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LEGAL DEVELOPMENTS

IRS Posts FAQs for SECURE 2.0 Disaster Relief Guidance

This column discusses Section 331 of SECURE 2.0, which provides for automatic and permanent disaster relief to be available as soon as a major disaster is declared.

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Over the years, Congress has been very good about providing plan sponsors with optional disaster relief to help participants obtain additional funds from their retirement plan (or individual retirement plan (IRA)) on a tax-favored basis, or providing for expanding plan loans and repayment relief for those impacted by a natural disaster declared by the Federal Emergency Management Agency (FEMA). But the one historical complaint regarding this very welcomed relief is that it comes too late. Well, no longer! Section 331 of SECURE 2.0 Act of 2022 provides for automatic and permanent disaster relief, which is available as

soon as a disaster is declared a “major disaster.” This relief is retroactive beginning January 26, 2021, and is intended to replace the ad hoc disaster relief that has been available over the years for various disasters. The Internal Revenue Service (IRS) posted a “Frequently Asked Questions” (FAQ) information page on its website in May 2024 to provide additional information and “soft guidance” to plan sponsors about this SECURE 2.0 section. [Fact Sheet 2024-19, <https://www.irs.gov/newsroom/disaster-relief-frequent-asked-questions-retirement-plans-and-iras-under-the-secure-20-act-of-2022>]

The relief takes on three forms, a plan sponsor can decide what, if any, of the relief provisions it wants to adopt and offer to its participants. The three forms of relief, which are more fully described below, are:

1. Distribution relief—expands distribution rights and related tax relief;
2. Plan loan relief—expands the loan limits for qualified plans and permits a one-year delay in loan repayments; and
3. Home purchase relief—provides an ability to repay 401(k) or 403(b) plan hardship distributions taken for principal residence purchase or construction that never actually happen

Any “qualified individual” is eligible for the relief. A qualified individual is broadly defined as an individual:

1. with a principal residence in the disaster area at any time during the incident period. The “Incident Period” means the period specified by FEMA as the period during which the disaster occurred. See FEMA website at <https://www.fema.gov/disaster/declarations>; and
2. who sustained an economic loss by reason of the disaster (for example, loss/damage to real or personal property from fire, flooding, looting, vandalism, theft, wind, loss related to displacement from their home, loss of livelihood due to temporary or permanent layoffs).

The SECURE 2.0 relief is available only if the President has declared the event to be a major disaster (not an emergency) after Dec. 27, 2020. Incidents that are declared to be major disasters are on the FEMA website. [See <https://www.fema.gov/disaster/declarations>] Notably, a plan sponsor or plan administrator can rely on a participant’s reasonable representation that they are eligible for the relief, absent actual knowledge to the contrary.

The IRS’s FAQs largely tracks the same approach as taken for Katrina distributions issued back in 2005

via Notice 2005-92. We take a closer look at the relief below.

The Relief

New Distributable Event

In general, qualified plans (including IRAs and governmental 457(b) plans) may be amended to permit a new distributable event for a “qualified disaster recovery distribution” of up to \$22,000 aggregate individual lifetime limit for all qualified plans and IRAs per disaster. The distribution is also eligible for the following special tax relief:

- It is not subject to Internal Revenue Code (Code) Section 72(t) 10 percent early withdrawal tax if it is distributed prior to age 59½ (for reporting on Form 1099-R, either code “1” or “2” can be used for this purpose in box 7);
- It is generally eligible for repayment back to the plan (if the plan otherwise accepts rollover contributions);
- It is subject to taxation in equal amounts over a three-year period (the current year of distribution, and the next two), unless the participant elects to be taxed entirely in the year of distribution on Form 8915-F; and
- It is not treated as an eligible rollover distribution (so no mandatory 20 percent federal income withholding and, instead, 10 percent federal withholding applies unless the participant elects out of withholding), and is not treated as eligible for tax-free rollover to an IRA or plan.

