JONES WALKER

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PLAN LOAN AND HARDSHIP RULES RELAXED IN THE WAKE OF HURRICANE KATRINA

"For the first time ever, the IRS and Departments of Treasury and Labor are providing broad-based relief to retirement plan participants affected by a major disaster." So says the IRS in a September 15 release. The IRS is backing up its claim, and will soon get an assist from Congress (more on that later).

Many employers who sponsor 401(k) and Profit Sharing plans have been besieged by participants in the disaster area (all of Louisiana and specified counties in Alabama, Florida and Mississippi) requesting plan loans or hardship distributions. Some plans do not allow loans or hardship distributions. Other plans allow hardship distributions, but existing rules may pose a problem for many participants.

In Announcement 2005-70, the IRS took steps to open up new sources of emergency cash for Katrina victims. First, hurricane relief automatically qualifies as a hardship. Second, the IRS will allow plans to issue loans and make hardship distributions to participants even if the plan document does not at present allow loans or hardship distributions, so long as the plan is retroactively amended to add those features.

Furthermore, much of the "red tape" involved in obtaining a hardship distribution can be removed. Plans may rely on the representations of participants as to the need for and amount of a hardship distribution (unless the plan administrator has actual knowledge to the contrary). Documentation that might normally be required for a hardship distribution or plan loan, but is unavailable, can be temporarily omitted, provided that the plan administrator makes a reasonable attempt as soon as practicable to assemble the omitted documentation.

Also, participants will not be required to suspend 401(k) contributions after a hardship withdrawal (normally, a six-month suspension would be required).

This relief applies if any of the following applies: the participant resides within the disaster area; the participant's place of employment was in the disaster area; or a dependent, spouse, or lineal ascendant or descendant of the participant resided in or had a place of employment in the disaster area. The relief applies to hardship withdrawals and loans made during the period from August 29, 2005 to March 31, 2006.

Keep in mind that other rules remain, including the adverse tax treatment of hardship withdrawals. Congress is likely to include in disaster-relief legislation some significant tax relief for hurricane victims with regard to hardship withdrawals. A subsequent e-zine will report on those changes as soon as they are enacted.

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. In addition, the authors of this summary will be happy to field your questions, at the following telephone numbers:

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