

Part III. Procedural, Administrative, and Miscellaneous

Hurricane Katrina Relief under sections 101 and 103 of the Katrina Emergency Tax Relief Act of 2005

Notice 2005-92

PURPOSE

This notice provides guidance relating to the application of sections 101 and 103 of the Katrina Emergency Tax Relief Act of 2005, P.L. 109-73 (KETRA) for qualified individuals and eligible retirement plans. KETRA was enacted on September 23, 2005. Under section 101 of KETRA, qualified individuals receive favorable tax treatment with respect to distributions from eligible retirement plans that are qualified Hurricane Katrina distributions (Katrina distributions). A Katrina distribution is not subject to the 10% additional tax under § 72(t) of the Code (including the 25% additional tax under § 72(t)(6) for certain distributions from SIMPLE IRAs), is generally includible in income over a 3-year period, and, to the extent the distribution is eligible for tax-free rollover treatment and is contributed to an eligible retirement plan (recontributed) within a 3-year period, will not be includible in income. Section 103 of KETRA increases the allowable plan loan amount under § 72(p) of the Code and permits a suspension of payments for plan loans outstanding on or after August 25, 2005 that are made to qualified individuals.

BACKGROUND

Under § 402(c)(8) of the Code, an eligible retirement plan includes an individual retirement arrangement (IRA) under § 408(a) or (b), a qualified plan under § 401(a), an annuity plan under § 403(a), a section 403(b) plan, and a governmental deferred compensation plan under § 457(b). Distributions from these plans are generally includible in the distributee's gross income in the year of the distribution. For example, for qualified plans, § 402(a) provides that any amount actually distributed to a distributee is taxable to the distributee in the taxable year of the distribution under § 72. Similar rules exist for section 403(b) plans under § 403(b)(1), for governmental section 457(b) plans under § 457(a), and for IRAs under § 408(d)(1).

Section 402(f) provides that a plan is required to provide a distributee, within a reasonable period of time before an eligible rollover distribution is made, with a written explanation of the distributee's rollover rights and the tax and other potential consequences of the distribution or rollover.

Section 402(c)(4) provides that any distribution of all or a portion of the balance to the credit of an employee under a qualified plan is an eligible rollover distribution with certain exceptions. These exceptions include substantially equal periodic payments over a specified period of at least 10 years, or for the life or the life expectancy of the employee (or the employee and the employee's designated beneficiary); minimum distributions required under § 401(a)(9); and any distribution that is made upon the hardship of an employee. This same definition of eligible rollover distributions applies to distributions from section 403(b) plans under § 403(b)(8) and governmental section 457(b) plans under § 457(e)(16). Generally, any distribution from an IRA is eligible for rollover except a required minimum distribution or certain distributions from inherited IRAs.

Under § 401(a)(31), if a distributee elects to have an eligible rollover distribution paid directly to an eligible retirement plan and specifies the eligible retirement plan to receive the distribution, a qualified plan must pay the distribution to that eligible retirement plan in a direct rollover. Similar rules apply to section 403(b) plans under § 403(b)(10) and governmental section 457(b) plans under § 457(d)(1).

Q&A-14 of §1.401(a)(31)-1 of the Income Tax Regulations provides that if a plan accepts an invalid rollover contribution, the contribution will be treated, for purposes of applying the qualification requirements to the receiving plan, as if it were a valid rollover contribution, if two conditions are satisfied. First, when accepting the amount from the employee as a rollover contribution, the plan administrator of the receiving plan reasonably concludes that the contribution is a valid rollover contribution. Second, if the plan administrator later determines that the rollover contribution was an invalid rollover contribution, any amount attributable to the invalid rollover contribution (including earnings) must be distributed to the employee within a reasonable amount of time after the determination.

Under § 402, if an eligible rollover distribution is contributed to an eligible retirement plan in a direct rollover or within 60 days from the date of distribution as a rollover contribution, the amount rolled over is not includible in the distributee's gross income.

Section 72(t)(1) imposes an additional tax on early distributions from eligible retirement plans. In general, this additional tax is equal to 10% of the portion of the distribution that is includible in income. For any amount distributed from a SIMPLE IRA during the 2-year period described in § 72(t)(6), the rate of the additional tax is increased from 10% to 25%. Section 72(t)(2) provides a number of exceptions to this additional tax, including, for example, exceptions for distributions made on or after the employee attains age 59½, distributions made to a beneficiary on or after the employee's death, distributions made because of the employee's disability, and distributions that are a part of substantially equal periodic payments made over the employee's life or life expectancy.

