Q&As Regarding the CARES Act and Other Common Questions You May Have Concerning Distributions, Loans or Contributions

Coronavirus Aid, Relief, and Economic Security Act (CARES Act)

1. **Does the CARES Act contain special rules that affect qualified retirement plans?**

   Yes, the CARES Act contains provisions that allows certain individuals to take a new type of "coronavirus-related distribution", increases the limitation for plan loans from the plan for certain individuals, and waives the 2020 Required Minimum Distributions. These new rules are outlined below.

2. **Who is an eligible or qualified individual, with respect to the special distribution and loan rules as provided in the CARES Act?**

   An eligible or qualified individual is an individual:

   - who is diagnosed with COVID-19;
   - whose spouse or dependent is diagnosed with COVID-19; or
   - who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, having work hours reduced, being unable to work due to lack of child care due to COVID-19, closing or reducing hours of a business owned or operated by the individual due to COVID-19, or other factors as determined by the Treasury Secretary.

3. **Are there special distribution rules if a distribution is in connection with COVID-19?**

   Yes, the CARES Act provides for a special "coronavirus-related distribution" to COVID-19 eligible individuals that waives the 10% early withdrawal penalty for distributions up to $100,000 from IRA's and qualified retirement plans for coronavirus-related purposes made on or after Jan. 1, 2020 to Dec. 31, 2020. In addition, income attributable to such distributions would be subject to tax over three years, and the participant may recontribute the funds to an eligible retirement plan within three years without regard to that year's cap on contributions. The "coronavirus-related distribution" is not subject to the 20% mandatory federal withholding.

4. **Are there special loan limitations if the loan is to a COVID-19 qualified individual?**

   Yes, the CARES Act increases the loan limitation to qualified individuals, as defined above, for loans taken on or before Sept. 23, 2020 (180-day period beginning on March 27, 2020). Individuals who meet this definition have increased loan limits of 100% of the participants vested account balance or $100,000, whichever is less. If the participant is not a COVID-19 qualified individual, the normal loan limits discussed under the **Other Common Questions Q&A 1 "Can a participant take a loan from the plan?"** apply.

5. **Are there special loan payment rules if a loan is to a COVID-19 qualified individual?**

   Yes, the CARES Act delays the loan payments for a COVID-19 qualified individual for any loan outstanding on or after March 27, 2020 through Dec. 31, 2020 for 1 year for any COVID-19 affected individual, as defined above. Interest will continue to accrue on the loan. In determining the 5-year period and the term of the loan, the period during which the payments are delayed shall be disregarded.

6. **Does the Employer need to verify whether an individual qualifies for a COVID-19 Distribution or Loan?**

   No. The employer may rely on the individual's certification for eligibility.

7. **I'm over age 70 ½ and required to take Required Minimum Distributions (RMDs) from my retirement plan or IRA. Do I have to take my 2020 RMD?**

   The CARES Act waives the RMD rules for certain retirement plans, including 401(k) plans and 403(b) plans, and IRAs for calendar year 2020. This provision provides relief to individuals who would otherwise be required to withdraw funds

from such retirement accounts. Note that this relief is not provided for individuals covered by defined benefit pension plans.

If you have already received your 2020 RMD, the 2020 distribution could be recontributed or rolled over to an IRA or other qualified plan if completed within 60 days of receiving the original distribution. It is expected that there may be relief coming as to an extension for timing of the repayment. More guidance from the IRS is needed concerning the timing of repayment of RMDs already received.

8. If I want to implement any of the above changes provided for under the CARES Act, when do I need to amend my plan?

You may begin utilizing the changes provided under the CARES Act immediately. Your plan will need to be formally amended on or before the last day of the first plan year beginning on or after Jan. 1, 2022, unless the IRS delays further. This means if you maintain a calendar year plan, your plan will need to be amended on or before Dec. 31, 2022. Please notify your document provider if you want to implement any of these changes so they can make sure your plan is amended appropriately.

