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IRS Expands and Clarifies CARES Act Distribution Rules

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Since March 27, 2020 when the CARES Act was signed into law, many questions have mounted related to implementing the retirement plan provisions. Now, with roughly 3 months under our belts since the issuance of the Act and countless CARES Act distributions and loan suspensions processed, the IRS clarified several eligibility, administrative, and taxation reporting rules by issuing IRS Notice 2020-50. The Notice provides safe harbors, a model certification, and information reporting codes. It is a must-read for those responsible for administering employer-sponsored retirement plans. We discuss the basics of the CARES Act in an earlier article.

Coronavirus-Related Distributions

The CARES Act authorized eligible retirement plans to offer for a limited time a new type of distribution, a Coronavirus-Related Distribution (CRD), which is afforded special tax treatment. Only Qualified Individuals (QI) are eligible for a CRD. Significantly, the Notice expands the definition of a QI under Section 2202 of the CARES Act to include individuals whose:

- Pay was reduced because of COVID-19, including self-employment income;
- Job offer was rescinded or postponed;
- Spouses' or other household members (someone who shares the individual's principal residence) experience a COVID-19 related adverse financial consequence, including the closing or reducing of hours of a business they own and operate.

The CARES Act allows employers to rely on an employee's certification, barring any actual knowledge to the contrary, of being a QI when requesting a CRD. Administrators do not have a duty to investigate. Instead, actual knowledge is present only when the administrator already knows facts to determine the truthfulness of the certification. The Notice provides sample language of an acceptable certification for employers and individuals to use for documentation.

The Notice clarifies the types of distributions that qualify as CRD, noting that even distributions to beneficiaries, required minimum distributions, and plan loan offset amounts can qualify. A QI may consider a distribution to be a CRD for personal tax reporting even if the plan does not. But the Notice explicitly excludes certain distributions from designation as a CRD, including:

- Corrective distributions of elective deferrals;
- Loans treated as deemed distributions;
- Dividends on employer securities;
- Distributions from an eligible automatic contribution arrangement.

The Notice also clarifies that an employer may expand options for CRDs to include sources that ordinarily are not permitted without a distributable event or reaching age 59 ½. Examples of these sources include qualified nonelective or qualified matching contributions. However, the Notice reminds employers that the CARES Act does not change the distribution rules normally applicable to plans, noting for example that pension plans and money purchase pension plans cannot permit distributions before a permissible distribution event, even if it would qualify as a CRD.

Unlike other need-based distributions, e.g., hardship distributions, the amount a QI requests as a CRD need not correspond to an actual amount of need. But the eligible retirement plan and any related plans are limited to an aggregate amount of $100,000 for a CRD to anyone QI.

CRDs are not subject to the 10% early withdrawal penalty, reportable as gross income over 3 years and most may be recontributed and treated as a rollover contribution over a 3-year period to an eligible retirement plan that accepts rollovers. Notice 2020-50 clarifies how to treat a CRD for tax purposes and provides specific codes an administrator should use in box 7 of the Form 1099-R.

Recontributions of CRD

A QI may recontribute a CRD as a rollover contribution over 3 years to an eligible retirement plan that accepts rollovers. The Notice explains how a CRD may be recontributed, even for distributions not normally eligible for rollover. The Notice identifies one situation, any CRD paid to a QI as a beneficiary of an employee, where a QI may not recontribute a CRD. The employer may also rely on the individual’s certification of satisfaction of the QI requirements when determining the status of a CRD as eligible for recontribution.

A plan that does not accept rollovers need not accept recontributions of CRDs. Instead, the decision of whether to amend a retirement plan to implement these CARES Act provisions is at the discretion of the employer.

Loans

Among other plan loan changes, the CARES Act allows certain loan repayments due by QI to be suspended. The Notice provides a safe harbor for implementing these plan loan suspension rules. The safe harbor applies if the loan is re-amortized after the suspension period (which must not end later than December 31, 2020) over the remaining period of the loan plus 1 year. Interest accruing during the suspension period must be included in the re-amortized payments.

The Notice acknowledges there are other reasonable, and perhaps more complicated, ways to implement the CARES Act plan loan suspension provisions. The safe harbor is not the only option available.

Required Minimum Distributions

The SECURE Act raised the beginning age for Required Minimum Distributions from 70 ½ to 72. The CARES Act waived the requirement that an individual receive the distribution in 2020. Individuals may elect to not receive their Required Minimum Distribution in 2020. The Notice provides that a QI eligible to receive a Required Minimum Distribution may elect to receive the distribution and consider it a CRD on their individual tax return, which would allow the individual to include the amount in gross income over 3 years. But these distributions are not eligible for recontribution into an eligible retirement plan.

Cancellation of 409A Deferral Elections

The adverse financial effects of the COVID-19 pandemic have not been limited to only certain factions of the workforce. The Notice acknowledges that those participating in nonqualified deferred compensation plans also may experience financial challenges. It provides that an individual qualifying for a CRD will be treated as having received a hardship distribution for purposes of the regulations implementing Section 409A of the tax code, enabling service providers to cancel nonqualified deferred compensation plan deferral elections if the plan so permits.

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