March 2020

PENSION ANALYST

Important information—Plan administration and operation

CARES Act includes retirement plan relief

Who's affected

This relief is generally available to sponsors of and participants in qualified plans, ERISA and non-ERISA 403(b) plans, and governmental section 457 plans. Some of the relief is available only to participants and beneficiaries affected by the coronavirus situation.

Background and summary

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act" or "Act"). Among other relief, this law allows plans to provide a new form of distribution to eligible individuals affected by the coronavirus to alleviate financial burdens caused by the outbreak of the virus. It also lessens the tax consequences related to these special distributions. The law also allows plans to provide increased loan limits and delayed loan repayment deadlines for eligible individuals. The CARES Act appears to be modeled on past tax relief laws for certain disasters, including the Disaster Tax Relief Act of 2017 (DTRA) which provided relief to victims of Hurricane Harvey, Hurricane Irma, and Hurricane Maria.

Plan sponsors are not required to adopt the special distribution and loan relief available under the CARES Act and may choose to rely on hardship withdrawal and distribution rules already in place under their plan, as applicable.

The CARES Act also provides 2020 required minimum distribution (RMD) relief for participants and beneficiaries in individual retirement accounts or annuities (IRAs) and defined contribution plans (including 401(a) plans, 403(b) plans, and governmental section 457(b) plans). This RMD relief is not limited to individuals affected by the coronavirus.

In addition, the Act includes funding and benefit restriction relief for single-employer defined benefit plans. These plans are not required to meet 2020 funding obligations until January 1, 2021. Additionally, plan sponsors may elect to apply the plan's funded status for the 2019 plan year in determining the application of benefit restrictions for 2020. The CARES Act did not include funding relief for multiemployer plans.

Separate from the CARES Act, the IRS issued guidance providing delayed tax filing and payment deadlines for taxpayers with an April 15 deadline. The IRS also extended certain plan document deadlines for 403(b) plans and pre-approved defined benefit plans. This publication discusses the delayed deadlines applicable to retirement plans and IRAs.

Action and next steps

Plan sponsors should review this publication to become familiar with the relief provided in the CARES Act. Although sponsors will not need to immediately amend their plans for the relief, sponsors will need to notify Prudential Retirement if they wish to allow the optional provisions of the relief under their plans. Prudential Retirement will contact plan sponsors to obtain plan elections in the near future. Additionally, we expect the IRS to issue additional future guidance regarding provisions of the CARES Act and will keep you informed as guidance is published.

In this issue

Coronavirus-related distributions

The CARES Act permits eligible individuals to take "coronavirus-related distributions" (CRDs) from retirement plans of the types described below. Coronavirus-related distributions will be eligible for special tax treatment. Plan sponsors may permit such distributions immediately, as long as they amend their plans within required timing periods to provide for them.

A CRD is a distribution made to an individual:

- Who is diagnosed with the virus SARS-Co-V-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention,
- Whose spouse or dependent is diagnosed similarly with the virus or disease, or
- Who experiences "adverse financial consequences as a result of being quarantined, being furloughed or laid off or having work hours reduced due to the virus, being unable to work due to a lack of child care due to the virus, or closing or reducing hours of a business owned or operated by the individual due to the virus."

Plan administrators may rely on an employee's certification that the employee satisfies conditions above in determining whether an individual qualifies for the CRD.

CRDs must be made between January 1, 2020, and December 31, 2020. CRDs may be made from profit sharing plans (including section 401(k) plans), stock bonus plans, 403(b) plans, governmental section 457 plans, and IRAs. Distributions from defined benefit plans technically are eligible as coronavirus-related distributions. However, because defined benefit plans and money purchase pension plans generally do not allow in-service distributions prior to a certain age, this provision has limited applicability for these plans.

An individual's total CRDs, taken from all eligible plans and IRAs, may not exceed $100,000. When applying this limit, plan sponsors are responsible for tracking distributions from all plans that they or other members of their "controlled group" sponsor.

The following special tax rules apply to CRD:

- They are exempt from the 10% federal income tax penalty on early distributions.
- If made from a 401(a) qualified plan, 403(b) plan, or governmental section 457 plan, they are not eligible for rollover and therefore, are not subject to mandatory 20% federal tax withholding.
- They are included in the individual's gross income ratably over a three-taxable year period, beginning with the year in which the distribution occurred, unless the individual elects otherwise.
- They may be repaid within three years to an "eligible retirement plan" (i.e., an IRA, a 401(a) qualified plan, a governmental section 457 plan, or a 403(b) arrangement) in which the individual is participating, which is eligible to receive a rollover contribution. A participant need not make the repayment to the same plan or IRA from which the distribution was made.