9. Are there any provisions waiving the funding requirements for defined benefit pension plans?

The Cares Act provides that the required contributions otherwise due in 2020 (no later than 9 ½ months after the plan year-end) are instead due by Jan. 1, 2021. Employers are required to pay interest on the delayed payments at the plans effective interest rate up to the date of actual payment.

Other Common Questions

1. Can a participant take a loan from the plan?

Yes, if the plan contains a loan provision. The loan provision under the plan will determine features or restrictions such as:

- Available Sources (401(k), match, employer contributions, etc.) for loans
- Minimum loan amount
- Number of loans that may be outstanding at any one time

Generally, the maximum amount a participant may borrow from his or her plan is 50% of his or her vested account balance or $50,000, whichever is less. The employee must repay a plan loan within five years and must make payments at least quarterly. The law provides an exception to the 5-year requirement if the employee uses the loan to purchase a primary residence. However, see **CARES Act Section Q&A 4 “Are there special loan limitations if the loan is to a COVID-19 qualified individual?”**

If your plan currently does not contain a loan provision or you want to change your loan provisions to change for example, the number of outstanding loans available or the sources available, the plan can be amended.

2. I have employees with loans who are on unpaid leave or on a reduced work schedule, *not related to COVID-19*. Can we suspend the loan payments?

If during a leave of absence an employee’s compensation is reduced to the point at which the salary is insufficient to repay the loan, the employer may suspend repayment for up to one year. The loan repayment period is not extended. The employee will be required to catch up the loan or be required to increase the scheduled payment amounts upon return to work in order to pay off the loan in the originally scheduled period.

3. I have employees who are not COVID-19 eligible employees with loans who are continuing to work. Can they stop making loan payments?

Yes, but for a very limited time before the loan will be in default. A loan that is in default is generally treated as a deemed distribution (taxable distribution) from the plan in the amount of the outstanding loan balance at the time of default. The plan’s terms will generally specify how the plan handles a default. Many plan loan provisions provide that a loan does not become a deemed distribution until the end of the calendar quarter following the quarter in which the repayment was missed. For example, if quarterly payments were due March 31, June 30, Sept. 30, and Dec. 31, and the participant made the March payment but missed the June payment, the loan would be in default as of the end of June, and the loan would be treated as a deemed distribution at the end of September. Most plans use these default

timing rules but you will want to check with your document provider for the timing rules for your plan.

However, if the participant qualifies as a COVID-19 qualified individual, see **CARES Act Section Q&A 5 "Are there special loan payment rules if a loan is to a COVID-19 qualified individual?"**

4. I have an employee who terminated employment with a loan. What happens to the loan?

Employers may require an employee to repay the full outstanding balance of a loan upon termination of employment or if the plan is terminated. If the employee is unable to repay the loan, then the employer will treat the unpaid balance as a distribution and report it to the IRS on Form 1099-R. The employee can avoid the immediate income tax consequences by rolling over all or part of the loan's outstanding balance to an IRA or eligible retirement plan by the due date (including extensions) for filing the Federal income tax return for the year in which the loan is treated as a distribution. This rollover is reported on Form 5498. This is also stated in the special tax notice provided to employees upon termination.

5. Hardship distributions: Can a participant, who is not a COVID-19 qualified individual, take a distribution from the plan on account of financial hardship?

Although not required, a retirement plan may allow participants to receive hardship distributions. A hardship distribution can generally only be made if the distribution is both:

- Due to an immediate and heavy financial need
- Limited to the amount necessary to satisfy that financial need

An employee is automatically considered to have an immediate and heavy financial need if the distribution is for:

- Medical care expenses for the employee, the employee's spouse, dependents, or beneficiary;
- Costs directly related to the purchase of an employee's principal residence (excluding mortgage payments);
- Tuition, related educational fees, and room and board expenses for the next 12 months of postsecondary education for the employee or the employee's spouse, children, dependents, or beneficiary;
- Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence;
- Funeral expenses for the employee, the employee's spouse, children, dependents, or beneficiary;
- Certain expenses to repair damage to the employee's principal residence;
- Expenses and losses (including loss of income) on account of federally declared disaster area disaster designated by the Federal Emergency Management Agency (FEMA) if your principal residence or place of employment at the time of a disaster was in an area FEMA designates as qualifying for individual assistance in connection with a federally declared disaster.

