Ataxplan Publications Special Report:

Hurricane Relief Provisions

Hurricane Katrina (September 2005) prompted Congress to enact numerous special tax code provisions designed to benefit its victims, in the Katrina Emergency Tax Relief Act of 2005 (KETRA). P.L. 109-73. The relief was later expanded to include victims of Hurricanes Wilma and Rita; see § 1400Q[1]. IRS Notice 2005-92, 2005-51 I.R.B. 1165, was issued after KETRA but before the relief was expanded to cover Rita and Wilma. For more IRS guidance on everything discussed here, see IRS Publication 4492 and Form 8915.

This Special Report summarizes hurricane relief provisions applicable to retirement plan distributions in § 1400Q, other than those applicable only to plan administrators, and presumes that Notice 2005-92 applies to all three hurricanes, not just Katrina. Other forms of tax-related disaster relief (such as filing deadline extensions) issued by the IRS are not covered here; see, *e.g.*, IRS Announcement 2005-70.

.01 ***Definition of qualified hurricane distribution***

§ 1400Q creates special favorable rules for a "qualified hurricane distribution" (QHD), defined as follows:

A. **Who it's paid to.** A QHD is a distribution paid to an individual whose "principal place of abode" (see Notice 2005-92, § 1(E), for definition) on a certain date is in a specified disaster area (see "B") and "who has sustained an economic loss [see "C"] by reason of" the hurricane in question. The dates are: August 28, 2005, for the Hurricane Katrina disaster area; September 23, 2005, for the Hurricane Rita disaster area; and October 23, 2005, for the Hurricane Wilma disaster area. § 1400Q(a)(4)(A). A QHD could be made to a beneficiary (after the participant's death) as well as to a participant. Notice 2005-92, § 1(C).

B. **Disaster areas.** The applicable disaster areas are defined in § 1400M: for Hurricane Katrina, see § 1400M(2); for Hurricane Rita, see § 1400M(4); for Hurricane Wilma, see § 1400M(6). To find whether a particular location was declared a disaster area during the required time frame, go to FEMA's web site, http://www.fema.gov/news/disasters.fema?year=2005. According to the Instructions for IRS Form 8915, the Katrina disaster area includes all of Alabama, Louisiana, Florida, and Mississippi; Rita's includes all of Louisiana and Texas; and Wilma's includes all of Florida.

C. **Economic loss.** The Code has no requirements regarding the amount or nature of the "economic loss" the individual must have suffered in order to qualify for a QHD. "Thus, even though [an]…individual is required to have sustained an economic loss, [QHDs] are permitted without regard to the …individual's need and the amount of the distribution is not required to correspond to the amount of the economic loss suffered…." Notice 95-2002, § 1(C).

D. **Type of plan.** A QHD must be from an "eligible retirement plan" as defined in § 402(c)(8)(B). § 1400Q(a)(4)(B). This includes IRAs (§ 408(a)), individual retirement annuities (§ 408(b)), qualified plans (§ 401(a)), and all 403(b) and 457 plans. It also includes Roth IRAs because Roth IRAs are treated as IRAs under § 408(a) for all purposes of the Code except as otherwise provided in § 408A. § 408A(a).

E. **Date of the distribution.** A QHD must be distributed before January 1, 2007, and "on or after" either August 25, 2005 (for the Hurricane Katrina disaster area), September 23, 2005 (for the Hurricane Rita disaster area), or October 23, 2005 (for the Hurricane Wilma disaster area). § 1400Q(a)(4)(A).

F. **$100,000 maximum.** No more than $100,000 of plan distributions to a particular individual may be treated as QHDs. § 1400(a)(2)(A). If the individual receives otherwise-qualifying distributions in both 2005 and 2006, and wants to "save" the relief for the 2006 distributions, it appears that he can do so by not "designating" the 2005 distributions as QHDs. Notice 2005-92, § 4(A).

G. **No requirement that distribution be hurricane-related.** The distribution does not have to be related to the disaster. Thus, MRDs and SOSEPP payments the individual would have taken anyway can be QHDs. See Notice 2005-92, § 1(C), for which distributions and deemed distributions may be QHDs.

.02 Benefits of a QHD

Though Congress stopped short of making QHDs tax-free, QHDs do receive several favorable treatments. Note that there are some subcategories of QHDs that are entitled to additional favorable treatments, just to keep things complicated.

A. **Penalties under § 72(t).** The 10 percent penalty on pre-age 59½ distributions (Chapter 9[2]) and the 25 percent penalty on early SIMPLE distributions do not apply to QHDs. § 1400A(a)(1). Also, a QHD from a plan from which the participant is receiving a SOSEPP (¶ 9.2) will not be treated as a "modification" of the series (¶ 9.3). Notice 2005-92, § 4(H).

B. **Extended rollover deadline.** An individual may contribute an aggregate amount not exceeding the amount of the QHD to an eligible retirement plan during the 3-year period beginning the day after the distribution was received. This will be treated as an eligible rollover distribution. § 1400Q(a)(3). This provision generally does not change the rules regarding who can roll over what where (¶ 2.6) other than extending the deadline. For example, this would not permit a nonspouse beneficiary to roll over a QHD from an inherited plan, nor permit rollover of a SOSEPP payment or MRD. Notice 2005-92, § 1(D). However, because this type of rollover is treated as a direct rollover (§ 2.6.01(B)), it is exempt from the once-per-12-months rule (¶ 2.6.07). § 1400Q(a)(3)(B), (C). Also, a hardship distribution that is a QHD may be rolled over, even though hardship distributions are usually not eligible rollover distributions. ¶ 2.6.02(E). Notice 2005-92, § 1(D). See Notice 2005-92, § 4(C)–(F) for income tax reporting when a QHD is rolled over.

C. **Three-year spread of income.** A taxpayer can elect to have the income resulting from a QHD included in his income ratably over three years (beginning with the year of the distribution) or to have it taxed all in the year of the distribution. § 1400Q(a)(5). He can make this election for any year in which he receives a QHD (2005 and/or 2006), but must elect to treat all QHDs in any particular year the same way. The election to use the three-year option is irrevocable. Notice 2005-92, § 4(B). Death accelerates the inclusion of the amounts not reported in prior years onto the final return. Notice 2005-92, § 4(G).

D. **Income tax withholding.** A QHD is not subject to mandatory income tax withholding (¶ 2.2). § 1400Q(a)(6)(A).

E. **Some plan requirements relaxed.** A plan may distribute a QHD even if such a distribution would otherwise not be permitted because of the restrictions on in-service distributions under cash-or-deferred plans. § 1400Q(a)(6)(B). However, a plan is not *required* to relax that restriction. Other limitations, such as the inability of a pension plan to make in-service distributions and the spousal consent requirements (¶ 3.4) are *not* waived for QHDs. Notice 2005-92, § 2(A).

F. **Plan loans.** For rules allowing increased QRP loans and more lenient repayment terms to certain hurricane-affected individuals, see § 1400Q(c) and Notice 2005-92, § 5.

G. **Home purchases.** For special rules for certain plan distributions (not QHDs) prior to February 28, 2006, that were intended to be used for constructing or purchasing a principal residence in the disaster area, but were not so used "on account of" the hurricane, see § 1400Q(b).

1. § references refer to the Internal Revenue Code of 1986 as amended, unless otherwise indicated.

2. Chapter references refer to Chapters of *Life and Death Planning for Retirement Benefits* (6th ed. 2006), Ataxplan Publications; see www.ataxplan.com to purchase.

3. ¶ references refer to sections and subsections of *Life and Death Planning for Retirement Benefits* (6th ed. 2006).