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Delving into CARES Act relief for retirement plan participants (revised)

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In this article

The Coronavirus Aid, Relief and Economic Security (CARES) Act (Pub. L. No. 116-136) makes it easier for retirement plan participants affected by the pandemic to use their savings to regain their financial footing. For affected participants, the act lets defined contribution (DC) plans offer special in-service "coronavirus-related distributions," doubles the maximum loan amount plans can make and allows suspension of loan repayments for the remainder of 2020. The CARES Act also waives all required minimum distributions from DC plans in 2020 (see SECURE, CARES acts change rules on required minimum distributions (April 7, 2020)). Updates to this article, first published April 10, detail IRS and Department of Labor (DOL) guidance on the scope of the CARES Act relief and implementation issues.

IRS, DOL issue CARES Act guidance for retirement plans

Until agencies issued guidance on the CARES Act's retirement provisions, plan administrators with implementation questions could look to IRS Notice 2005-92, which addressed essentially identical relief under the Katrina Emergency Tax Relief Act (KETRA) of 2005 (Pub. L. No. 109-73). This article initially analyzed the pandemic relief in light of the 2005 notice, but now includes several rounds of CARES Act guidance for retirement plans that IRS and DOL have published since late April:

- IRS Notice 2020-50, issued on June 19, provides formal guidance on the CARES Act's retirement plan relief and includes a number of key clarifications:
  - Employers can choose — but aren't required — to offer any or all of the retirement plan relief.

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  - An expanded definition of a "qualified individual" adds employees who receive a pay cut or who have a spouse or household member (regardless of relationship) experiencing any of the listed adverse financial consequences.
  - Employees can self-certify their eligibility for all of the CARES Act relief — not just the coronavirus-related distributions, as suggested by the statute.
  - Plan administrators don't need to inquire whether an employee self-certifying eligibility for relief actually meets the eligibility criteria. The notice also provides a model self-certification statement.
  - Plans don't have to accept repayment of coronavirus-related distributions. Plans that do accept repayment can rely on participants' self-certification that they are qualified individuals repaying a coronavirus-related distribution.
  - The safe harbor method for suspending plan loan repayments differs slightly from what IRS provided for Hurricane Katrina victims. Under the new notice, plans can extend a participant's loan term by up to one year (instead of by the duration of the loan delay period).

- IRS Q&As about the CARES Act relief, posted May 4, confirm that employers could rely on Notice 2005-92 until the agency provided formal guidance.
- DOL Disaster Relief Notice 2020-01, issued April 29, provides relief from ERISA's plan loan requirements for CARES Act loans and loan-repayment suspensions.

Participants eligible for relief

The CARES Act extends retirement plan relief to a "qualified individual," defined as a participant who meets any of the following:

- Is diagnosed with SARS-CoV-2 or coronavirus disease 2019 (referred to as COVID-19 throughout Notice 2020-50 and this article) with a test approved by the Centers for Disease Control and Prevention (CDC)
- Has a spouse or dependent diagnosed with SARS-CoV-2 or COVID-19
- Experiences adverse financial consequences from being quarantined, furloughed or laid off; having work hours reduced; being unable to work due to lack of child care; or closing or reducing the hours of a business owned or operated by the individual

IRS expands eligibility criteria

The act authorizes Treasury to expand the eligibility criteria beyond what is specified in the statute. In response to input from employers and practitioners, IRS Notice 2020-50 makes several additions to the criteria.

Pay cuts, rescinded job offers or delayed start dates. The act doesn't define a qualified individual to include an employee who receives a pay cut due to the pandemic. However, Notice 2020-50 clarifies that such an individual is eligible for relief. The notice also expands qualified individuals to include anyone experiencing a reduction in future pay due to a rescinded job offer or a deferred start date for a new job.

Financial consequences for spouses, other family members. The act's eligibility criteria do not include an employee whose spouse experiences any of the adverse financial consequences listed in the statute. However, Notice 2020-50 clarifies that an employee is a qualified individual if the employee's spouse or any member of the employee's household suffers any of the listed adverse financial consequences. A household member includes anyone who shares the employee's principal residence — e.g., an unmarried significant other, child or roommate.

Approved COVID-19 tests. The notice clarifies that a CDC-approved COVID-19 diagnostic test includes one authorized under the Federal Food, Drug and Cosmetic Act.

Self-certification allowed

The act lets plan administrators rely on a participant's self-certification of eligibility for relief. Notice 2020-50 clarifies that self-certification is available for all of the relief — including the loan relief (the statute appeared to limit self-certification to eligibility for coronavirus-related distributions). The act doesn't mention written certification, which seemed to suggest participants could certify their eligibility by phone. Notice 2020-50 includes a model written self-certification statement but is silent on whether employees can certify their eligibility by phone. Although the notice stops short of requiring a written certification, employers should consider requiring written confirmation of the participant's eligibility.