If a participant is under the age of 59 ½, distributions under the hardship provisions are subject to a 10% early withdrawal penalty but are not subject to 20% withholding. However, if the distribution is made to a COVID-19 affected individual see **CARES Act Section Q&A 3: "Are there special distribution rules if a distribution is in connection with COVID-19?"**

If your plan does not have a hardship distribution provision, the plan can be amended to add the provision.

6. What are other in-service distributions options?

Many plans will allow distributions at age 59 ½ for any reason to those currently employed. Distributions made after age 59 ½ are not subject to the 10% early distribution penalty. Your plan will dictate the sources available (i.e. 401(k), match, profit sharing, etc.). If your plan does not contain an in-service distribution provision at age 59 ½ or you would like to amend the sources available or other restrictions, the plan can be amended to add or change this provision.

7. Can my employees reduce or stop making Salary Deferral Contributions?

Probably. Your plan's operational policies dictate how often participants may modify contribution elections. Most plans permit employees to reduce to zero at any time. If a participant changes their salary deferral to zero, your plans' operational administrative policy will determine when the participant can start making deferrals again.

8. **My plan is a Safe Harbor plan, can I suspend or reduce the Safe Harbor Contributions?**

Yes, but the employer must be either:

- be operating at an economic loss; or
- the annual Safe Harbor Notice, if applicable, must have included a statement that the plan could be amended during the plan year to reduce or suspend safe harbor contributions. This language is typically contained in the annual notices.

Other conditions that also must be met are:

- You need to inform your participants in advance. The employer must distribute a notice 30 days prior to the effective date of the suspension or reduction;
- The plan will need to be amended to remove the Safe Harbor provision prior to the effective date of the change;
- Participants must be given a reasonable opportunity (including a reasonable period after receipt of the advance notice) prior to the reduction or suspension of Safe Harbor contributions to change their cash or deferred elections;
- The plan will have to test the deferral and match, if applicable, under the ADP/ACP nondiscrimination rules for the **entire** plan year;
- The employer must make the Safe Harbor contribution to the plan from the beginning of the plan year until the effective date of the change;
- If your plan is Top Heavy — the plan may no longer rely on the safe harbor Top Heavy exemption.

It is important to note that more legislation may be coming. There are proposals to waive required contributions including the 2019 Safe Harbor or other employer contributions that have not been made yet, and required contributions for 2020 including Safe Harbor contributions without the need for a 30-day advanced notice. The proposal also waives the ADP/ACP nondiscrimination testing for those plan suspending Safe Harbor contributions. We will keep you informed as to the progress of these proposals.

9. **If I have a significant lay off or staff reduction are there issues that may affect my plan?**

Your plan may have what is called a *Partial Plan Termination*. Employers who have significant staff reduction or layoffs may become subject to IRS partial plan termination rules. In general, the IRS defines a partial plan termination as a 20% or greater decrease in plan participants during a 12-month period, normally the plan year. If a partial plan termination occurs, all affected participants who terminated during the 12-month period must become 100% vested in all employer contributions that may otherwise be subject to a vesting schedule. Safe Harbor contributions would not be impacted since they are always 100% vested. Partial plan termination rules are complex and subject to a facts and circumstances determination. If your organization is experiencing significant employee turnover, it is important to work with your plan administrator or recordkeeper to understand how this affects your plan. It is anticipated that these rules may also be modified in the near future to provide clarity and relief to plan sponsors. We will provide an update if and when this occurs.

Need More Help?

We will continue to monitor for updates related to retirement plan relief as they become available. For more information about the impact the COVID-19 virus is having on businesses, please visit our **COVID-19 Resource Center**.

You can also contact Bernie Kaplan at 617.761.0541 or **bkaplan@cbiz.com**, Diane Caron at 617.761.0539 or **dcaron@cbiz.com**, or Marianne Galluzzo Downs at 617.761.0540 or **mdowns@cbiz.com**.

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