June 2020

PENSION ANALYST

Important information—Plan administration and operation

IRS provides CARES Act distribution and loan guidance

Who's affected

This guidance applies to sponsors of and participants in qualified plans, ERISA and non-ERISA 403(b) plans, and governmental 457(b) plans.

Background and summary

The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") enacted on March 27, allows plans to provide a new form of distribution to eligible individuals affected by coronavirus to alleviate financial burdens caused by the outbreak of the virus. It also lessens the tax consequence related to these special distributions. The law also allows plans to provide increased loan limits and delayed loan repayment deadlines for eligible individuals.

On Friday, June 19, the IRS issued Notice 2020-50, providing guidance regarding the special coronavirus-related distribution (CRD) and loan provisions, including clarification of:

- An individual's eligibility for CARES Act relief;
- The types of distributions that may be classified as CRDs;
- Applicable federal tax withholding and reporting rules; and
- Plan loan repayment suspension provisions.

On Tuesday, June 23, the IRS also provided guidance relating to the waiver of 2020 required minimum distributions (RMDs) in Notice 2020-51. This notice will be discussed in an upcoming Pension Analyst publication.

Action and next steps

Plans sponsors that adopted CARES Act relief should review this publication to become familiar with the rules that apply to CARES Act distributions and loans.

In this issue

Qualified individuals

Under the CARES Act, 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."

The CARES Act granted authority to the Secretary of Treasury to provide additional factors for eligibility. Notice 2020-50 expands the list of factors for an individual to qualify as having adverse financial consequences to include:

- The individual having a reduction in pay (or self-employment income) due to COVID-19 or having a job offer rescinded or start date delayed due to COVID-19;
- The individual's spouse or member of the individual's household 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 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 these purposes, a member of the individual's household is someone who shares the individual's principal residence.

CRDs

A CRD is defined as any distribution made on or after January 1, 2020, and before December 31, 2020, to a qualified individual. The amount of aggregate distributions from all eligible retirement plans that can be treated as coronavirus-related distributions for a qualified individual is limited to no more than $100,000.

The following types of distributions may be considered CRDs:

- Periodic payments;
- Amounts that would have been required minimum distributions if the 2020 CARES Act waiver had not applied;
- Plan loan offsets amounts;
- Hardship withdrawals;
- In-service withdrawals; and
- Termination of employment or retirement distributions.

CRDs are not eligible for direct rollover. As a result, plan administrators do not have to provide section 402(f) rollover notices before making these distributions and the distributions are not subject to 20% federal withholding. However, they are subject to the alternative 10% voluntary withholding. They are not subject to the 10% additional tax on early distributions.

CRDs must be reported on Form 1099-R, even if they are recontributed to the same plan during the same year. These distributions are automatically taxed pro-rata, over the 3-year period beginning with the year of distribution, unless the individual elects to treat the entire amount as taxable in the year he or she receives the distribution. In accordance with IRS guidance, Prudential will report the entire amount on Form 1099-R for the year of distribution and leave it to the individual to choose the actual tax treatment when filing Form 8915-E with his or her tax return. Form 8915-E is expected to be available before the end of 2020.

The administrator of an eligible retirement plan may rely on an individual's certification that the individual satisfies the conditions to be a qualified individual in determining whether a distribution is a CRD, unless the administrator has actual knowledge to the contrary. This "actual knowledge" requirement does not require the administrator to inquire into whether an individual has satisfied the conditions to be a qualified individual. Rather, it is limited to situations in which the administrator already possesses information regarding the accuracy of a certification. While an administrator may rely on an individual's certification in making and reporting a distribution, the individual is entitled to treat the distribution as a CRD on his or her tax return only if he or she actually meets the CRD eligibility requirements.

A qualified individual is generally permitted to designate a distribution as a CRD on his or her tax return if the individual qualifies and the distribution meets the conditions for a CRD, even if the plan did not treat the distribution as a CRD.