The IRS Q&As released in early May clarify that administrators can rely on an employee's self-certification for a distribution, unless they have actual knowledge to the contrary. Notice 2020-50 formalizes this guidance and further clarifies that administrators don't need to confirm that the self-certification is true. This is a welcome clarification, since some employers have expressed concern about potential plan consequences if employees make false certifications. As long as the administrator doesn't possess information to know a certification is false, the plan won't be penalized for extending the relief to an ineligible participant who self-certifies eligibility.

Coronavirus-related distributions

The CARES Act allows a qualified individual to treat up to $100,000 in distributions received from an eligible retirement plan from Jan. 1 through Dec. 30, 2020, as a "coronavirus-related distribution." An "eligible retirement plan" has the same meaning that applies for plan rollovers and includes 401(a) qualified plans, 403(a) annuity plans, 403(b) plans and governmental 457(b) plans, as well as IRAs.

In-service distributions allowed

The CARES Act allows — but does not require — employers to offer special in-service coronavirus-related distributions to qualified individuals until Dec. 30, 2020. The distributions can be made from most sources in a participant's account. Ordinarily, 401(k), 403(b) and 457(b) plans can distribute elective deferrals only after certain events — for example, termination of employment, death or disability. Coronavirus-related distributions are deemed to satisfy these requirements, which allows plans to distribute deferrals to qualified individuals who haven't had any of the usual distribution events. Although employers don't have to offer these distributions, if the plan treats any distribution as a coronavirus-related distribution, the plan must be consistent in its treatment of all similar distributions.

Favorable tax treatment

A coronavirus-related distribution is taxable to the participant, but on more favorable terms than the requirements that ordinarily apply to retirement plan distributions:

- The 10% penalty on distributions before age 59-1/2 doesn't apply.
- Distributions are taxed ratably over three years, unless participant elects full taxation in 2020.
- The mandatory 20% withholding on eligible rollover distributions doesn't apply. Instead, the withholding rules for other retirement plan distributions apply — 10% withholding, unless the participant elects different or no withholding.
- Employers don't have to offer a direct rollover or provide a 402(f) rollover notice.

Distributions from Roth accounts. Distributions from designated Roth accounts after a participant attains age 59-1/2, dies or becomes disabled are tax-free if made more than five years after the participant's first contribution to the Roth account. If a distribution occurs before the participant satisfies these requirements, the participant must pay tax on the earnings portion of the distribution. The CARES Act does not make an exception for coronavirus-related distributions from Roth accounts. This presumably means that a qualified individual who takes a coronavirus-related distribution from a Roth account before satisfying the tax-free distribution requirements will owe taxes on the earnings — but under the more-favorable rules for coronavirus-related distributions.

$100,000 cap

The $100,000 cap on coronavirus-related distributions applies to all eligible retirement plans — including employer plans and IRAs — in which the qualified individual has an account.

> Example. Tom is a participant in his employer's 401(k) plan and also has an IRA. Tom tests positive for COVID-19. He can take coronavirus-related distributions through Dec. 30, 2020, from both his 401(k) plan account and his IRA. However, his total 401(k) and IRA distributions cannot exceed $100,000.

An employer is responsible for ensuring that a qualified individual takes no more than $100,000 in coronavirus-related distributions from all plans in the employer's controlled group. However, employers do not have to determine whether a qualified individual has taken distributions from an IRA or a plan outside the controlled group that count toward the $100,000 cap.

Repayment allowed

The act allows — but doesn't require — a qualified individual to repay all or part of a coronavirus-related distribution. Repayments are treated as rollover contributions (the usual 60-day rollover deadline is deemed to be satisfied), so qualified individuals can repay their distributions to any employer-sponsored plan that accepts rollovers or to an IRA. If a qualified individual takes an in-service coronavirus-related distribution and then terminates employment, the individual can repay the distribution to the employer's 401(k) plan if it accepts rollovers from former employees. If not, the individual can roll the distribution over to an IRA.

The total amount repaid cannot exceed the amount of the distribution (so the distribution can't be repaid with interest). Qualified individuals have three years from the day after receiving a coronavirus-related distribution to repay it. If a qualified individual takes more than one coronavirus-related distribution, then each distribution has its own three-year repayment period.

> Example. Rita contracts COVID-19 from her husband, Tom. She takes a $50,000 coronavirus-related distribution from her 401(k) plan on May 1, 2020. Rita has until May 2, 2023, to repay the distribution. She takes another $50,000 coronavirus-related distribution from the 401(k) plan on July 1, 2020. Rita has until July 2, 2023, to repay the second distribution.

