



Offering CARES Act distributions to defined benefit plan participants

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The Coronavirus Aid, Relief and Economic Security (CARES) Act ([Pub. L. No. 116-136](#)) gives favorable tax treatment for retirement plan distributions to individuals affected by the coronavirus pandemic. Much discussion around these coronavirus-related distributions (CRDs) has focused on payments from defined contribution (DC) plans. But defined benefit (DB) plan participants may also benefit from these CARES Act provisions. Based on IRS guidance in [Notice 2020-50](#) and a series of [Q&As](#), this GRIST addresses some FAQs about CRDs from DB plans. The article discusses only those issues specific to CRDs paid from DB plans. For a comprehensive discussion of CRD issues in general, see [Delving into CARES Act relief for retirement plan participants](#).

Deciding whether to offer CRDs

Can a DB plan pay CRDs? The CARES Act does not limit CRDs to DC plans. Under the act and related guidance, CRDs may be paid to a “qualified individual” from any eligible retirement plan, including 401(a) qualified plans, 403(a) annuity plans, 403(b) plans, governmental 457(b) plans and individual retirement arrangements (IRAs). But sponsors don’t have to offer CRDs; adopting the CARES Act relief is optional for DB and DC plan sponsors.

When can DB plans pay CRDs? The CARES Act allows DC plans — but not DB plans — to pay in-service CRDs to qualified individuals who aren’t otherwise eligible for a distribution. That means DB plans can pay CRDs only under the usual distribution rules — that is, to participants who have terminated employment or are at least age 59-1/2.

A participant can get CRD treatment on a distribution in three different ways:

- The plan offers a special distribution option designated as a CRD. For instance, an employer that doesn't ordinarily provide lump sums might want to offer a lump sum CRD in conjunction with a reduction in force.
- The plan designates a regular distribution as a CRD. This gives the participant the opportunity for reduced withholding (10% default unless the employee elects otherwise, instead of the mandatory 20% that ordinarily applies to eligible rollover distributions).
- The participant claims CRD treatment for a distribution (up to \$100,000) on the 2020 federal income tax return and files Form 8915-E, Qualified 2020 Disaster Retirement Plan Distributions and Repayments (this form will be available later this year).

Under what circumstances might a DB plan sponsor want to offer CRDs? Even if a plan already offers a lump sum, the employer still might want to designate payments (up to \$100,000) to qualified individuals as CRDs so participants can take advantage of the reduced withholding. For example, participants who elect no withholding on a \$100,000 lump sum will have an additional \$20,000 in pocket this year (the full \$100,000 lump sum instead of the \$80,000 they would have received if the usual mandatory 20% withholding applied). These participants might still owe tax on the lump sum but will have three years to pay it. Without this election, a participant could still benefit from the favorable CRD tax treatment, but not until the 2020 tax refund arrives.

What about CRDs to active employees? Employers whose plans don't already offer in-service distributions could offer in-service CRDs to qualified individuals who are age 59-1/2 or older. However, some employers might decide providing the option to such a limited group isn't worth the additional administrative complexity. If a plan already offers in-service distributions starting at 59-1/2, qualified individuals eligible for in-service distributions can take one and elect CRD treatment on their tax returns.

If a DB plan doesn't offer CRDs, does it have to change its withholding practices for participants claiming CRD treatment? DB plans not offering CRDs don't need to change their tax withholding and reporting for participants claiming CRD treatment for a plan distribution. The payment will be subject to the plan's regular withholding treatment. The employee will be responsible for claiming CRD treatment on the 2020 tax return to get a refund of any excess withholding.

Administering CRDs

How does a DB sponsor verify the employee is a qualified individual? Employees can self-certify as qualified individuals, and Notice 2020-50 provides a sample certification. The plan administrator may rely on the employee's self-certification unless the administrator knows — based on information already in its possession — that the certification is false.

Do the spousal consent requirements apply to CRDs? Notice 2020-50 clarifies that the spousal consent requirements for distributions from pension plans apply to CRDs. [Notice 2020-42](#) provides relief from the “physical presence requirement” that usually applies when spousal consents are witnessed by a notary public or plan representative. The relief is available until the end of 2020.