Section 401(k)(2)(B)(i) generally provides that amounts attributable to elective contributions under a qualified cash or deferred arrangement may not be distributable to participants or beneficiaries earlier than severance from employment, death or disability, plan termination, or attainment of age 59½. This same restriction applies to any amount attributable to qualified nonelective contributions and qualified matching contributions under qualified cash or deferred arrangements. An amount equal to the dollar amount of elective contributions can generally be distributed upon hardship of the employee. Parallel rules apply to custodial accounts under § 403(b)(7)(A)(ii), to annuity contracts under § 403(b)(11), and to governmental section 457(b) plans under § 457(d)(1)(A).

Section 72(p) imposes certain requirements relating to plan loans. Unless these requirements are satisfied, an amount received by a participant as a loan is treated as having been received as a distribution from the plan (deemed distribution). Deemed distributions are includible in income and are subject to the 10% additional tax under § 72(t), unless an exception applies.

Under § 72(p)(2)(A), a plan loan (when added to the outstanding balance of all other loans outstanding) must not exceed the lesser of (1) \$50,000 reduced by the excess of the highest outstanding balance of loans from the plan during the 1-year period ending on the day before the date on which the loan is made over the outstanding balance of loans from the plan on the date that the loan is made or (2) the greater of \$10,000 or one-half of the present value of the participant's nonforfeitable accrued benefit under the plan. Section 72(p)(2)(B) provides that a loan must be repaid within 5 years. However, an exception to the 5-year repayment rule applies for loans used to acquire any dwelling unit that will be used (determined at the time the loan is made) as the participant's principal residence. Section 72(p)(2)(C) requires substantially level amortization of a plan loan (with payments not less frequently than quarterly) over the term of the loan.

Q&A-10(a) of § 1.72(p)-1 of the regulations provides that the failure to make any installment payment when due, in accordance with the terms of a loan, violates § 72(p)(2)(C) and, accordingly, results in a deemed distribution at the time of such failure. However, the plan administrator may allow a cure period and § 72(p)(2)(C) will not be considered to have been violated if the installment payment is made not later than the end of the cure period, which period cannot continue beyond the last day of the calendar quarter following the calendar quarter in which the required installment payment was due. If there is a failure to pay the installment payments required under the terms of the loan (taking into account any cure period allowed under Q&A-10(a)), then the amount of the deemed distribution equals the entire outstanding balance of the loan (including accrued interest) at the time of such failure.

SECTION 1: QUALIFIED HURRICANE KATRINA DISTRIBUTIONS

A. Special tax treatment for Qualified Hurricane Katrina distributions.

Section 101 of KETRA provides for special tax treatment for a Katrina distribution. Section 101 of KETRA provides an exception to the 10% additional tax under § 72(t) of the Code (including the 25% additional tax under § 72(t)(6) for certain distributions from SIMPLE IRAs), allows the distribution to be included in income ratably over 3 years, and provides that the distribution will be treated as though it were paid in a direct rollover to an eligible retirement plan if the distribution is eligible for tax-free rollover treatment and is recontributed to an eligible retirement plan within 3 years of the date of the distribution. Section 101 of KETRA also permits special treatment for Katrina distributions under employer retirement plans, as described in section 2 of this notice.

B. Definition of qualified individual.

For purposes of this notice, a qualified individual is an individual whose principal place of abode on August 28, 2005, is located in the Hurricane Katrina disaster area as defined in section 2(1) of KETRA and who has sustained an economic loss by reason of Hurricane Katrina. For purposes of the relief provided under KETRA, the term "Hurricane Katrina disaster area" as set forth in section 2(1) means the entire states of Louisiana, Mississippi, Alabama, and Florida.¹

C. Definition of Katrina distribution.

Section 101(d)(1) of KETRA defines a Katrina distribution as any distribution from an eligible retirement plan made on or after August 25, 2005, and before January 1, 2007, to a qualified individual. Section 101(b) of KETRA limits the amount of distributions that can be treated as Katrina distributions to no more than \$100,000.