Recontribution of CRDs

In general, CRDs that are eligible for tax-free rollover treatment may be recontributed to eligible retirement plans. This includes hardship withdrawals that meet the CRD requirements, even though hardship withdrawals are not normally eligible to be rolled over.

Participant recontributions must be made within the 3-year period beginning on the day after the date the distribution is made. For example, if a plan makes a CRD on June 17, 2020, the recontribution deadline would be June 18, 2023. A different recontribution deadline applies to each CRD distribution made to an individual. Recontributions do not have to be made to the plan that made the original distribution, and partial recontributions are permitted.

When accepting recontributions, plan sponsors and administrators must reasonably conclude that the amount is eligible for recontribution and is being made during the appropriate timeframe. Plan sponsors may rely on the individual's reasonable representations that the distribution was a CRD, unless the plan administrator has actual knowledge to the contrary. Recontributions are to be treated as direct rollover contributions. As a result, Prudential will hold these in a rollover contribution source. If a plan does not accept rollover contributions, the plan is not required to change its terms or procedures to accept recontributions of CRDs.

CARES Act plan loans

The limit on CARES Act loans is the lesser of $100,000 or 100% of the participant's vested account balance. The CARES Act also allows plan sponsors to suspend for one year loan repayments due during the period beginning on March 27, 2020, and ending on December 31, 2020. Any subsequent repayments of the loan shall be adjusted to appropriately reflect the delay and any interest accruing during the delay. The period of the delay is disregarded in determining the 5-year period and the term of the loan. Plans are not required to provide these CARES Act repayment suspensions but may choose to do so.

The IRS guidance provides a safe harbor for loan repayment suspensions. Under this safe harbor, a plan sponsors suspends repayments due during the period beginning March 27, 2020, and ending on December 31, 2020 (the "suspension period"). Loan repayments resume at the end of the suspension period, adjusted for the interest accruing during the suspension period, and the term of the loan is extended by up to one year from the date the loan was originally due to be repaid.

For example:

- Martha borrowed $20,000 on April 1, 2020, to be repaid over a 5-year period.
- Monthly payroll deduction repayments were $368.
- Martha made these repayments through June 30, 2020.
- Martha is a qualified individual under the CARES Act.
- At her request, the plan sponsor suspends her loan repayments for the period beginning July 1, 2020, through December 31, 2020.
- Martha's payments resume on January 1, 2021, with the monthly amount at $343 for the loan to be repaid by March 31, 2026 (the date the loan originally would have been repaid, plus 1 year).

The guidance notes that other methods of applying the CARES Act suspension provision are also possible.

Plan amendments

Sponsors of qualified plans, ERISA 403(b) plans, and governmental section 457(b) plans that want to offer CRDs or CARES Act plan loans or temporarily suspend loan repayments will need to amend their plans to reflect these provisions. In general, the amendment deadline will not be earlier than the last day of the first plan year beginning on or after January 1, 2022. For governmental plans, the amendment deadline will not be earlier than the last day of the first plan year beginning on or after January 1, 2024. If Prudential Retirement provides document services for your plan, we will work with you to draft the appropriate amendments to reflect your plan's elected provisions by the appropriate deadline.

Permitted cancellation of deferral election under nonqualified plan

A nonqualified deferred compensation plan may provide for a cancellation of a service provider's deferral election, or such a cancellation may be made, due to an unforeseeable emergency or a hardship distribution. If a service provider receives a distribution from an eligible retirement plan that constitutes a CRD, that distribution will be considered a hardship distribution. As a result, a nonqualified deferred compensation plan may provide for a cancellation of the service provider's deferral election, or such cancellation may be made, due to a CRD. The deferral election must be cancelled, not merely postponed or otherwise delayed.

Next steps

Prudential Retirement will be contacting plan sponsors in the near future to provide information on how we will accommodate this guidance in our CARES Act offering.

Pension Analyst by Prudential Retirement
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