

IRS Releases Additional Guidance on CARES Act



RETIREMENT MANAGEMENT SERVICES, LLC
Plan Consulting • Administration • Design

RETIREMENT MANAGEMENT SERVICES, LLC
905 Lily Creek Road Louisville, KY 40243
6/25/2020

The CARES Act, enacted on March 27, 2020, provides that “qualified individuals” – that is, individuals who have been affected by the Coronavirus, either due to illness or having their employment impacted – are eligible for favorable tax treatment with respect to retirement plan distributions and for enhanced loan provisions from a qualified retirement plan. See our article “Retirement Plan Provisions in the CARES Act”

<https://www.consultRMS.com/Resources/57/COVID-19-CARES-Act/142/Retirement-Plan-Provisions-in-the-CARES-Act>.

However, there were many unanswered questions regarding how plan administrators and recordkeepers were to administer the distributions and loans provided under the Act. The IRS has now issued **Notice 2020-50** and **Notice 2020-51** to provide additional guidance on Coronavirus-Related Distributions (CRDs) and Loans under the CARES Act, and to extend the rollover period for individuals who received a Required Minimum Distribution (RMD) in 2020.

It is important to note that employers may decide whether or not to amend their retirement plans to allow for Coronavirus-Related Loans and/or Distributions. If the employer does NOT amend the plan to allow for CRDs or Coronavirus-Related Loan provisions, then participants are still subject to the plan rules for when distributions and loans are permitted. If the plan is amended to allow CRDs and/or Coronavirus-Related Loans, the employer may choose which sources (i.e., 401(k) deferrals, employer profit sharing, employer safe harbor, etc.) may be accessed. If a plan does allow CRDs, but requires spousal consent for a distribution, the addition of the CRD distribution option does not eliminate the need for the participant to obtain spousal consent – the spouse will still have to consent to the distribution.

DETERMINATION OF QUALIFIED INDIVIDUAL

Notice 2020-50 expands the definition of a “qualified individual” for purposes of the Act. Under the original definition, a qualified individual for a CRD or Coronavirus-Related Loan is:

- Any individual diagnosed with SARS-CoV-2 or COVID-19 by a test approved by the CDC or whose spouse or dependent is so diagnosed; or
- An individual who experiences adverse financial consequences as a result of being quarantined, furloughed or laid off; having work hours reduced; being unable to work due to lack of child care; or being the owner of a business that closes or has reduced hours due to COVID-19.

The expanded definition under the Notice states that an individual may also be a “qualified individual” if his/her pay is reduced (the lack of this provision in the CARES Act appeared to be an oversight) or if his/her spouse or member of his/her household meets certain requirements.

Retirement Management Services, LLC
905 Lily Creek Road
Louisville, KY 40243



www.consultRMS.com Phone: 502-429-0767

Specifically, the Notice states that in addition to the above definitions, a qualified individual may also be an individual who experiences adverse financial consequences as a result of:

- The individual 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 member of the individual's household being quarantined, furloughed or laid off, or having work hours reduced due to COVID-19, or having a reduction in pay, or having a job offer rescinded or start date for a job delayed due to COVID-19; or
- The individual's spouse or member of the individual's household being the owner of a business that closes or has reduced hours due to COVID-19.

For the purposes of applying these additional criteria, a member of the individual's household is someone who lives at the same residence as the individual.

The plan administrator may rely on the individual's certification that he satisfies the conditions to be a "qualified individual". The plan administrator is not required to inquire into the participant's personal information to verify that the participant is indeed qualified. However, if the plan administrator has actual knowledge because he already possesses sufficiently accurate information to determine that the individual is not "qualified", then the plan administrator may deny the request for the CRD or Coronavirus-Related Loan.

CORONAVIRUS-RELATED DISTRIBUTIONS

Any "qualified individual" who takes a distribution of up to \$100,000 (including an age 70 ½ RMD) between January 1 and December 31, 2020 may designate the distribution as a Coronavirus-Related Distribution (CRD) on his federal income tax return, *regardless of whether or not the plan is amended to allow for CRDs*. If a distribution is treated as a CRD by the employer plan, then the usual upfront 20% tax withholding is not required. Instead, the distribution is subject to 10% voluntary withholding, unless the individual opts out or elects a different withholding percentage.