Special Plan Loan Provisions

Under the Act, plans may allow individuals who are eligible to take CRDs to take larger loans from qualified plans, 403(b) plans, and governmental section 457 plans. In addition, any of those individuals who had an outstanding plan loan on or after the qualified beginning date, may delay payments without causing the loan to become taxable.

The maximum loan amount available to these individuals for loans taken on or after March 27, 2020, and before September 23, 2020, (when added to the outstanding balance of all other loans from the plan), may not exceed the lesser of $100,000, or 100% of the participant's vested account balance.

In addition, an individual with an outstanding plan loan on March 27, 2020 or before January 1, 2021 may delay for one year any loan repayments due during such period. *For example, a repayment originally due on September 18, 2020, may be delayed to September 18, 2021.* This delay will not cause the loan to become a taxable deemed distribution. After the one-year period ends, the loan must be re-amortized to adjust payments for the new due date and accrued interest. (Interest will continue to accrue during the suspension of loan repayments.) The one-year postponement period will be ignored with respect to the term of the loan.

It is important to note that while the Act increased the maximum loan amount on nontaxable loans to $100,000 or 100% of the participant's vested account balance, it did not similarly increase the ERISA loan limit. As a result, a plan loan equal to 100% of a participant's vested account balance would not be considered a taxable distribution but could be a "prohibited transaction" under ERISA, if the plan administrator does not obtain additional security for the loan outside the plan. (The Department of Labor is aware of this issue.)

Waiver of required minimum distributions for 2020

Generally, RMDs must begin to be made from retirement plans by April 1 of the calendar year following the later of the calendar year in which a participant reaches required minimum distribution age (i.e., age 70 ½ for participants born before July 1, 1949, age 72 for participants born after June 30, 1949). The CARES Act provides 2020 RMD relief for participants and beneficiaries in individual retirement accounts or annuities (IRAs) and defined contribution plans (including 401(a) plans, 403(b) plans, and governmental section 457(b) plans). As a result, RMDs that are required to be made in 2020, both with respect to persons who attained age 70 ½ in 2019 (unless they received an RMD in 2019) and those who attained 70 ½ in earlier years, are not required to be made.

For example, a participant who attained age 70 ½ in 2019 normally would have a "required beginning date" of April 1, 2020. With the waiver provided by the CARES Act, such a participant would not be required to receive an RMD in 2020. However, if the participant received an RMD in 2019, the RMD characterization of the 2019 distribution cannot be changed.

The 2020 RMD relief also applies to the five-year rule applicable to beneficiaries when a participant dies before his required beginning date and the death occurred before January 1, 2020. As a result, beneficiaries will receive an extra year to receive total payouts of their account balances if the payment deadline was December 31, 2020, or later. For example, for an account of an individual who died in 2018, the five-year period ends in 2024 instead of 2023.

The 2020 RMD relief does not apply to nongovernmental section 457(b) plans. Participants and beneficiaries in nongovernmental 457(b) plans must receive their 2020 RMD as scheduled.

In addition, the CARES Act permits plans to allow participants and beneficiaries to make direct rollovers to other plans or IRAs of amounts that but for the RMD waiver provided by the CARES Act would have been 2020 RMDs. However, those distributions are not subject to the 402(f) notice requirements and will not be subject to the 20% mandatory federal income tax withholding. As a result, if the portion that would otherwise be the 2020 RMD is paid as a cash distribution, that portion is subject to 10% federal income tax withholding, unless the participant elects out of withholding.

If a plan does not allow participants and beneficiaries to make direct rollovers of amounts that would otherwise be RMDs for 2020, these individuals will still be able to indirectly roll over the portion that would be considered an RMD within 60 days after receipt of the payment.

Plan amendments

In general, the deadline for plan amendments due to these coronavirus-related distribution, loan, and RMD provisions is the last day of the first plan year beginning on or after January 1, 2022. For governmental plans, plan amendments must be adopted by the last day of the first plan year beginning on or after January 1, 2024. Naturally, the effective dates specified in these amendments must be retroactive to the date the provisions were first made effective. The IRS may establish different amendment deadlines, if they perceive a need to do so.

Delay in pension funding and benefit restrictions

The CARES Act provides for a delay in single-employer defined benefit funding obligations that are due during 2020. Under the Act, these plans are not required to satisfy 2020 funding obligations until January 1, 2021. Interest will accrue for late payments for the period between the original due date for the contributions and the payment date.