Plans not required to accept repayment. IRS anticipates that most plans will accept repayment of coronavirus-related distributions. But Notice 2020-50 clarifies that plans aren't required to accept repayment. For example, plans that don't accept rollovers don't have to start accepting these contributions.

Limits on repayment. Although most 2020 distributions can be coronavirus-related, Notice 2020-50 clarifies that repayment is allowed only for distributions that would be eligible rollover distributions

regardless of the relief. For example, a qualified individual can treat periodic annuity payments in 2020 as coronavirus-related distributions, but the individual can't repay those amounts since periodic payments aren't eligible rollover distributions. Similarly, a coronavirus-related distribution paid to a qualified individual as a beneficiary of an employee can't be repaid.

Other distributions can be treated as coronavirus-related

The CARES Act allows treating virtually any retirement plan distribution from Jan. 1 through Dec. 30, 2020, as coronavirus-related. For example, if an employer has a reduction in force this year, payments under the plan's distribution provisions for terminated employees can be coronavirus-related.

Plan loan offsets. A plan loan offset occurs when a participant has a loan outstanding at the time of a distribution. The plan offsets the participant's account by the remaining loan balance to satisfy the participant's repayment obligation. The offset amount is a taxable distribution to the participant and an eligible rollover distribution subject to the usual 60-day rollover period. However, if the distribution is made upon the participant's termination of employment, the participant has until the tax filing deadline for the year in which the offset occurred to roll over the offset amount.

Notice 2020-50 confirms that plan loan offsets made this year to qualified individuals can be treated as coronavirus-related distributions. This gives qualified individuals significantly more time to roll over offsets occurring this year: three years from the day after the offset occurs.

Plans aren't required to change withholding practices. Notice 2020-50 confirms that employers not offering in-service coronavirus-related distributions don't have to change their plans' withholding procedures, even for distributions made to qualified individuals. Instead, the individuals can claim the special tax treatment by reporting the distributions as coronavirus-related on their federal income tax returns and the new IRS Form 8915-E (which will be available later this year).

Distributions that can't be coronavirus-related. Notice 2020-50 states that certain distributions can't be treated as coronavirus-related, including:

- Deemed distributions of plan loans that violate Internal Revenue Code Section 72(p)
- Distributions of excess contributions under Section 415
- Distributions of excess elective deferrals under Section 402(g)
- Distributions to correct ADP and ACP nondiscrimination testing failures
- Dividends paid on employer securities
- Costs of current life insurance protection

- Prohibited allocations under an S corporation's employee stock ownership plan that are treated as deemed distributions
- Permissible withdrawals from an eligible automatic contribution arrangement within 30–90 days of a participant's automatic enrollment
- Distributions of premiums for accident or health insurance

Hardship distributions distinguished

Notice 2020-50 confirms that coronavirus-related distributions aren't subject to the rules for hardship distributions. So employers offering in-service coronavirus-related distributions don't have to require that qualified individuals show they have an immediate and heavy financial need and are requesting only the amount necessary to meet that financial need.

Nonetheless, employers that want to discourage unnecessary withdrawal of retirement savings can choose to offer coronavirus-related distributions under a plan's hardship distribution provisions. In this case, employees would have to show that they are qualified individuals, have an immediate and heavy financial need, and are limiting the distribution request to the amount necessary to meet that need. If an employee satisfies these requirements, then the hardship distribution would receive the favorable tax treatment that applies to coronavirus-related distributions.

Even though hardship distributions aren't usually eligible rollover distributions, a qualified individual can repay a coronavirus-related hardship distribution. Notice 2020-50 specifically notes that the prohibition on rolling over hardship distributions doesn't apply to hardship distributions that are treated as coronavirus-related.

Defined benefit (DB) plans

DB plans can distribute benefits after a participant's employment has ended. In-service distributions are also allowed, but only to participants who have reached age 59-1/2. The CARES Act does not make an exception to these payment rules for coronavirus-related distributions from DB plans. Notice 2020-50 confirms that DB plans cannot allow in-service distributions to qualified individuals merely because the distribution, if made, would be a coronavirus-related distribution.

However, the notice also confirms that if a DB plan participant has a permissible distribution event in 2020, then the participant can treat payments received this year as coronavirus-related. For example, if a DB plan allows in-service distributions at age 59-1/2, the plan can allow a qualified individual who is least that age to take a distribution and treat it as coronavirus-related. A terminated employee likewise can treat distributions up to $100,000 as coronavirus-related. Notice 2020-50 also clarifies that DB plan

participants can treat periodic annuity payments as coronavirus-related for tax purposes (but can't repay the distributions, since annuity payments aren't eligible rollover distributions).

