

Congress Adds Plan Distribution Tax Relief for Recent Disasters

The Disaster Tax Relief and Airport and Airway Extension Act of 2017, signed by President Trump last Friday, includes relief from the 10% premature distribution penalty for withdrawals from retirement savings and provides expanded loan availability to qualified plan participants. It also offers withholding exceptions, delayed taxation, and extended repayment options to ease the financial bite of tapping retirement savings for hurricane recovery. This relief is in addition to recent IRS, PBGC and DOL guidance that extended deadlines and relaxed documentation requirements.

Background

In response to Hurricanes Harvey, Irma and Maria, IRS, PBGC and DOL issued guidance extending deadlines and relaxing select plan documentation requirements for accessing retirement plan funds to help finance individual recovery efforts. We provide details in our *For Your Information* articles from [September 6](#), [September 13](#), and [September 19, 2017](#). The individual participant relief for accessing funds through hardship withdrawals eased access, but did not change taxation treatment. For example, distributions prior to age 59½ would generally be subject to the usual 10% penalty on premature distributions in addition to being taxed as ordinary income. While the initial relief also gave plan sponsors flexibility in adding plan loan features, it didn't expand the available loan amounts or relieve existing loan repayment obligations for individual participants.

New Law Mirrors Katrina, Rita, Wilma Relief

Aside from the name of the hurricane and relevant dates, the Relief Act language for plan distributions is generally identical to that in the Katrina Emergency Tax Relief Act of 2005 (KETRA) and its replacement 2005 Gulf Opportunity Zone Act (2005 GO Zone Act) – now Code Section 1400Q. Agency guidance on the details of what is permitted or required for this new trio of hurricanes will likely follow suit with the guidance, such as [Notice 2005-92](#), provided for KETRA.

Congress Goes an Extra Mile

The [Disaster Tax Relief and Airport and Airway Extension Act of 2017](#) (Relief Act) adds to the help available to victims of the three recent hurricanes who tap retirement savings in employer plans or IRAs. In addition to premature distribution penalty relief, the new law provides the ability to stretch taxation over multiple years. It also

allows for larger loans and offers extra time for repayments. In general, this relief is applicable to employer-sponsored retirement plans – e.g., 401(k), 403(b) and 457(b) – and IRAs.

Who's Eligible?

Unlike earlier IRS distribution relief that was extended to individuals living or working in the disaster areas as well as their lineal ascendants or descendants, spouses or dependents, Congress' relief is limited to those with a principal "place of abode" in the disaster areas who sustained an economic loss because of the associated hurricane.

On the other hand, Congress applies the relief to individuals in the "disaster areas" that are "determined by the President" and not just the specific counties [identified by FEMA](#) as eligible for individual assistance where the IRS, PBGC and DOL relief is available. For example, the president signed a major disaster declaration for Georgia for Hurricane Irma, but FEMA only designated seven Georgia counties as eligible for individual assistance. Given this distinction, it appears that an individual whose principal place of abode was in Georgia on September 4 and who sustained an economic loss by reason of Hurricane Irma would be eligible for the relief in the Relief Act even though the abode or loss was not in one of the seven counties (which would be necessary for IRS, PBGC and DOL relief).

What's the Relief?

Congress' additional relief includes the following.

Penalty Waiver. Individuals may receive qualified hurricane distributions of up to \$100,000 without incurring the 10% tax penalty that normally applies to early withdrawals. The maximum can be taken in increments; but it must be taken before January 1, 2019. The timing of permitted distributions would presumably be subject to any plan-based restrictions.

No Disqualification. Plans will not violate any tax code provision when they allow qualified hurricane distributions as long as they limit all the distributions from controlled group plans to an individual to the \$100,000 cap. Monitoring of the overall limit across other employers and/or any IRAs is the responsibility of the individual taxpayer.