This relief permits in-service distribution of 401(k) and 403(b) deferrals and the rest of the plan’s account balance, as well as benefits under a money purchase pension plan, without regard to the participant’s age. For a defined benefit pension plan, the participant does not have a new distributable event. However, if the participant is otherwise eligible for a distribution, the participant can take advantage of the tax benefits of this relief for that distribution. This ability to take advantage of the tax benefits listed above is also true for participants in plans where the plan sponsor has not offered this relief; the participant can still take advantage of the tax benefits for any existing plan distribution with their tax return and filing Form 8915-F. Note that a pension plan distribution is still subject to the qualified joint and survivor annuity distribution requirements,

unless the spouse consents to a lump sum disaster distribution.

Plan Loan Relief

In addition, the relief includes the following loan provisions for qualified plans:

- The maximum loan amount available to qualified individuals for certain new loans following the disaster is increased from \$50,000 to \$100,000. Specifically, the maximum amount for all plan loans that a plan can permit is the lesser of: (i) the greater of \$10,000 or 100 percent (rather than 50 percent) of the individual's vested benefit under the plan; or (2) \$100,000 (rather than \$50,000).
- The loan repayments for certain plan loans can be suspended for up to a year. Specifically, the loan repayments can be delayed under the plan for up to one year for any plan loan that was outstanding on or after the latest of three dates: (i) December 29, 2022; (ii) the first day of the Incident Period; or (iii) the date of the disaster declaration. If the loan is eligible for this relief, any repayment that is due between the first day of the Incident Period and the date that is 180 days after the last day of the Incident Period can be suspended for up to one year. Any payments after the suspension period will be adjusted to reflect that delay and any interest accruing during the delay.

Repayment of Hardship Intended, But Not Used, to Purchase a Home

A hardship distribution taken for purposes of purchasing or constructing a principal residence in a qualified disaster area can repay all or a portion of such distribution to the plan (or IRA) and avoid taxation on the initial distribution. This means that any distribution that is a hardship distribution from a Section 401(k) or Section 403(b) plan (or a qualified first-time homebuyer distribution from an IRA), that meets the following requirements can be repaid to the plan and the participant will not need to pay the tax on the distribution:

1. The distribution amount was to be used to purchase or construct a principal residence in a qualified disaster area, but wasn't so used because of the disaster;

2. The distribution was received during the period beginning 180 days before the first day of the Incident Period of the qualified disaster and ending 30 days after the last day of that Incident Period; and
3. Was repaid as a permissible rollover contribution during the period beginning on the first day of the Incident Period and ending on the date that is 180 days after the latest of the following three dates: (i) December 29, 2022; (ii) the first day of the Incident Period, or (iii) the date of the disaster declaration.

Reliance on the FAQs

The IRS FAQs are part of a "fact sheet," which provides general information to taxpayers. They do not address any particular taxpayer's specific facts and circumstances, and they may be updated or modified upon further review. Because these FAQs have not been published in the Internal Revenue Bulletin, they will not be relied on or used by the IRS to resolve a case. Similarly, if an FAQ turns out to be an inaccurate statement of the law as applied to a particular taxpayer's case, the law will control the taxpayer's tax liability. But, nonetheless, a taxpayer who reasonably and in good faith relies on these FAQs will not be subject to a penalty that provides a reasonable cause standard for relief, including a negligence penalty or other accuracy-related penalty, to the extent that reliance results in an underpayment of tax. For plan sponsors, although the FAQs are silent on this issue, the fact that the same rules that apply under Notice 2005-92 apply to these distributions implies that following these rules should help ensure plan qualification.

Conclusion

The IRS website provides helpful guidance for plan sponsors and recordkeepers to implement the relief provided under SECURE 2.0 in relation to federal disasters. As this provision is optional, plan sponsors should consider whether they want to offer this relief, which has historically been viewed very favorably by participants facing a natural disaster. Although the distribution is limited to \$22,000, and not the historic \$100,000 limit, this distribution feature will still be welcomed relief for participants (and the repayment feature helps participants restore their retirement funds when their situation improves). Amendments to reflect the adoption by the plan sponsor of these provisions is not needed until the extended SECURE

amendment date of December 31, 2026 (unless the plan is terminating), so we have time before a plan amendment is needed. But that said, if the provision is

offered, the distribution package (along with rollover, reporting, and withholding processes) will need to be revised to reflect these special rules. ■

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