

## BENEFITS BRIEF

### CARES ACT – RETIREMENT PLAN DISTRIBUTION AND LOAN RULES LIBERALIZED

August 2020

This *Benefits Brief* is an update of an earlier version posted to the Coronavirus Hub on [www.ButlerSnow.com](http://www.ButlerSnow.com) to reflect subsequent IRS guidance.

With the economic fallout from the public health measures taken to mitigate the spread of the SARS-CoV-2 virus and COVID-19 disease, many employers have had to resort to unprecedented employment actions, including terminating, furloughing, or laying off employees, and dramatically altering historic employee benefit plans and perks. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) passed by Congress and signed by the President on March 27, 2020 includes two provisions designed to help affected employees during these difficult times by liberalizing the distribution and participant loan provisions. In this *Benefits Brief*, we will briefly summarize the new coronavirus-related distribution provision and the change in the participant loan rules applicable to most tax-qualified retirement plans, including 401(k) and profit sharing plans, Section 403(b) plans, and governmental Section 457(b) plans.

#### Coronavirus-Related Distributions

The following are the key elements of the new “coronavirus-related distribution” provision:

- Distributions can be made between January 1, 2020 and December 30, 2020 to “qualified individuals” up to the lesser of the participant’s vested accrued benefit or \$100,000.
  - In plans with participant loans that are treated as participant-directed investments (which virtually all plans do), the portion of a participant’s balance reflected by the loan would need to be excluded in determining his/her vested account balance for this purpose.
  - Likewise, the amount of a participant’s vested account balance available for this purpose will need to be adjusted to the extent he/she is invested in assets subject to withdrawal restrictions (e.g., an investment option, such as a real estate fund, that does not permit daily transfers).
- “Qualified individuals” include:
  - A participant who is diagnosed with the virus SARS-CoV-2 or with coronavirus disease (COVID-19) under a CDC approved test;
  - A participant whose spouse or dependent (as defined in Section 152 of the Internal Revenue Code) is diagnosed with the virus or disease under a CDC approved test;
  - A participant who experiences adverse financial consequences as a result of: being quarantined; being furloughed or laid off or having work hours reduced due to such virus or disease; being unable to work due to lack of child care due to such virus or disease; closing or reducing hours of a business owned or operated by the individual due to the virus or disease; or other factors as determined by the Secretary of the Treasury (or the Secretary's delegate); or

- An participant who experiences adverse financial consequences as a result of the participant having a reduction in pay (or self-employment income) due to COVID-19 or having a job offer rescinded or start date of a job delayed due to COVID-19; the participant's spouse or member of the participant's household (i.e., someone who shares the participant's principal residence) 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 participant's spouse or member of his/her household due to COVID-19.

As used in these definitions, the term "participant" includes a beneficiary of a deceased participant.

- The \$100,000 limit is determined on an affiliated group basis (i.e., considering all plans of all members of a controlled group or an affiliated service group).
  - Note, the \$100,000 limit is also an individual limit that applies to all withdrawals by a participant from qualified plans, 403(b) plans, and governmental 403(b) plans in which he/she is a participant as well as withdrawals from his/her individual retirement accounts.
- Distributions can be made from accounts that would normally be precluded from in-service withdrawals, including pre-tax elective deferral accounts, qualified matching or nonelective contribution accounts, or safe harbor contribution accounts in a 401(k) plan.
- Distributions are permitted only if the participant is otherwise entitled to a distribution from the plan.
  - Spousal consent requirements applicable to plan distributions must be satisfied.
  - With limited exceptions, a participant can treat most distributions from a plan as a coronavirus-related distribution even if the plan does not specifically adopt these provisions.
- Participants younger than 59 ½ are not subject to the 10% premature distribution penalty.
- The Plan Administrator can rely on the participant's certification that he/she is a "qualified individual" so long as the Plan Administrator does not have actual knowledge to the contrary. The Plan Administrator is not required to investigate.
  - Distributions are permitted without regard to the participant's need for the funds nor must the amount of the distribution correspond to the adverse consequences experienced by the participant.
- Provided the plan allows coronavirus-related distributions, federal income tax withholding is optional, federal income tax should be withheld at the rate of 10% unless the participant elects otherwise, and Plan Administrator is not required to distribute the "Special Tax Notice" normally required before making a distribution from the plan.
- The amount of the distribution received can be included in the participant's income ratably over three years.

- All or part of the distribution can be repaid to the plan or another plan or IRA during the three-year period starting on the day after the distribution provided the distribution when made would have been eligible for rollover to another plan or IRA or was a hardship withdrawal. Earnings on the distribution cannot be re-contributed. The participant is not subject to income tax on the portion re-contributed.
  - Repayment can be made in multiple payments.
  - IRS guidance addresses plan acceptance and reporting procedures.

## **Changes in Participant Loan Rules**

The following provisions apply to loans from tax-qualified defined contribution plans and Section 403(b) plans; governmental Section 457(b) plans are ineligible for the liberalized rules.

- The maximum aggregate loan limit is increased for a “qualified individual” (as defined above) from \$50,000 to \$100,000, up to 100% (from 50%) of the participant’s vested accrued benefit.
  - Applies to loans made between March 27, 2020 and September 22, 2020.
  - The self-certification by “qualified individuals” applies in the same manner as coronavirus-related distributions.
- A “qualified individual” (as defined above) can defer for up to one year, any payments due between the date of enactment (March 27, 2020) and December 31, 2020.
  - Interest will accrue during the deferral period and the remaining loan payments will be re-amortized.
  - This provision applies to loans outstanding on the date of enactment (March 27, 2020) and after.
  - The IRS has implemented more detailed rules for implementing the suspension provisions.
- This extension is ignored for purposes of the five-year term limit imposed under the Internal Revenue Code for loans not made to acquire the participant’s principal residence (so-called “general purpose loans”).

## **Alternatives for Participants who are Not “Qualified Individuals”**

Participants who do not qualify for these provisions (assuming the employer adds them) who wish to access their plan account must qualify for a plan loan under the existing rules (if the plan allows loans) or qualify for a distribution by reason of termination of employment, a hardship withdrawal (if the plan permits hardship withdrawals), or another in-service withdrawal permitted under the plan terms.

## **Plan Sponsor and Administrator Action Items**

The distribution and loan provisions are optional with the plan sponsor. Plan sponsors interested in adding one or both provisions and their plan administrators should consult with their recordkeeper to discuss the logistics of adding them, including the timeline for implementation, the documents the employer must execute, the changes needed in administrative forms and processes, the actions necessary by participants, and the participant communications, if any, the recordkeeper will provide the plan sponsor or directly to participants. Plan sponsors who prefer not to add either or both provisions at this time but anticipate they may wish to do so later this year (after seeing how long it takes for things to return to normal) should discuss with the plan recordkeeper whether later changes will be

permitted. In practice, we have seen many of the large plan recordkeepers proceed with automatically adding these provisions in their customer's plans absent the plan sponsor's affirmative election within a narrow election period *not* to add them.

Plan amendments to implement these provisions are not needed at this time. For most plans, an amendment will not be required before the last day of the 2022 plan year. Plans with a separate participant loan policy should be amended by the end of this year if the loan changes are implemented at this time.

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