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IRS Releases Detailed Guidance on CARES Withdrawal and Loan Relief

by R. Sterling Perkinson

On June 19, 2020, the Internal Revenue Service ("IRS") released guidance (Notice 2020-50) clarifying many aspects of the retirement plan withdrawal and loan relief provisions of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act").

The CARES Act contains three principal items of withdrawal and loan relief:

- Certain employer-sponsored retirement plans and IRAs may permit participants affected by COVID-19 ("Eligible Individuals") to take special distributions of up to $100,000, which are given favorable tax treatment and may be voluntarily recontributed to the same or a different Eligible Plan ("CARES Withdrawals" and "CARES Recontributions", respectively).
- The CARES Act temporarily adjusted the loan limits for an employer's 401(k) or 403(b) plan to the lesser of $100,000 or 100% of a participant's vested account balance (increased from the $50,000 or 50% thresholds) ("CARES Loans").
- An employer's 401(k) or 403(b) loan program may permit Eligible Individuals to defer certain loan repayments for up to 1 year ("CARES Loan Deferment").

The IRS also released guidance regarding required minimum distributions for 2020 for 401(k) and other defined contribution retirement plans, which we are addressing in a separate blog post.

As described in our prior article, the Katrina Emergency Tax Relief Act of 2005 ("KETRA"), provided withdrawal and loan relief provisions very similar to those found in the CARES Act, and the IRS had earlier issued FAQs indicating that the IRS would generally apply the principles of its KETRA guidance to the loan and withdrawal relief under the CARES Act.

Eligible Individuals

The IRS expanded the categories of participants who may take a CARES Withdrawal, a Cares Loan or a CARES Loan Deferment. The CARES Act defines an Eligible Individual to include a participant who is, or whose spouse or dependent is, diagnosed with COVID-19, or who experiences financial consequences as the result of being quarantined, furloughed, laid off or having reduced hours as the result of COVID-19 (or owning or operating a business that must close or reduce its hours as a result of COVID-19), being unable to work due to lack of childcare as the result of COVID-19, or other factors as determined by the Treasury and IRS.

Notice 2020-50 expands the Eligible Individuals definition to include those who experience adverse financial consequences as a result of:

- the individual's having a reduction in pay (or self-employment income) due to COVID-19 or having a job offer rescinded or start date for a job delayed due to COVID-19;
- the individual's spouse or a member of the individual's household (as defined below) being quarantined, being furloughed or laid off, or having work hours reduced due to COVID-19, being unable to work due to lack of childcare due to COVID-19, having a reduction in pay (or self-employment income) due to COVID-19, or having a job offer rescinded or start date for a job delayed due to COVID-19; or
- closing or reducing hours of a business owned or operated by the individual's spouse or a member of the individual's household due to COVID-19.

For purposes of applying these additional factors, a member of the individual's household is someone who shares the individual's principal residence.

Self-Certification

The CARES Act permits plan administrators to rely on employees' self-certifications that they are Eligible Individuals for purposes of determining whether a distribution qualifies for a CARES Withdrawal. Notice 2020-50 clarifies that the plan administrators may rely on a certification of Eligible Individual status for all purposes (CARES Withdrawal, CARES Loan, and CARES Loan Deferment), not just CARES Withdrawal purposes.

While the self-certifications may not be relied on to the extent that the administrator has actual knowledge to the contrary, Notice 2020-50 clarifies that a plan administrator does not have an affirmative obligation to inquire into whether an individual meets the Eligible Individual standard. Notice 2020-50 also provides an example of an acceptable certification.

Eligible Plans

The CARES Act allows the following plan types to permit a CARES Withdrawal to be made notwithstanding the regular restrictions on plan distributions:

- 401(k) plans
- 403(b) plans
- Governmental 457(b) plans

However, regular distributions from other qualified retirement plans and IRAs can be treated as CARES Withdrawals for certain purposes (for purposes of individual tax treatment and eligibility to make a CARES Recontribution) even if the distributing plan/employer did not categorize it as a CARES Withdrawal.

Notice 2020-50 clarifies that CARES Withdrawals are not permitted under a defined benefit pension or money purchase pension plan unless a participant would otherwise have a right to a distribution, such as on account of having incurred a termination of employment. CARES Withdrawals are also not exempt from spousal consent requirements that otherwise apply under the plan.

CARES Withdrawals

A CARES Withdrawal is a distribution that is made from a retirement plan to an Eligible Individual on or after January 1, 2020, and before December 31, 2020, up to an aggregate limit of $100,000 from all plans and IRAs. This limit applies across all plans maintained by the employers within the controlled group.

The retirement plan is not required to provide participants with a rollover notice or to withhold 20% of the distribution for an eligible rollover distribution – although CARES Withdrawals are subject to voluntary withholding.