Comment. The Relief Act specifically refers to various restrictions on savings plan distributions such as hardship and pre-age 59½ distributions, but does not specify relief from pension restrictions. In Katrina guidance, IRS interpreted this to mean that hurricane distributions could not ignore those restrictions. Hence, restrictions based on employment status or age (pre-age 62), funding based limits, and the requirement to obtain spousal consent would need to be observed (except to the extent relaxed administration is permitted under other IRS hurricane relief).

Increased Loan Limits and Repayment Relief. Plan loans are normally limited to the lesser of \$50,000 or half the vested account balance and generally must be repaid over a five-year period. For affected individuals, the limit is raised to the lesser of \$100,000 or 100% of the vested account balance for loans made by December 31, 2018.

Affected individuals who had an outstanding loan or take a new loan from their plan and have a repayment due between the hurricane date and the end of 2018 may delay their loan repayment up to one year. Although any

delay is not counted against the maximum loan repayment period, future repayments must be adjusted to include interest accrued during the delay.

Comment. While the expansion of the amount available for a loan could be attractive to some participants, plan sponsors are not required to provide it. Reasons for keeping the amount as it stands today could include concerns about the ability of participants to successfully repay such a large loan, particularly over a period of five or fewer years, or recordkeeper limitations on the amount available for a loan. In addition, plans may take the position that participants with access to loans outside the plan who need a loan for purchase of a new home might be better served taking a mortgage loan because the interest repaid on such a loan would be deductible on an itemized federal tax return, while plan loan interest is not.

Stretching Out Taxation. Individuals may choose to include the taxable income resulting from a withdrawal before January 1, 2019 from savings apportioned over three years. The \$100,000 cap continues to apply across all of the individual's qualified hurricane distributions.

Repayment. Unlike normal hardship withdrawals that are not eligible for rollover, qualified hurricane distributions (distributions on or after the date of the relevant hurricane and before 2019) can be contributed back to the plan or to an IRA any time during the three-year period after the distribution. In addition, if, between February 28, 2017 and September 21, 2017, an individual took a distribution from a plan or IRA to purchase a home, and that home was not purchased because of one of the three hurricanes, the distribution may be recontributed to the plan or IRA by February 28, 2018.

Comment. The Relief Act does not require plans to accept these repayments – however, because they are viewed as rollover contributions, plans that accept rollovers presumably have the appropriate mechanism in place to do so. Alternatively, individuals always have the option of moving the repayments to their own IRAs.

Exemption from Withholding. Because qualified hurricane distributions won't be treated as eligible rollover distributions for income tax withholding and other rollover rules, mandatory 20% withholding will not apply. Instead, the distribution is subject to 10% withholding, which may be waived by the participant. Also, the usual 402(f) notice requirement will not apply.

Plan Amendments. Under this new legislation and prior IRS guidance, plans and annuity contracts do not need to be amended to memorialize operational changes made to accommodate disaster distributions until the end of the plan year beginning in 2019. Governmental plans get an additional two years beyond that to amend.

Uncertainty for Puerto Rico

Although the rules for administering hardships and loans for qualified plans in Puerto Rico are nearly identical to those that apply to U.S. qualified plans, their tax system is not administered by IRS and the local taxing authorities are not bound by the Relief Act or other IRS hurricane relief. Thus it appears that for retirement plans subject to

Relief Limited for Participants with Relatives in Puerto Rico

Plan administrators should note that while the earlier IRS relief allowed relatives of hurricane victims to access plan funds for lineal ascendants and descendants, IRS has not to date announced Hurricane Maria relief for plan distributions. Thus, for example, plan participants in New York or Miami with relatives in Puerto Rico can tap into their own funds for damage done by Hurricane Irma, but not by Hurricane Maria.

local qualification rules in Puerto Rico (including plans that are also qualified in the U.S.), the plans' local tax qualification may be jeopardized if the plan applies the relief in the Relief Act or from IRS without confirming that the local taxing authorities have provided similar relief.

In Closing

Plan sponsors should determine if they have plan participants who qualify for any of the statutory and/or regulatory relief. If so, they will need to decide how to administer any mandatory requirements for these individuals. They'll also need to determine which, if any, of the other relief provisions to implement and how this will be done.

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