Under current funding rules, benefit restrictions apply to defined benefit plans that do not meet specific funding levels. When determining benefit restriction status, the CARES Act allows single-employer defined benefit plan sponsors to apply the plan's 2019 funded status for plan years that include calendar year 2020.

The Act does not include any relief for multiemployer plan funding.

Expansion of DOL authority to postpone certain deadlines

The DOL currently has authority to delay ERISA deadlines by up to one year in the case of a Presidentially-declared disaster or a terroristic or military action. The Act expands this authority to including a public health emergency declared by the Secretary of Health and Human Services pursuant to section 319 of the Public Health Service Act.

ERISA deadlines are not automatically delayed. The DOL would need to provide guidance regarding postponed deadlines.

Hardship distributions provide alternative to CARES Act distributions

In lieu of amending plans to permit additional funds to be distributed as coronavirus-related distributions, plan sponsors might consider whether existing hardship provisions are a sufficient means for participants to access retirement plan accounts when needed. Hardship distributions under 401(k) and 403(b) plans are permitted if the participant has an immediate and heavy financial need and if the distribution is necessary to satisfy the financial need. Hardship distributions are generally subject to the 10% federal income tax penalty on early distributions.

Existing hardship rules provide a "safe harbor" definition of hardship, under which distributions are deemed to be for an immediate and heavy financial need if it satisfies certain requirements. While the IRS has not yet provided guidance specific to hardship distributions related to COVID-19, hardship distributions may be permitted under the existing "safe harbor" for certain expenses for medical care, to prevent eviction, or to cover funeral expenses (among other reasons) and in connection with federally declared disasters to residents in disaster areas.

Certain states have been identified as federally declared disaster areas under FEMA eligible for individual assistance due to COVID-19. (As of the writing of this publication, these states include: California, Florida, Illinois, Louisiana, Massachusetts, Michigan, New Jersey, New York, Washington, and Texas). For plans that have added the federally declared disasters to their list of permitted reasons for hardship distributions, certain expenses and losses (including the loss of income) for participants who live or work in one of these states may qualify for a hardship distribution if the participant incurs a hardship related to COVID-19. Additional states continue to be added to the list of major disaster declarations on the FEMA website. In evaluating hardship distributions related to COVID-19 declared disasters and coronavirus-related distributions (CRDs) under the CARES

Act, plan sponsors should note that eligibility conditions for a CRD generally are understood to be laxer than conditions for hardship.

While hardship distributions are not treated as “coronavirus-related distributions” (CRD) at the time of distribution, it is possible but not certain that the IRS will issue guidance that grants some favorable tax treatment to hardship distributions and other types of distributions if the recipient otherwise would be an “eligible individual” under the CRD rules. IRS has issued similar guidance in connection with natural disasters. Under past guidance, participants were able to claim relief by filing IRS Form 8915 with their personal income tax returns. Since Prudential cannot provide tax advice to plan sponsors or participants, participants should consult with his or her tax advisor when completing his or her 2020 tax return.

Extended IRS deadlines

On March 20, the IRS issued Notice 2020-18, extending 2019 Federal income tax return filing and payment deadlines from April 15 to July 15 for all taxpayers with an April 15 deadline, in response to the coronavirus national emergency. On March 24, the IRS provided answers to frequently asked questions regarding the relief in the Notice. While these responses are not citable as legal authority, the Treasury and IRS are considering issuing guidance on these issues. The FAQs clarify the following:

- The deadline to make contributions to an individual retirement account (IRA) for 2019 is postponed to July 15, 2020.
- The delay to July 15, 2020 also applies to a payment of the 10% early distribution penalty.
- Employers with a tax filing due date of April 15, 2020 have until July 15, 2020 to make 2019 deductible employer contributions.
- The date to remove excess deferrals from a 401(k) or similar plan is currently unchanged and remains at April 15, 2020.

Additionally, the IRS also extended the below plan document deadlines:

- The March 31, 2020 deadline for 403(b) plans to adopt pre-approved and individually designed 403(b) plan document restatements has been extended to June 30, 2020.
- The April 30, 2020 deadline for pre-approved defined benefit plans to adopt a plan restatement and submit a determination letter application on Form 5307 under the six-year remedial amendment cycle has been extended until July 31, 2020.

Next Steps

Prudential Retirement is actively working on implementing the provisions of the CARES Act to allow plan sponsors to adopt those provisions. We are also working with industry groups and others in seeking additional guidance on certain provisions.

We expect to provide sponsors with additional information and options in the near future.

Pension Analyst by Prudential Retirement
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Editor: Julie Koos (563) 585-6811