As noted in our earlier article, CRDs are exempt from the 10% early withdrawal penalty for distributions to participants under age 59 1/2 and the qualified individual may choose to include one-third of the taxable amount in income each year for three consecutive years in order to spread the tax burden over a longer period of time. In addition, during the 3-year period beginning on the day after the distribution is received, any individual who receives a CRD may repay all or part of the distribution back to the plan that distributed the funds, to another plan or to an IRA. The repayment may be made as 1 or more contributions which do not, in the aggregate, exceed the amount of the distribution. A CRD that is repaid to an IRA will not count toward the otherwise applicable one-rollover-per-year limitation that applies to IRAs. As long as the distribution is repaid before the end of the 3-year period, it will be treated as if it were an eligible rollover, meaning

Retirement Management Services, LLC
905 Lily Creek Road
Louisville, KY 40243



it is not subject to taxes. **Notice 2020-50** provides that even though a distribution on account of hardship is not normally eligible to be rolled over, if the hardship distribution is made to a participant who is a qualified individual for a CRD, then the distribution is permitted to be recontributed.

It should be noted that, unlike a hardship withdrawal where the participant has to demonstrate a need for the funds and substantiate the amount that is being requested, the CARES act does not limit CRDs in this manner. If the plan allows CRDs, the qualified individual may request any amount up to \$100,000 without the need for any additional evidence of a corresponding need.

The Notice clarifies that there are certain distributions that **cannot be treated as CRDs by the individual**, namely:

- Corrective distributions returned due to Section 415 failure
- Excess 401k contributions due to ADP failure
- Excess matching contributions due to ACP failure
- 401k contributions refunded because they are in excess of the annual limit
- Dividends paid on employer securities
- Loans that are deemed to be distributed
- Section 409(p) allocations that are deemed distributions
- Cost of life insurance protection
- Distributions that are permitted withdrawals under an automatic contribution arrangement
- Distributions of premiums for accident or health insurance

TAX TREATMENT FOR CRDs UNDER THE CARES ACT

Notice 2020-50 also provides additional guidance on the tax reporting for CRDs. The plan must report the distribution on a Form 1099-R using either code 1 or code 2 in box 7, if the individual is under age 59 ½, or code 7 if the individual is age 59 ½ or older. A qualified individual who receives a CRD is eligible to recontribute any portion of the distribution to an eligible retirement plan at any time during the 3-year period after the distribution is received. The administrator of the plan accepting the contribution may rely on the individual's certification that the individual satisfies the conditions to be eligible for the rollover. If the plan does not accept rollovers, it is not required to accept recontributions of CRDs. If the plan does accept rollovers, the language of the Notice seems to indicate that the plan must accept the CRD recontribution, as well, but this is not 100% clear in the Notice language.

An individual who receives a CRD will report the distribution on the 2020 federal income tax form and on Form 8915-E. The 10% early distribution tax will not apply. The individual will also use Form 8915-E to report any recontribution made during the taxable year and to determine the amount

Retirement Management Services, LLC
905 Lily Creek Road
Louisville, KY 40243



www.consultRMS.com Phone: 502-429-0767

of the CRD to include in income for the particular year, if the individual is spreading out the tax burden over the allowable 3-year period. The Notice explains that the qualified individual who takes a CRD must make an election when he files his 2020 tax return as to whether he/she will include the distribution ratably over a 3-year period beginning with 2020, or include the entire amount in income for 2020. This election cannot be changed once the 2020 tax return is filed.

If the individual includes the entire CRD as income for 2020 and then repays any portion of the CRD to an eligible plan PRIOR to filing the 2020 tax return, then the amount of the recontribution will reduce the amount of the CRD included in gross income for 2020. On the other hand, if the individual includes the entire CRD as income for 2020 and then recontributes any portion of the CRD to an eligible plan AFTER the 2020 tax return is filed, then the individual will need to file an amended income tax return for 2020, including a revised Form 8915-E.