Increased plan loan limit

The CARES Act allows — but does not require — plans to make loans to qualified individuals up to the lesser of $100,000 or the individual's entire vested benefit (instead of the usual cap equal to the lesser of $50,000 or 50% of the vested benefit). This increased loan cap is available until Sept. 22, 2020. Other rules for plan loans are unchanged. For example, a qualified individual who takes a loan at the higher limit is still subject to the maximum five-year repayment period and substantially equal payment requirements.

ERISA Title I relief. ERISA requires plan loans to be available on a reasonably equivalent basis to all participants and adequately secured. Under DOL rules, the prohibited-transaction exemption for plan loans states that plans cannot use more than 50% of the present value of a participant's vested accrued benefit to secure all outstanding plan loans made to the participant.

Loans made at the CARES Act's increased plan loan cap appear to violate these requirements, since they are available only to qualified individuals and can total 100% of a participant's account. However, DOL Notice 2020-01 provides relief. The agency will not find plans in violation of ERISA Title I, "including the adequate security and reasonably equivalent basis requirements," solely because a plan makes loans to qualified individuals under the CARES Act.

Suspension of loan repayments

The CARES Act allows qualified individuals to suspend all plan loan repayments until Dec. 31, 2020. The suspension is available for both new loans and loans taken before the act became law.

Safe harbor method. Notice 2020-50 provides a safe harbor method for implementing the CARES Act's loan suspension. Under the safe harbor, a plan is treated as complying with the loan suspension if a qualified individual's obligation to repay a plan loan is suspended any time between March 27 and Dec. 31, 2020. Repayments must resume in January 2021, and the plan may extend the loan term by up to one year. (The safe harbor for the KETRA loan-repayment suspension allowed an extension of the loan term by the duration of the suspension period). The loan balance and future payments must be adjusted for interest during the delay. The delay will not cause a loan to violate the maximum five-year repayment period or the requirement to have substantially equal installments for repaying plan loans.

Is delay mandatory or optional? The CARES Act states that due dates for all plan loan repayments during the remainder of 2020 "shall be delayed" for qualified individuals. Some employers and practitioners interpreted this language to suggest employers must make the relief available to qualified individuals (i.e., the individual can decide whether to continue making payments). However, IRS views the relief as

optional. Notice 2020-50 states that "an employer is permitted to choose to allow this delay in loan repayments."

ERISA Title I relief. DOL Notice 2020-01 confirms that the agency will not treat loan-repayment suspensions made under the CARES Act as violating ERISA's plan loan rules.

Employer considerations for offering relief

Plans may — but don't have to — offer coronavirus-related distributions, plan loans at the increased cap or suspension of loan repayments. Some employers might prefer to make all of the relief available to give participants the greatest flexibility. Different employers may prefer one option over the other. The decision will depend on a host of employer-specific factors, including the pandemic's anticipated impact on the employer's workforce.

For example, employers that expect to lay off workers might decide only to offer coronavirus-related distributions, since repayment would be optional for affected workers. However, an employer not expecting a workforce reduction might prefer to offer only loans to ensure employees will return the funds to their retirement accounts.

Other employers might feel their plans' loan and hardship provisions already provide relief to employees, especially because qualified individuals can elect to treat almost any distribution as coronavirus-related. However, these employers still might consider notifying their employees that the relief is available, so qualified individuals can claim the favorable tax treatment.

Plan amendment deadlines

Nongovernmental employers have until the end of the first plan year beginning on or after Jan. 1, 2022, to amend their plans for the relief (although IRS could extend the deadline). Governmental employers have an additional two years. All amendments will be retroactive to March 27, 2020 — the date of the legislation's enactment — or if later, the effective date of the amendment.

Related resources

Non-Mercer resources

- Notice 2020-50 (IRS, June 19, 2020)
- Coronavirus-related relief for retirement plans and IRAs Q&As (IRS, May 4, 2020)
- Disaster Relief Notice 2020-01 (DOL, April 29, 2020)

- Pub. L. No. 116-136, CARES Act (Congress, March 27, 2020)
- Notice 2005-92 (IRS, Nov. 30, 2005)
- Pub. L. No. 109-73, KETRA (Congress, Sept. 23, 2005)

Mercer Law & Policy resources

- IRS gives retirement plans more pandemic relief (June 2, 2020)
- IRS issues FAQs on CARES Act distributions and loans (May 5, 2020)
- Keeping track of COVID-19 laws affecting employee benefits, jobs (May 4, 2020)
- DOL gives retirement plans and participants pandemic relief (April 30, 2020)
- IRS, PBGC issue employee benefit plan relief for COVID-19 pandemic (April 16, 2020)
- SECURE, CARES acts change rules on required minimum distributions (April 7, 2020)
- Stimulus bill gives 2020 DB funding relief, access to DC savings (March 26, 2020)

Other Mercer resources

- Stay informed on the coronavirus (regularly updated)