A qualified individual is permitted to designate a distribution described above as a Katrina distribution. This designation is permitted to be made with respect to any distribution that would meet the requirements of a Katrina distribution without regard to whether the distribution was on account of Hurricane Katrina. Thus, periodic payments and required minimum distributions received by a qualified individual from an eligible retirement plan on or after August 25, 2005 and before January 1, 2007, are permitted to be treated as Katrina distributions. Similarly, any distribution received by a qualified individual

¹ This definition applies solely for purposes of relief provided under KETRA and does not apply for purposes of relief under other provisions. For example, see Notice 2005-73, 2005-42 I.R.B. 723, which defines taxpayers affected by Hurricane Katrina and designates disaster areas for purposes of the relief provided under § 7508A.

as a beneficiary can be treated as a Katrina distribution. In addition, a reduction or offset of a participant's account balance in order to repay a plan loan, as described in Q&A-9(b) of § 1.402(c)-2 of the regulations, is permitted to be treated as a Katrina distribution. However, any amount described in Q&A-4 of §1.402(c)-2 of the regulations is not permitted to be treated as a Katrina distribution. Thus, the following amounts are not Katrina distributions: corrective distributions of excess contributions under § 415, excess elective deferrals under § 402(g), excess contributions under § 401(k), and excess aggregate contributions under § 401(m); loans that are treated as deemed distributions pursuant to § 72(p); dividends paid on applicable employer securities under § 404(k); and the costs of current life insurance protection. See section 1.D of this notice for rules relating to which Katrina distributions are permitted to be recontributed to an eligible retirement plan.

The definition of Katrina distribution under section 101(d)(1) of KETRA does not limit the designation of a Katrina distribution to amounts withdrawn solely to meet a need arising from Hurricane Katrina. Thus, even though a qualified individual is required to have sustained an economic loss, Katrina distributions are permitted without regard to the qualified individual's need and the amount of the distribution is not required to correspond to the amount of the economic loss suffered by the qualified individual.

As explained in section 2.C of this notice, an employer retirement plan is also permitted to treat a plan distribution described above as a Katrina distribution. It is possible that a qualified individual's designation of a Katrina distribution may be different from the employer retirement plan's treatment of the distribution. This different treatment could occur, for example, if a qualified individual has more than one plan distribution that meets the requirements of a Katrina distribution. This different treatment could also occur if a qualified individual has distributions from more than one eligible retirement plan.

D. Certain Katrina distributions are permitted to be recontributed.

Subject to certain exceptions, distributions from an eligible retirement plan that satisfy the requirements of a Katrina distribution under section 1.C of this notice are permitted to be treated as Katrina distributions. Such distributions may be included in income ratably over 3 years and are not subject to the 10% additional tax under § 72(t) of the Code. However, only a Katrina distribution that is eligible for tax-free rollover treatment under § 402(c) (and 402(e)(6)), 403(a)(4), 403(b)(8), 408(d)(3), or 457(e)(16) is permitted to be recontributed to an eligible retirement plan, and such recontribution will be treated as having been made in a direct rollover to that eligible retirement plan.

In the case of a distribution from an eligible retirement plan other than an IRA, only a Katrina distribution that is an eligible rollover distribution within the meaning of § 402(c)(4) is permitted to be recontributed to an eligible retirement

plan. Thus, periodic payments (for a period of at least 10 years, or the life or the life expectancy of the employee (or the lives or joint life expectancies of the employee and the employee's designated beneficiary)) and required minimum distributions are not permitted to be recontributed to an eligible retirement plan even though those distributions are permitted to be treated as Katrina distributions if they satisfy the requirements under section 1.C of this notice. In the case of a distribution from an IRA, only a Katrina distribution that is eligible for rollover treatment under § 408(d)(3) is permitted to be recontributed to an eligible retirement plan. Thus, required minimum distributions are not permitted to be recontributed to an eligible retirement plan. Any Katrina distribution (whether from an employer retirement plan or an IRA) paid to a qualified individual as a beneficiary of an employee or IRA owner (other than the surviving spouse of the employee or IRA owner) cannot be recontributed. See section 4.C of this notice for rules relating to recontributions of Katrina distributions.

In general, a distribution from an employer retirement plan made on account of hardship is not an eligible rollover distribution. However, if such a distribution satisfies the requirements under section 1.C of this notice, then the distribution is not treated as made on account of hardship for purposes of this notice and, thus, any portion of the distribution is permitted to be recontributed to an eligible retirement plan. See section 4.C of this notice for rules relating to recontributions.

E. Definition of principal place of abode.

An individual's principal place of abode is where the individual lives unless temporarily absent due to special circumstances. A temporary absence from the household due to special circumstances, such as illness, education, business, vacation, or military service, will not change an individual's principal place of abode. See §§ 1.2-2, 1.152-1(b), and 1.152-2(a)(2)(ii) of the regulations for information relating to a temporary absence from a principal place of abode. If an individual's principal place of abode was in the Hurricane Katrina disaster area immediately before August 28, 2005, and the individual evacuated because of Hurricane Katrina, the individual's principal place of abode will be considered to be in the Hurricane Katrina disaster area on August 28, 2005.