If the individual chooses to include the CRD as income ratably over a 3-year period and recontributes any portion of the CRD to an eligible retirement plan at any date prior to the filing of the income tax form, the amount of the recontribution will reduce the ratable portion of the CRD for that tax year. If the recontribution exceeds the amount of the CRD that should be includable in income for a particular tax year, the excess amount of the recontribution is permitted to be carried forward to reduce the amount of the CRD includable for the next tax year, OR the excess amount may be carried back to a prior taxable year by filing an amended tax return for the prior year.

GUIDANCE RELATING TO LOANS UNDER THE CARES ACT

For loans taken between March 27, 2020 and September 23, 2020, the CARES Act increased the allowable individual loan amount for a qualified individual from the lesser of \$50,000 or 50% of the vested balance to the lesser of \$100,000 or 100% of the vested balance. Also, qualified individuals who have an outstanding loan on or after March 27, 2020 may suspend any loan repayments that are due during the period March 27, 2020 through December 31, 2020. The loan due date may then be extended by up to 1 year from the date the loan was originally due to be repaid. *Note that while the suspension of loan payments is for a maximum of 9 months, the due date extension is 12 months.* Any subsequent repayments shall be adjusted to reflect the delay and to account for any accrued interest during the suspension period, which must be added to the remaining principal of the loan.

There has been considerable disagreement and confusion on exactly how the loan payment suspension, re-amortization, and loan extension are supposed to work in practice. **Notice 2020-50** describes a safe harbor for satisfying the CARES Act by using the following example:

On April 1, 2020, a participant borrows \$20,000, which is to be repaid in monthly installments of \$368.33 for 5 years, meaning the loan will end on March 31, 2025. The participant makes 3 payments, for April, May and June. The participant is a qualified individual and eligible for a loan

Retirement Management Services, LLC
905 Lily Creek Road
Louisville, KY 40243



www.consultRMS.com Phone: 502-429-0767

suspension. The loan payments are suspended from July 1, 2020 through December 31, 2020. On January 1, 2021 the loan principal, plus accrued interest, is re-amortized to be repaid by March 31, 2026, which is the date the loan would have originally been repaid, plus 1 year. The amount of each monthly payment is now \$343.27.

The Notice also recognizes that there may be other, more complex, ways to administer the loan provisions of the Act.

What if the plan does not choose to implement the Coronavirus-Related Loan provisions and a plan participant with an outstanding loan misses several payments? In that case, the plan will determine if a deemed distribution has occurred. If the plan treats the outstanding loan balance as a deemed distribution, then even if the plan participant is a qualified individual for a Coronavirus-Related Loan, he will not receive any special tax treatment with respect to the deemed distribution.

REQUIRED MINIMUM DISTRIBUTIONS (RMDs) PAID IN 2020

The CARES Act provided that RMDs for calendar year 2020 for 401(a), 401(k), 403(a), 403(b), 457(b) and IRAs could be waived (note that RMDs for defined benefit plans may not be waived). Also, 2019 RMDs for individuals who attained age 70 ½ in 2019 and which were due to be paid by April 1, 2020 could be waived. However, some individuals had already taken the 2019 or 2020 RMD early in the 2020 year, before the CARES Act waiver was enacted. Individuals who have already received the distribution may treat it as an eligible rollover distribution and indirectly roll it over to a plan or IRA. **Notice 2020-51** addresses this situation by extending the usual 60-day deadline for a rollover so that the deadline is now August 31, 2020 for RMDs paid in 2020 (excluding RMDs from defined benefit plans). In the case of an IRA owner who received a distribution of an RMD, the distribution may be repaid to the distributing IRA and it will not be counted toward the one-rollover-per-year limitation that applies to IRAs.

PLAN AMENDMENT

Plans that have not yet chosen to allow CRDs or Coronavirus-related loan provisions may still elect to do so. The rules described in the CARES Act may be put into practice immediately, even if the plan does not currently allow for in-service distributions or loans, provided the plan is amended on or before the last day of the first plan year beginning on or after January 1, 2022, or later if prescribed by the Treasury Secretary. The plan may operate immediately as if the amendment were in effect and the amendment will be retroactive.

Annemarie Keehn, ERPA, QPA, QKA

Retirement Management Services, LLC
905 Lily Creek Road
Louisville, KY 40243



www.consultRMS.com Phone: 502-429-0767