Certain distributions are not permitted to be treated as CARES Withdrawals, including distributions of excess deferrals or deemed distributions resulting from a loan default. However, an Eligible Individual may be able to avoid adverse tax consequences from a deemed distribution through CARES Act relief alternatives. For example, if the participant has sufficient funds in their account, they may be able to take a CARES Withdrawal to pay off the loan to avoid or cure a loan default before a deemed distribution occurs. Alternatively, they may elect a CARES Loan Deferment.

The participant may treat a withdrawal as a CARES Withdrawal on his or her individual tax return even if it was not treated as a CARES Withdrawal by the plan. Conversely, in some cases, a retirement plan could treat a distribution as a CARES Withdrawal, even though the Eligible Individual does not (for example, because the Eligible Individual received total distributions across multiple unrelated retirement plans exceeding $100,000).

CARES Recontributions

CARES Withdrawals may be recontributed to an IRA or retirement plan that accepts rollover contributions within three years after the date the CARES Withdrawal was received, and the amount of any CARES Recontribution may be excluded from income.

The IRS anticipates (but does not specifically require) that retirement plans that accept rollover contributions will accept recontributions of CARES Withdrawals. The plan may rely on certifications that the recontribution is permitted under the CARES Act—(i.e., it is a recontribution within 3 years after a CARES Withdrawal). Amounts contributed in a CARES Recontribution are treated as a contributions from a direct rollover.

Reporting CARES Withdrawals

Retirement plans are required to report CARES Withdrawals on Form 1099-R (even if the amounts are recontributed within the same year). Notice 2020-50 clarifies that they may be reported using either distribution code 1 or distribution code 2 in box 7 of Form 1099-R.

CARES Loans

Notice 2020-50 helps Eligible Individuals take advantage of the relaxed rules for plan loan access and repayment under the CARES Act. In particular, (i) employers are not required to verify a participant's status as a qualified individual, but may instead rely on the participant's self-certification unless the plan administrator has actual knowledge to the contrary; (ii) the dollar limit on plan loans taken between March 27, 2020, and September 22, 2020, is raised from $50,000 to $100,000; and (iii) plans may suspend loan repayments through the end of 2020.

CARES Loan Deferment

The loan suspension rules of the CARES Act allow an Eligible Individual with a plan loan outstanding on or after March 27, 2020, to delay for one year any payments that become due during the period beginning March 27, 2020, and ending December 31, 2020. Any subsequent repayments of the loan must be adjusted to reflect the delayed payments and interest that accrued during such delay. The period of the delay is disregarded for purposes of the 5-year maximum loan term. Notice 2020-50 clarifies that a loan suspension is an optional feature for plans.

Notice 2020-50 provides plan administrators with a safe harbor procedure for loan deferments. Administrators may reamortize the loan on January 1, 2021, when the repayments resume (taking into account the loan balance at the time of

the suspension plus interest that accrued on the balance throughout the delayed period) and allow repayments to be made over the remaining period of the loan, plus one year. Some plan administrators conservatively anticipated that the loan term could be extended only for the period of deferment.

Allowing for a one-year extension of the loan term is a favorable result for participants, particularly for those who elect a loan deferment later in 2020. For example, if an Eligible Individual elects a CARES Loan Deferment in November 2020, the deferment would only allow for them to miss one payment before payments must resume. However, under the new safe harbor, the participant would still get the benefit of the CARES Loan Deferment because the remaining payments could be spread out over a longer loan term, resulting in lower payments. If the loan term were only extended by the period of deferment, the lowered payment due to the extension of the loan by one month would be very modest.

This safe harbor is not the only way of allowing for a loan deferment of one year, but it offers regulatory certainty and is an administratively convenient approach for complying with the loan deferment rules.

Nonqualified Deferred Compensation

An employee's election to defer compensation under a nonqualified deferred compensation plan (a 409A plan) is generally "locked in" for the calendar year in which the election is made. But an employee may cease deferrals under a 409A plan upon receiving either an unforeseeable emergency distribution under the 409A plan or a hardship distribution from the 401(k) plan (or other applicable qualified defined contribution retirement plan). Notice 2020-50 clarifies that a CARES Withdrawal from a 401(k) plan (or other applicable qualified defined contribution plan) will be treated as a hardship distribution for purposes of allowing an employee to cancel the deferral election.

Amendment Deadline

A non-governmental employer-sponsored retirement plan does not require an amendment to implement CARES withdrawal and loan relief until the last day of the first plan year beginning on or after January 1, 2022 (IRC section 414(d) governmental plans have until the last day of the first plan year beginning on or after January 1, 2024).

Notice 2020-50 notes that the IRS may further extend these amendment deadlines in later guidance.