Can a participant repay a CRD to a DB plan? The CARES Act allows participants to repay a CRD within three years of receiving it if the distribution would otherwise have been an eligible rollover payment. Repayments are treated as rollover contributions, so individuals can repay their distributions to any employer-sponsored plan that accepts rollovers or to an IRA. But Notice 2020-50 clarifies that employer plans aren’t required to accept repayment. For example, plans that don’t accept rollovers don’t have to start accepting them just so participants can repay their CRDs. (A participant can always roll the amount over to an IRA instead.)

Can DB annuity payments be CRDs? Notice 2020-50 says participants receiving periodic annuity payments can elect the special CRD tax treatment for those payments on their 2020 tax returns. This would allow a participant to spread the taxes over three years. But the employee can’t repay the payments to the plan or an IRA, since annuity payments aren’t eligible rollover distributions. The employer doesn’t need to amend the plan or make any changes to plan administration.

How does the \$100,000 limit on CRDs apply to DB plans? The CARES Act lets individuals claim CRD treatment for up to \$100,000 in distributions from employer retirement plans and IRAs. Employers don’t have to verify whether a participant is claiming CRD treatment for an IRA withdrawal or a distribution from another employer’s retirement plan. An employer must only apply the \$100,000 limit to total distributions designated as CRDs by the employer from all retirement plans across the controlled group.

Lump sum distributions from a DB plan will often represent the full value of a participant’s benefit and may exceed \$100,000. In that case, if an employer decides to offer CRDs, the plan can only designate up to \$100,000 as a CRD. The plan must treat the remainder as a regular distribution subject to the ordinary withholding rules, the 402(f) notice requirement and the 10% penalty (if applicable) on distributions before age 59-1/2.

Reporting, notices, plan amendments

How do plans report CRDs to IRS? A plan reports CRDs on the 2020 [Form 1099-R](#) in Box 7. The plan can use distribution code 2 (early distribution, exception applies (under age 59-1/2)) or distribution code 1 (early distribution, no known exception (in most cases, under age 59-1/2)), unless another code applies (e.g., code 7 for a participant at least age 59-1/2). The plan must report the distribution on Form 1099-R, even if the participant rolls the distribution back into the plan in the same year.

Does a plan have to change its 402(f) special tax notice for rollover-eligible distributions? IRS hasn’t issued any guidance that requires updating a plan’s [402\(f\) notice](#) to explain the favorable tax treatment

of CRDs. Notice 2020-50 confirms that employers don't have to provide 402(f) notices at all — or offer direct rollovers — for distributions designated by the plan as CRDs. But some plan sponsors may still want to revise their notices to alert participants to the favorable CRD tax treatment available to qualified individuals, even if the plan doesn't offer CRDs.

Must the plan be amended to offer CRDs? Employers whose plans don't already offer lump sums will need to amend their plans to provide for the new CRD option. Nongovernmental employers have until the end of the first plan year beginning on or after Jan. 1, 2022, to amend their plans for the CARES Act relief (although IRS could extend that deadline). Governmental employers have an additional two years. However, if an employer offers CRDs as part of a special benefit package (e.g., to participants who terminate employment in a reduction in force), the employer may need to amend the plan sooner for any non-CARES Act benefits offered in the package (such as additional service credits or benefit accruals).

The answer is less certain if the employer's DB plan already offers a lump sum, and the employer lets qualified individuals change their tax withholding on lump sums designated as CRDs. If the plan document describes the plan's withholding practices, the employer should amend the plan since withholding at less than the usual 20% would violate plan terms. Regardless of plan terms, employers should consult with legal counsel before deciding no amendment is needed.

Related resources

Non-Mercer resources

- [Notice 2020-50](#) (IRS, June 19, 2020)
- [Notice 2020-42](#) (IRS, June 3, 2020)
- [Coronavirus-related relief for retirement plans and IRAs Q&As](#) (IRS, May 4, 2020)
- [Pub. L. No. 116-136](#), the CARES Act (Congress, March 27, 2020)

Mercer Law & Policy resources

- [Delving into CARES Act relief for retirement plan participants](#) (June 22, 2020)
- [IRS OKs witnessing retirement plan elections, spousal consent by video](#) (June 8, 2020)
- [IRS releases FAQs on CARES Act distributions and loans](#) (May 5, 2020)

Other Mercer resources

- [Stay informed on the coronavirus](#) (regularly updated)

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