401(k) Loan and Distribution Considerations — Which, if any, should you take?

everhart ADVISORS

The Coronavirus Aid, Relief and Economic Security (CARES) Act makes it easier than ever for certain **'qualified individuals'**[1] to tap into their retirement plan accounts prior to retirement age and with fewer tax consequences. These new loan and withdrawal provisions allowed by the CARES Act are optional for employers to adopt and there are prudent reasons they may not.

You should contact your employer or recordkeeper to confirm if your retirement plan has voluntarily adopted any of the optional provisions permitted under the CARES Act and for help in determining whether you are a 'qualified individual.'

Decision Point: Should you access retirement money just because you can?

Just because these provisions may now be available does not mean you should utilize them. We suggest taking a loan or distribution only as a last resort—keeping the money in your retirement account is the best option.

The first question to ask yourself is whether you really ***need*** the money. If you have exhausted all other means, then certainly the coronavirus-related loan and distribution options are there for this very reason: to provide financial relief to your current situation. If you have no choice but to pull money from your retirement account, be sure to understand and consider the loan and distribution options before acting.

The Loan:

The allowable limits for coronavirus-related loans have doubled—you may be able take up to 100% of your vested account balance or $100,000, whichever is less, until September 23rd, 2020. In addition, for 'qualified individuals,' any loan payments due from March 27, 2020 through December 31, 2020 may be postponed up to one year.

Important to understand, if your employment were to be terminated, the balance of the loan will have to be paid back in full, with assets held outside of the retirement plan, by the time taxes are due for that year. If you are unable to pay back the loan in full by this time, the loan generally will be considered a withdrawal on which you must pay income tax and may also incur a 10% penalty if under the age of 55.

The Distribution:

For the full calendar year of 2020, 'coronavirus-related distributions' (CRD) can be up to $100,000 or 100% of your vested account balance, whichever is less. In addition, the 10% penalty for early withdrawals has been waived and the 20% tax withholding requirement maybe ignored for coronavirus-related distributions.

If you qualify and decide to take the distribution, realize any pre-tax dollars will be added to your taxable income and could bump you into a higher tax bracket for the year. While the mandatory 20% tax withholding requirement is waived under the CARES Act, this doesn't mean you won't owe taxes—it is very important to budget appropriately to pay your tax bill in the future.

Perhaps the most significant provision related to the 'coronavirus-related distribution' is the extraordinary flexibility to repay and/or manage the resulting tax liability. You can choose to spread the taxes owed over three years, while even better, the CARES Act gives you up to three years to redeposit the withdrawn money into a retirement account—usually you only have 60 days to do so. You can put the money back into an IRA or 401k within the three-year window and avoid the tax bill altogether.

- Diagnosed with COVID-19 by a test approved by the Centers for Disease Control and Prevention;
- whose spouse or dependent is diagnosed with COVID-19;
- 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.

Decision Point: So, which one is better for you, the loan or the coronavirus-related distribution (CRD)?

For those that believe they will continue working for their current employer, the plan loan is likely the better option because you will not owe ordinary income tax on the money, you can pay it off over a longer period of time, you're paying yourself the interest, and you eventually get the money back into your retirement account.

For those that are uncertain about their future employment, the distribution is likely the better option because you can delay taxes owed for up to 3 years, avoid the 10% penalty for early withdrawal, and also have the opportunity to replenish the funds within the three year time period.

Final Thoughts

The coronavirus-related loan and distribution may be helpful for those who truly need it. If you must dip into your retirement savings, take out only the minimum you need to cover necessities.

Not only should taking a loan or distribution be a last resort, we encourage you to continue contributing to your 401k, focus on the long term, and stay the course if you can—even if your employer has eliminated its 401k match due to the crisis.

You should contact your employer or recordkeeper to confirm if your retirement plan has voluntarily adopted any of the optional provisions permitted under the CARES Act, for help in determining whether you are a 'qualified individual,' and to confirm the process for submitting a loan or CRD request specific to your vendor.