SECTION 2. GUIDANCE FOR EMPLOYER RETIREMENT PLANS MAKING KATRINA DISTRIBUTIONS

A. Katrina distributions are generally treated as satisfying certain plan distribution restrictions.

Under section 101 of KETRA, a Katrina distribution designated by an employer retirement plan is treated as meeting the distribution restrictions for qualified cash or deferred arrangements under § 401(k)(2)(B)(i) of the Code, for

custodial accounts under § 403(b)(7)(A)(ii), for annuity contracts under § 403(b)(11), and for governmental deferred compensation plans under § 457(d)(1)(A). Thus, for example, an employer is permitted to expand the distribution options under its plan to allow an amount attributable to an elective, qualified nonelective, or qualified matching contribution under a qualified cash or deferred arrangement to be distributed as a Katrina distribution even though the distribution is before an otherwise permitted distributable event, such as severance from employment, disability, or attainment of age 59½.

Except as described above, section 101 of KETRA does not change the requirements for when plan distributions are permitted to be made from employer retirement plans. Thus, for example, a qualified plan that is a pension plan (e.g. a money purchase plan) is not permitted to make in-service distributions merely because the distribution, if made, would qualify as a Katrina distribution. Further, a pension plan is not permitted to make a distribution under a distribution form that is not a qualified joint and survivor annuity without spousal consent merely because the distribution, if made, could be treated as a Katrina distribution.

B. Direct rollover and 20% withholding requirements are not applicable to Katrina distributions.

If a distribution is treated as a Katrina distribution by an employer retirement plan, the rules for eligible rollover distributions under §§ 401(a)(31), 402(f), and 3405 of the Code are not applicable with respect to the distribution. Thus, the plan is not required to offer the qualified individual a direct rollover with respect to the distribution. In addition, the plan administrator does not have to provide a § 402(f) notice. Finally, the plan administrator or payor of the Katrina distributions is not required to withhold an amount equal to 20% of the distribution, as is usually required under § 3405(c)(1). However, a Katrina distribution is subject to the voluntary withholding requirements of § 3405(b) and § 35.3405-1T of the Temporary Employment Tax Regulations.

C. Treatment of distributions as Katrina distributions.

An employer is permitted to choose whether to treat distributions under its plans as Katrina distributions. Further, the employer (or plan administrator) is permitted to develop any reasonable procedures for identifying which distributions are treated as Katrina distributions under its retirement plans. However, if an employer retirement plan treats any distribution of an amount subject to § 401(k)(2)(B)(i), 403(b)(7)(A)(ii), 403(b)(11) or 457(d)(1)(A) as a Katrina distribution, the plan must be consistent in its treatment. Thus, the amount of the distribution must be taken into account in determining the \$100,000 limit on Katrina distribution payments made under the retirement plans maintained by the employer.

D. Distribution limits on Katrina distributions.

The total amount of distributions treated by an employer as Katrina distributions under its retirement plans with respect to a qualified individual is not permitted to exceed \$100,000. For purposes of this rule, the term “employer” means the employer maintaining the plan and those employers required to be aggregated with the employer under § 414(b), (c), (m), or (o). However, a plan will not fail to satisfy any requirement under the Code merely because a qualified individual’s total Katrina distributions exceed \$100,000, taking into account distributions from IRAs or other eligible retirement plans maintained by unrelated employers.

E. Reliance on reasonable representations.

In making a determination that a distribution is a Katrina distribution, a plan sponsor or plan administrator of an employer retirement plan is permitted to rely on reasonable representations from a distributee with respect to the distributee’s principal place of abode on August 28, 2005, and whether the distributee suffered an economic loss by reason of Hurricane Katrina, unless the plan sponsor or plan administrator has actual knowledge to the contrary.

F. An employer retirement plan will be treated as operating in accordance with its terms if certain requirements are satisfied.

The Internal Revenue Service will be issuing guidance in the future relating to plan amendments for KETRA. An employer retirement plan will not be treated as failing to operate in accordance with its terms merely because the plan implements the provisions of sections 101 and 103 of KETRA if the plan sponsor amends its plan by the applicable dates described below. For employer retirement plans other than a governmental plan, the date by which any plan amendment to reflect KETRA is required to be made will not be earlier than the last day of the first plan year beginning on or after January 1, 2007. For governmental plans under § 414(d) of the Code, the date by which any plan amendment to reflect KETRA is required to be made will not be earlier than the last day of the first plan year beginning on or after January 1, 2009.

