Insight for Administering the CARES Act

July 14, 2020

Recent IRS guidance in Notices 2020-50 and 2020-51 clarifies the rules for CARES Act[*] distributions and loans and provides transition relief for required minimum distribution (RMD) waivers.

Background – the IRS shows it CARES

The CARES Act provides help to retirement plan participants suffering from the effects of the coronavirus by:

- allowing early access to retirement plan balances (coronavirus-related distributions, or CRDs),
- increasing the maximum amount permitted to be borrowed in a plan loan, and
- waiving certain RMDs.

The Act also:

- exempts CRDs from early distribution penalties,
- allows taxation of CRDs to be spread out over three years,
- permits the repayment of CRDs, and
- allows the delay of loan repayments scheduled in 2020 by one year.

IRS clarifies who Is eligible for CRDs or special loan provisions

The CARES Act permits CRDs and special loan treatment for participants who are diagnosed with coronavirus (or whose spouses or dependents are). In addition, the statute, as clarified by Notice 2020-50, allows CRDs or special loan provisions to participants who face adverse financial consequences that result from the participant, the participant's spouse, or a member of the participant's household (someone who shares the participant's principal residence):

- being quarantined, furloughed, or laid off or having work hours reduced,
- being unable to work due to lack of childcare,
- having his or her business close or reduce hours, or
- having a reduction in pay, a job offer rescinded, or a start date for a job delayed.

Beneficiaries with plan accounts may also be eligible for CRDs.

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[*] Coronavirus Aid, Relief, and Economic Security Act (H.R. 748)

Administrators of the plan may rely on a participant's certification that he or she is a qualified individual unless the administrator has actual knowledge to the contrary. A sample certification is included in Notice 2020-50.

Employers can choose to treat a distribution as a coronavirus-related distribution…

To add a CRD feature, the employer:

- must amend the plan by December 31, 2022 for calendar year plans (December 31, 2024 for calendar year governmental plans)
- is not required to offer a direct rollover, provide a special tax notice, or apply the 20% mandatory withholding
- reports CRDs on Form 1099-R

…. or not!

Notice 2020-50 provides that, even if an employer does not elect to amend its defined contribution plan (or cannot amend its pension plan (including a money purchase plan)) to add a CRD feature:

- a participant (or beneficiary) who is a qualified individual can treat up to $100,000 of a distribution as a CRD, without regard to actual financial need, and
- RMDs received on or after January 1, 2020 and before December 31, 2020 by qualified individuals may be treated as CRDs and therefore included in income ratably over three years (see below for income tax filing details).

But:

- corrective distributions of excess deferrals or contributions and loans that are treated as deemed distributions may not be treated as CRDs.

IRS clarifies some aspects regarding the recontribution of CRDs to the plan

The CARES Act provides for the recontribution to a plan of most CRDs. Notice 2020-50 clarifies that:

- a recontribution will be treated as a tax-free rollover but will not count toward the one-rollover-per-year limitation under the Internal Revenue Code,
- the employer reports the payment of a CRD to a qualified individual on Form 1099-R, even if the CRD is recontributed in the same year, and
- CRDs to a non-spousal beneficiary may not be recontributed.

IRS explains how participants claim favorable tax treatment of CRDs

A qualified individual who receives a CRD may include it in income ratably over three years or include the entire amount in the year of distribution. This election:

- is handled through the individual's annual tax filing on Form 1040 (using accompanying Form 8915-E, Qualified 2020 Disaster Retirement Plan Distributions and Repayments),
- cannot be made or changed after filing the tax return, and
- must apply consistently to all CRDs received in a taxable year (i.e., either all distributions must be included in income over a 3-year period or all distributions must be included in income in the current year).

If a qualified individual dies before including all three years of the CRD in income, the rest is included in the year of death.

Notice 2020-50 also includes tax guidance for participants who recontribute some, or all, of the CRD.

IRS provides an example of the way employers can handle the repayment of plan loans that have been suspended and offers alternatives

Employers may opt to delay (up to a year) the due date for plan loan repayments otherwise required during the period beginning on March 27, 2020 and ending on December 31, 2020 (the maximum suspension period). Employers offering the delay must adjust the subsequent repayments to reflect the delay and any interest accruing during the delay. How this is accomplished can vary, but must be reasonable:

- The simplest method, which the Notice treats as a "safe harbor," is to resume repayments effective January 1, 2021, with the amount of each monthly installment reamortized to include the suspended payments so that the loan is repaid by the date the loan would have been fully repaid plus one year.
- One alternative is to delay each payment that was suspended to one year from the initial date of the suspension period, require the originally scheduled payments to begin in 2021, and then reamortize the outstanding balance of the loan beginning on the one year anniversary of the suspension over a period that is one year longer than the original term of the loan.

IRS explains how to deal with required minimum distributions that have already been made or will be waived

The CARES Act allows plan sponsors to waive RMDs for defined contribution plans that are paid in 2020 (or paid in 2021 for a participant who has a required beginning date of April 1, 2021) ("2020 RMDs"). Notice 2020-51:

- permits the rollover of the waived RMDs, including rollovers of payments that are part of a series of substantially equal periodic payments (e.g., annuities) that include 2020 RMDs,

- extends the time by a year (until December 31, 2021) for an employee or beneficiary who has the option under the terms of the plan to make an election whether RMDs are determined using the 5-year or life expectancy rule. (The Notice does not, however, extend the 5-year period (or the new 10-year limit for certain nonspouse beneficiaries under the SECURE Act) for deaths that occur during or after 2020),
- extends the deadline (until December 31, 2021) for a nonspouse designated beneficiary to make a direct rollover to an inherited IRA, and
- requires amendments by December 31, 2022 for calendar year plans to implement the CARES Act RMD waiver (December 31, 2024 for calendar year governmental plans). The Notice includes a sample amendment that employers may adopt to give plan participants and beneficiaries whose RMDs are waived a choice as to whether to receive the waived RMD as a distribution anyway.

However, the CARES Act was enacted on March 27, leaving plan sponsors no time to stop distributions in process for April 1 required beginning dates or a way to unwind 2020 RMDs that had already been made. Notice 2020-51 addresses these issues, by:

- characterizing these distributions as *eligible rollover distributions* rather than RMDs, even though the paperwork that is normally required for eligible rollover distributions was not provided,
- excluding these distributions from the automatic rollover, special tax notice, and 20% withholding requirements, and
- excepting distributions already made in 2020 from the 60-day rollover rule so that the deadline for rolling over these amounts will not be before August 31, 2020. That means they can be recontributed to the plan or contributed to an IRA.

Conclusion

IRS provided much needed answers to plan sponsors' questions following the passage of the CARES Act. This will help plan sponsors administer their plans in the near term, though it remains to be seen how many participants will take advantage of the expanded accessibility and tax-favored rules and whether participants' retirement readiness will suffer in the long term.

For questions, please contact a member of our Benefits Team. For more information on benefits issues related to the pandemic, please visit our COVID-19 Resources Page.