clay, Choctaw, Clarke, Coahoma, Copiah, Covington, DeSoto, Forrest, Franklin, George, Greene, Grenada, Hancock, Harrison, Hinds, Holmes, Humphreys, Issaquena, Itawamba, Jackson, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lafayette, Lamar, Lauderdale, Lawrence, Leake, Lee, Leflore, Lincoln, Lowndes, Madison, Marion, Marshall, Monroe, Montgomery, Neshoba, Newton, Noxubee, Oktibbeha, Panola, Pearl River, Perry, Pike, Pontotoc, Prentiss, Quitman, Rankin, Scott, Sharkey, Simpson, Smith, Stone, Sunflower, Tallahatchie, Tate, Tippah, Tishomingo, Tunica, Union, Walthall, Warren, Washington, Wayne, Webster, Wilkinson, Winston, Yalobusha, and Yazoo.
<b>Alabama</b>	Counties of: Baldwin, Choctaw, Clarke, Greene, Hale, Mobile, Pickens, Sumter, Tuscaloosa, and Washington.	Counties of: Baldwin, Bibb, Choctaw, Clarke, Colbert, Cullman, Greene, Hale, Jefferson, Lamar, Lauderdale, Marengo, Marion, Mobile, Monroe, Perry, Pickens, Sumter, Tuscaloosa, Washington, Wilcox, and Winston.
<b>Florida</b>	<i>None.</i>	Counties of: Bay, Broward, Collier, Escambia, Franklin, Gulf, Miami-Dade, Monroe, Okaloosa, Santa Rosa, and Walton.

<b>Special Hurricane Katrina Distributions</b>		
	<b>Announcement 2005-70 Hardship Withdrawals</b>	<b>KETRA Qualified Hurricane Katrina Distributions</b>
<b>Eligible Participants</b>	<p>Employees or former employees:</p> <ul style="list-style-type: none"> <li>• Whose principal place of residence on <b>August 29, 2005</b> was located in a Louisiana parish, Mississippi county or Alabama county eligible for "<a href="#">Individual Disaster Assistance</a>;" or</li> <li>• Whose principal place of employment was located in one of these Individual Disaster Assistance areas on August 29, 2005; or</li> <li>• Whose lineal ascendant or lineal descendant, dependent, or spouse had a principal place of residence or employment was located in one of these Individual Disaster Assistance areas on August 29, 2005.</li> </ul>	<p>Individuals who:</p> <ul style="list-style-type: none"> <li>• As of <b>August 28, 2005</b>, had their principal place of residence in the "<a href="#">Hurricane Katrina Disaster Area</a>;" and</li> <li>• Sustained an economic loss due to Hurricane Katrina.</li> </ul>
<b>Distribution Period: On or after Before</b>	August 29, 2005 April 1, 2006	August 25, 2005 January 1, 2007
<b>Dollar Limit</b>	As provided in the plan; cannot exceed 100% of vested account balance	\$100,000 total from all of the participant's qualified plan accounts, 403(b) programs and IRAs; employer must monitor from "controlled group" perspective.
<b>Taxation</b>		
<b>Inclusion in income</b>	In year distributed.	Included ratably over 3-year period beginning with year distributed, unless participant elects to include entirely in year distributed.
<b>Federal Withholding</b>	Not eligible for rollover; subject to 10% withholding, but can elect no withholding.	Not eligible for rollover; subject to 10% withholding, but can elect no withholding.
<b>10% Penalty Tax on Early Distributions (§72(t))</b>	Applies.	Does not apply.
<b>Repayment Options</b>	Not available; not eligible for rollover.	May be recontributed to any retirement program accepting rollovers.
<b>Plan Amendment Requirements</b>	No amendment required if plan already permits Hardship Withdrawals.	Amendment required in all cases.
<b>Deadline(s)</b>	Last day of first Plan Year beginning on or after January 1, 2006.	<p><u>General</u>: Last day of first Plan Year beginning on or after January 1, 2007.</p> <p><u>Governmental Plans</u>: Last day of first Plan Year beginning on or after January 1, 2009.</p>

<b>Hurricane Katrina Plan Loans</b>		
	<b>Announcement 2005-70</b>	<b>KETRA</b>
<b>Eligible Participants</b>	<p>Employees or former employees:</p> <ul style="list-style-type: none"> <li>• Whose principal place of residence on <b>August 29, 2005</b> was located in a Louisiana parish, Mississippi county or Alabama county eligible for "<a href="#">Individual Disaster Assistance</a>;" or</li> <li>• Whose principal place of employment was located in one of these Individual Disaster Assistance areas on August 29, 2005; or</li> <li>• Whose lineal ascendant or lineal descendant, dependent, or spouse had a principal place of residence or employment was located in one of these Individual Disaster Assistance areas on August 29, 2005.</li> </ul>	<p>Individuals who:</p> <ul style="list-style-type: none"> <li>• As of <b>August 28, 2005</b>, had their principal place of residence in the "<a href="#">Hurricane Katrina Disaster Area</a>;" and</li> <li>• Sustained an economic loss due to Hurricane Katrina.</li> </ul>
<b>Loan Grant Date: On or after Before</b>	<p>August 29, 2005 April 1, 2006</p>	<p>September 23, 2005 January 1, 2007</p>
<b>Dollar Limit</b>	<p>The lesser of :</p> <ol style="list-style-type: none"> <li>1. \$50,000, minus the difference between <ul style="list-style-type: none"> <li>• The highest outstanding loan balance during the last 12 consecutive month period, and</li> <li>• The outstanding loan balance on the date the loan is made; or</li> </ul> </li> <li>2. The greater of: <ul style="list-style-type: none"> <li>• 50% of the vested account balance, or</li> <li>• \$10,000.</li> </ul> </li> </ol>	<p>The lesser of :</p> <ol style="list-style-type: none"> <li>1. \$100,000, minus the difference between <ul style="list-style-type: none"> <li>• The highest outstanding loan balance during the last 12 consecutive month period, and</li> <li>• The outstanding loan balance on the date the loan is made; or</li> </ul> </li> <li>2. The greater of: <ul style="list-style-type: none"> <li>• 100% of the vested account balance, or</li> <li>• \$10,000.</li> </ul> </li> </ol>
<b>Repayment Requirements General Purpose Loans  Principal Residence Loans</b>	<p>Level installments, payable at least quarterly, within 5 years.</p> <p>Level installments, payable at least quarterly, may extend beyond 5 years.</p> <p>Individuals who qualify for KETRA Plan Loans may postpone for one year repayments due after 8/25/05 and before 1/1/07, with the one-year postponement disregarded in determining the length of the loan.</p>	<p>Level installments, payable at least quarterly, within 5 years.</p> <p>Level installments, payable at least quarterly, may extend beyond 5 years.</p> <p>For both types of loans, repayments due after 8/25/05 and before 1/1/07 may be postponed for one-year, with the one-year postponement disregarded in determining the length of the loan.</p>
<b>Plan Amendment Requirements  Deadline(s)</b>	<p>No amendment required if plan already permits plan loans.</p> <p>Last day of first Plan Year beginning on or after January 1, 2006.</p>	<p>Amendment required in all cases.</p> <p><u>General</u>: Last day of first Plan Year beginning on or after January 1, 2007.</p> <p><u>Governmental Plans</u>: Last day of first Plan Year beginning on or after January 1, 2009.</p>

**Pension Analyst by Prudential Retirement**

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