SECTION 3. GUIDANCE FOR ELIGIBLE RETIREMENT PLANS MAKING, OR ACCEPTING RECONTRIBUTION OF, KATRINA DISTRIBUTIONS

This section provides guidance for eligible retirement plans (i.e., employer retirement plans and IRAs) making, or accepting recontribution of, Katrina distributions.

A. Tax Reporting on Katrina distributions.

An eligible retirement plan must report the payment of a Katrina distribution to a qualified individual on Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. This reporting is required even if the qualified individual recontributes the Katrina distribution to the same eligible retirement plan in the same year. If a payor is treating the payment as a Katrina distribution and no other appropriate code applies, the payor is permitted to use distribution code 2 (early distribution, exception applies) in box 7 of Form 1099-R. However, a payor is also permitted to use distribution code 1 (early distribution, no known exception) in box 7 of Form 1099-R.

B. Reliance on representations relating to the recontribution of a Katrina distribution.

In general, a qualified individual who receives a Katrina distribution that is eligible for tax-free rollover treatment is permitted to recontribute, at any time in a 3-year period, any portion of the distribution to an eligible retirement plan that is permitted to accept eligible rollover contributions. The relief in Q&A-14 of § 1.401(a)(31)-1 of the regulations applies to an employer retirement plan accepting recontributions of Katrina distributions. In order to obtain the relief described in Q&A-14 of § 1.401(a)(31)-1, a plan administrator accepting the recontribution of a Katrina distribution must reasonably conclude that the recontribution is eligible for direct rollover treatment under section 101(c) of KETRA and that the recontribution is made in accordance with the rules under section 4.C of this notice. In making this determination, the rule in section 2.E of this notice applies. Thus, a plan administrator may rely on the reasonable representations of a qualified individual with respect to the individual's principal place of abode on August 28, 2005 and whether the individual suffered an economic loss by reason of Hurricane Katrina, unless the plan administrator has actual knowledge to the contrary.

SECTION 4. GUIDANCE FOR INDIVIDUALS RECEIVING KATRINA DISTRIBUTIONS UNDER SECTION 101 OF KETRA

This section provides guidance for qualified individuals requesting and receiving Katrina distributions. A qualified individual receiving a Katrina distribution is entitled to favorable tax treatment with respect to the distribution. First, the 10% additional tax under § 72(t) of the Code (including the 25% additional tax under § 72(t)(6) for certain distributions from SIMPLE IRAs) does not apply to any Katrina distribution. Second, a Katrina distribution is permitted to be included in income ratably over 3 years. Third, a qualified individual is permitted to recontribute any portion of a Katrina distribution that is eligible for tax-free rollover treatment to an eligible retirement plan within 3 years from the day after the date of the distribution, and the recontribution will be treated as if it were paid in a direct rollover to an eligible retirement plan. See section 1.D of

this notice for rules relating to which Katrina distributions are permitted to be recontributed. Qualified individuals will use Form 8915², Qualified Hurricane Katrina Retirement Plan Distributions and Repayments, to report any recontribution made during the taxable year and to determine the amount of the Katrina distribution includible in income for the taxable year.

A. Election to designate a distribution as a Katrina distribution.

A qualified individual is permitted to designate any distribution described in section 1.C of this notice as a Katrina distribution provided the total amount treated by the individual as Katrina distributions does not exceed \$100,000. For example, if a qualified individual received a distribution of \$50,000 in 2005 and a distribution of \$75,000 in 2006 and both distributions satisfy the definition of a Katrina distribution, only \$100,000 of the \$125,000 received by the qualified individual can be treated as a Katrina distribution. Thus, if such individual treated the 2005 distribution of \$50,000 as a Katrina distribution on his or her 2005 tax return, the individual can only treat \$50,000 of the 2006 distribution as a Katrina distribution on his or her 2006 tax return. Assuming no § 72(t)(2) exception applies, the remaining \$25,000 of the 2006 distribution is an early distribution. This amount will be subject to the 10% additional tax, must be included on the individual's 2006 tax return, and will not be eligible for 3 year recontribution to an eligible retirement plan.

Example. A section 401(k) plan distributes \$35,000 to a qualified individual on December 1, 2005. The qualified individual also receives a distribution from his or her IRA on December 1, 2005 of \$15,000. The individual is permitted to treat both the \$35,000 from the plan and the \$15,000 from the IRA as Katrina distributions on the individual's 2005 tax return.

B. Income inclusion for Katrina distributions

There are two methods for a qualified individual to include in income the taxable portion of a Katrina distribution. First, a qualified individual who receives a Katrina distribution is permitted to include the taxable portion of the amount of the distribution in income ratably over a 3-year period that begins in the year of the distribution. Second, a qualified individual is permitted to elect out of the 3-year ratable income inclusion and include the entire amount of the taxable portion of the Katrina distribution in income in the year of the distribution. All Katrina distributions received in a taxable year must be treated consistently (either all distributions are included in income over a 3-year period or all distributions are included in income in the current year). If a qualified individual uses the 3-year ratable income inclusion method, such method cannot be changed after the timely filing of the individual's tax return (including extensions) for the year of the distribution.

² Form 8915 is expected to be available soon.

Example. Taxpayer A receives a \$30,000 distribution from his or her IRA on October 1, 2005. Taxpayer A is a qualified individual and elects to treat the distribution as a Katrina distribution. Taxpayer A uses the 3-year ratable income inclusion for the \$30,000 distribution. Taxpayer A should include \$10,000 in income with respect to the Katrina distribution on each of his or her 2005, 2006, and 2007 tax returns.

C. Tax treatment of recontributions of Katrina distributions.

If a Katrina distribution is eligible for tax-free rollover treatment (taking into account section 1.D of this notice), a qualified individual is permitted, at any time in the 3-year period beginning the day after the date of a Katrina distribution, to recontribute any portion of the distribution, but not in excess of the amount of the distribution, to an eligible retirement plan. A recontribution of a Katrina distribution will not be treated as a rollover contribution for purposes of the one-rollover-per-year limitation under § 408(d)(3)(B).

D. Tax treatment of recontributions of a Katrina distribution using the 1-year income inclusion method.

If a qualified individual elects to include all Katrina distributions received in a year in gross income for that year and recontributes any portion of the Katrina distributions to an eligible retirement plan at any time during the 3-year recontribution period, then the amount of the recontribution will reduce the amount of the Katrina distribution included in gross income for the year of the distribution. The qualified individual will report the amount of the recontribution on Form 8915, which will be filed with the individual's income tax return.

If a qualified individual includes a Katrina distribution in gross income in the year of the distribution and recontributes the distribution to an eligible retirement plan after the timely filing of the individual's tax return for the year of the distribution (i.e., after the due date, including extensions), the individual will need to file an amended tax return. The qualified individual will need to file a revised Form 8915 with his or her amended return to report the amount of the recontribution and should reduce his or her gross income by the amount of the recontribution, but not to exceed the amount of the Katrina distribution.

Example 1. Taxpayer B receives a \$45,000 distribution from a section 403(b) plan on November 1, 2005. Taxpayer B is a qualified individual and treats the distribution as a Katrina distribution. Taxpayer B receives no other Katrina distribution from any eligible retirement plan in 2005. After receiving reimbursement from his or her insurance company for a casualty loss, Taxpayer B recontributes \$45,000 to an IRA on March 31, 2006. Taxpayer B reports the recontribution on Form 8915 and files the 2005 tax return on April 10, 2006. For Taxpayer B, no portion of the Katrina distribution is includible as income for the 2005 tax year.

Example 2. The facts are the same as Example 1 of this section 4.D, except that Taxpayer B timely requests an extension of time to file the 2005 tax return and makes a recontribution on August 2, 2006, before he or she files the 2005 tax return. Taxpayer B files the 2005 tax return on August 10, 2006. As in Example 1, no portion of the Katrina distribution is includible in income for the 2005 year because Taxpayer B made the recontribution before the timely filing of the 2005 return.

Example 3. Taxpayer C receives a \$15,000 distribution from a section 457(b) plan on January 10, 2006. Taxpayer C is a qualified individual and treats the distribution as a Katrina distribution. Taxpayer C elects out of the 3-year ratable income inclusion on Form 8915 and includes the entire \$15,000 in gross income for the 2006 taxable year. On December 31, 2008, Taxpayer C recontributes \$15,000 to the section 457(b) plan. Taxpayer C will need to file an amended return for the 2006 tax year to report the amount of the recontribution and reduce Taxpayer C's gross income by \$15,000 with respect to the Katrina distribution on the 2006 original tax return.

E. Tax treatment of recontributions of a Katrina distribution using the 3-year ratable income inclusion method.

As explained above, a qualified individual is permitted to include a Katrina distribution in income ratably over a 3-year period. If a qualified individual includes a Katrina distribution ratably over a 3-year period and the individual recontributes any portion of the Katrina distribution to an eligible retirement plan at any date before the timely filing of the individual's tax return (i.e., by the due date, including extensions), the amount of the recontribution will reduce the ratable portion of the Katrina distribution that is includible in gross income for the tax year of the filed return.

Example 1. Taxpayer D receives \$75,000 from a section 401(k) plan on December 1, 2005. Taxpayer D is a qualified individual and treats the \$75,000 distribution as a Katrina distribution. Taxpayer D uses the 3-year ratable income inclusion method for the distribution. Taxpayer D makes one recontribution of \$25,000 to the section 401(k) plan on April 10, 2007. Taxpayer D files the 2006 tax return on April 15, 2007. Without the recontribution, Taxpayer D should include \$25,000 in income with respect to the Katrina distribution on each of D's 2005, 2006, and 2007 tax returns. However, as a result of the recontribution to the section 401(k) plan, Taxpayer D should include \$25,000 in income with respect to the Katrina distribution on the 2005 tax return, \$0 in income with respect to the Katrina distribution on the 2006 tax return, and \$25,000 in income with respect to the Katrina distribution on the 2007 tax return.

Example 2. The facts are the same as Example 1 of this section 4.E, except that Taxpayer D recontributes \$25,000 to the section 401(k) plan on August 10, 2007. Taxpayer D files the 2006 tax return on April 15, 2007, and

does not request an extension of time to file the return. As a result of the recontribution to the section 401(k) plan, Taxpayer D should include \$25,000 in income with respect to the Katrina distribution on the 2005 tax return, \$25,000 in income with respect to the Katrina distribution on the 2006 tax return, and \$0 in income with respect to the Katrina distribution on the 2007 tax return.

F. Recontributions of a Katrina distribution may be carried back or forward when using the 3-year ratable income inclusion.

If a qualified individual using the 3-year ratable income inclusion method recontributes an amount of a Katrina distribution for a taxable year that exceeds the amount which is otherwise includible in gross income for the tax year of the filed return, as described in section 4.E of this notice, the excess amount of the recontribution is permitted to be carried forward to reduce the amount of the Katrina distribution that is includible in gross income in the next taxable year. Alternatively, the qualified individual is permitted to carry back the excess amount of the recontribution to a prior taxable year or years in which the individual included income attributable to a Katrina distribution. The individual will need to file an amended return for the prior taxable year or years to report the amount of the recontribution on Form 8915 and reduce his or her gross income by the excess amount of the recontribution.

Example. Taxpayer E receives a distribution of \$90,000 from his or her IRA on November 15, 2005. Taxpayer E is a qualified individual and treats the distribution as a Katrina distribution. Taxpayer E ratably includes the \$90,000 distribution over a 3-year period. Without any recontribution, Taxpayer E will include \$30,000 in income with respect to the Katrina distribution on each of the 2005, 2006, and 2007 tax returns. Taxpayer E includes \$30,000 in income with respect to the Katrina distribution on the 2005 tax return. Taxpayer E then recontributes \$45,000 to an IRA on November 10, 2006 (and made no other recontribution in the 3-year period). Taxpayer E is permitted to do either of the following:

Option 1. Taxpayer E includes \$0 in income with respect to the Katrina distribution on the 2006 tax return. Taxpayer E carries forward the excess recontribution of \$15,000 to 2007 and includes \$15,000 in income with respect to the Katrina distribution on E's 2007 tax return.

Option 2. Taxpayer E includes \$0 in income with respect to the Katrina distribution on the 2006 tax return and \$30,000 in income on the 2007 tax return. Taxpayer E then files an amended return for 2005 to reduce the amount included in income as a result of the Katrina distribution to \$15,000.

G. Special rules for 3-year ratable income inclusion method for Katrina distributions.

If a qualified individual dies before the full taxable amount of the Katrina distribution has been included in gross income, then the remainder must be included in gross income for the taxable year that includes the individual's death.

H. Katrina distributions will not be treated as a change in substantially equal periodic payments.

In the case of an individual receiving substantially equal periodic payments from an eligible retirement plan, the receipt of a Katrina distribution from that plan will not be treated as a change in substantially equal payments as described in § 72(t)(4) merely because of the Katrina distribution.

SECTION 5. APPLICATION OF SECTION 103 OF KETRA TO PLAN LOANS

This section provides guidance regarding the application of section 103 of KETRA to plan loans, including a safe harbor that is treated as satisfying section 103(b) of KETRA.

A. Increase in the allowable loan amount.

Special rules apply to a loan made from a qualified employer plan (as defined in § 1.72(p)-1, Q&A-2) to a qualified individual on or after September 24, 2005 (the day after the date of enactment of KETRA) and before January 1, 2007. For these loans, section 103(a) of KETRA changes the limits under § 72(p)(2)(A) of the Code. In applying § 72(p) to a plan loan, the \$50,000 aggregate limit in § 72(p)(2)(A)(i) is increased to \$100,000 and the rule in § 72(p)(2)(A)(ii) limiting the aggregate amount of loans to one half of the employee's vested accrued benefit is increased to 100 percent of the employee's vested accrued benefit.³

B. Suspension of payments and extension of term of loan.

A special rule applies if a qualified individual has an outstanding loan from a qualified employer plan on or after August 25, 2005. Section 103(b) of KETRA provides that, for purposes of § 72(p), in the case of a qualified individual with a loan from a qualified employer plan outstanding on or after August 25, 2005, if the due date for any repayment with respect to the loan occurs during the period beginning on August 25, 2005, and ending on December 31, 2006, such due date shall be delayed for one year. In addition, any subsequent repayments for

³ The Department of Labor has advised the Department of the Treasury and the Service that it will not treat any person as having violated the provisions of Title I of the Employee Retirement Income Security Act (ERISA), including the adequate security and reasonably equivalent basis requirements in ERISA section 408(b)(1) and 29 CFR 2550.408b-1, solely because the person made a plan loan to a qualified individual in compliance with KETRA section 103, Code § 72(p), and the provisions of this notice.

the loan shall be appropriately adjusted to reflect the delay and any interest accruing for such delay, and the period of delay shall be disregarded in determining the 5-year period and the term of the loan under § 72(p)(2)(B) and (C). Thus, an employer is permitted to choose to allow this delay in loan repayments under its plan with respect to a qualified individual, and, as a result, there will not be a deemed distribution to the individual under § 72(p).

This notice provides the following safe harbor for satisfying section 103(b) of KETRA. Under this safe harbor, a qualified employer plan will be treated as satisfying the requirements of § 72(p) pursuant to section 103(b) of KETRA if a qualified individual's obligation to repay a plan loan is suspended under the plan for any period beginning not earlier than August 25, 2005, and ending not later than December 31, 2006 (suspension period). The loan repayments must resume upon the end of the suspension period, and the term of the loan may be extended by the duration of such suspension period. If a qualified employer plan suspends loan repayments during the suspension period, the suspension will not cause the loan to be deemed distributed even if, due solely to the suspension, the term of the loan is extended beyond five years. Interest accruing during the suspension period must be added to the remaining principal of the loan. A plan satisfies these rules if the loan is repaid thereafter by amortization in substantially level installments over the remaining period of the loan (i.e., five years from the date of the loan, assuming that the loan is not a principal residence loan, plus the suspension period). If an employer, under its plan, chooses to permit a suspension period that is less than the suspension period described above, the employer is permitted to extend subsequently the suspension period, but not beyond December 31, 2006.

Example. On March 31, 2005, a participant with a nonforfeitable account balance of \$40,000 borrowed \$20,000 to be repaid in level monthly installments of \$394 each over 5 years, with the repayments to be made by payroll withholding. The participant makes 8 monthly payments until December 1, 2005. The participant's home is in the Hurricane Katrina disaster area and the participant sustained an economic loss. The participant's employer takes action to suspend payroll withholding repayments, for the period from December 1, 2005, through the end of 2006, for loans to qualified individuals that are outstanding on or after August 25, 2005, but only for its employees who have a principal place of abode in the Hurricane Katrina disaster area and sustained an economic loss. Because the participant is an employee of the employer who has a principal place of abode in the Hurricane Katrina disaster area and notifies the employer that he or she has sustained an economic loss, no further repayments are made on the participant's loan until January 1, 2007 (when the balance is \$19,045). At that time, repayments on the loan resume, with the amount of each monthly installment increased to \$423 in order to repay the loan by April 30, 2011 (which is the date the loan originally would have been fully repaid, plus the 13-month loan suspension period that resulted from Hurricane Katrina).

C. Qualified employer plan may rely on reasonable representations.

A qualified employer plan is permitted to rely on a participant's reasonable representations that such participant is a qualified individual and therefore qualifies for the special treatment for loans under section 103 of KETRA, unless the plan administrator (or other responsible person) with respect to the qualified employer plan has actual knowledge to the contrary.

Drafting Information

The principal authors of this notice are Pamela R. Kinard and Vernon Carter of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, please contact the Employee Plans taxpayer assistance telephone service at (877) 829-5500 (a toll free number) between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday.