Patterson Belknap Webb & Tyler LLP

Employee Benefits and Executive Compensation Alert June 2020

COVID-19 Update: IRS Issues Guidance on Coronavirus-Related Distributions and Plan Loans Under the CARES Act

The IRS recently issued IRS Notice 2020-50 ("Notice 2020-50") which provides guidance for retirement plan sponsors and administrators, as well as to individuals, relating to the application of coronavirus-related distributions and certain relief relating to plan loans that are available to qualified individuals under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). Importantly, the guidance clarifies several key points impacting the administration of employer retirement plans under the CARES Act.

Background

As described in more detail in our prior alert (available here), Section 2202 of the CARES Act allows certain retirement plans to permit coronavirus-related distributions ("CRDs"), to increase the maximum allowable loan amount for loans taken between March 27, 2020 and September 22, 2020, and to suspend loan repayments for the remainder of calendar year 2020. Generally, only "qualified individuals" (as defined below) are eligible to designate certain distributions as CRDs and eligible to take advantage of the plan loan relief (to the extent permitted by the plan).

Expansion of "Qualified Individuals"

Qualified individuals under the CARES Act are generally:

i. Individuals diagnosed with SARS-COV-2 or Coronavirus 2019 ("COVID-19") by a test approved by the Centers for Disease Control and Prevention,

ii. Individuals whose spouse or dependent (as defined by IRC §152) is so diagnosed, or

iii. Individuals who experience adverse financial consequences as a result of:

a. the individual being quarantined, furloughed or laid off or having work hours reduced due to COVID-19;

b. the individual being unable to work due to lack of child care due to COVID-19;

c. closing or reducing hours of a business owned or operated by the individual due to COVID-19; or

d. *other factors as may be determined by the Secretary of the Treasury or its delegate*. (emphasis added)

Under Notice 2020-50 and pursuant to its authority, the IRS has added the following three additional factors that will enable an individual to be a "qualified individual", if the individual experiences adverse financial consequences as a result of one or more of them:

e. the individual having a reduction in pay (or self-employment income) due to COVID-19 or having a job offer rescinded or start date for a job delayed due to COVID-19;

f. the individual's spouse or a member of the individual's household (as defined below) being quarantined, being furloughed or laid off, or having work hours reduced due to COVID-19, being unable to work due to lack of childcare due to COVID-19, having a reduction in pay (or self-employment income) due to COVID-19, or having a job offer rescinded or start date for a job delayed due to COVID-19; or

g. closing or reducing hours of a business owned or operated by the individual's spouse or a member of the individual's household due to COVID-19.

For these purposes, a member of the individual's household is defined as someone who shares the individual's principal residence.

The expansion of the types of situations that could support qualified individual status should provide welcome relief to plan participants impacted by COVID-19.

Reliance by Plans on Self Certification

Keeping in line with IRS guidance in prior disaster relief situations,[1] Notice 2020-50 generally permits plan administrators to rely on an individual's certification that the individual satisfied the conditions to be a qualified individual in determining whether an amount is a CRD both (a) at the time the distribution is requested to be taken by the individual in 2020 and (b) in order to accept a recontribution of a CRD (to qualify for treatment as a direct rollover contribution) which may occur anytime during the three year period beginning the day after the distribution of the CRD. An individual's certification regarding their status as a qualified individual can also be relied upon with regard to the CARES Act provisions related to plan loans.

It is important to note, however, that Notice 2020-50 states that a plan administrator is not permitted to rely on the individual's certification if they have actual knowledge that is contrary to the individual's certification. Helpfully, though, the Notice provides that the "actual knowledge to the contrary" standard does not require the plan administrator to conduct any inquiries or investigations, and it is limited to situations where the plan administrator already possesses sufficient accurate information to determine the veracity of the certification.

Notice 2020-50 includes an example of an acceptable certification form, which includes the new criteria permitted under the Notice that can be used by plans.

Guidance on Plan Loan Repayment Delays

The application of the CARES Act relief around plan loan repayment delays has been a source of much confusion in among retirement plan administrators as the statutory language in Section 2202 of the CARES Act is susceptible to multiple potential interpretations. Prior IRS guidance under KETRA relating to plan loan repayment delays did not directly address the timing questions that arise from COVID-19 plan loan repayment delays.

As an initial matter, Notice 2020-50 provides that the CARES Act plan loan relief (*i.e.*, both the increase in the loan amount and the delay of loan repayments) is optional, and employers are permitted to choose whether, and to what extent, to implement such plan loan relief (and such decision is independent of whether CRDs are permitted under the plan). In addition, to the extent that a plan chooses to implement the plan loan repayment delay relief, and loan repayments that are otherwise due during the period from March 27, 2020 through December 31, 2020 are suspended, the IRS acknowledges that there is more than one way that the plan can administer loan repayments once they begin again.

In an effort to simplify plan administration, the IRS provided a safe harbor method of satisfying the CARES Act loan repayment delay requirements. Under the safe harbor, (i) loan repayments may be suspended during the period from March 27, 2020 through December 31, 2020 (or a shorter period determined by the employer, the "Suspension Period"), (ii) interest accruing during the Suspension Period must be added to the principal of the loan, (iii) the term of the loan may (but is not required to) be extended by up to 1 year from the original due date of the loan, (iv) loan repayments must commence at the end of the Suspension Period (but no later than January 1, 2021), and (v) these loan repayments must reflect the reamortization of the principal balance (including the interest that accrued during the Suspension Period) in substantially level installments over the remainder of the term of the loan (which must include any extension of the loan term).

While the safe harbor under Notice 2020-50 provides a relatively straight forward method for implementing the plan loan repayment delay relief, the IRS acknowledges that there may be other reasonable (perhaps more complex) ways to administer this relief under the CARES Act. For instance, the CARES Act permits each repayment that becomes due during the Suspension Period to be delayed for up to 1 year, and then reamortized (taking into account interest) over a period that is up to 1 year longer than the original term of the loan. Accordingly, it is possible for a loan repayment that would have been due on April 1, 2020 to be delayed until April 1, 2021, with originally scheduled loan repayments to be made during the period from January 2021 to March 2021, and reamortized loan repayments to commence beginning April 1, 2021.

[1] See, for example, the disaster relief relating to Hurricane Katrina (under Katrina Emergency Tax Relief Act of 2005, or "KETRA" and IRS Notice 2005-92) and Hurricane Harvey, Irma and Maria and the California Wildfires (under Disaster Tax Relief and Airport and Airway Extension Act of 2017, or "DTRA" and IRS Publication 976 (February 2018)).

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Other Guidance and Clarifications

Notice 2020-50 clarifies and confirms various other points relating to CRDs and the CARES Act plan loan relief, in a manner that is generally consistent with prior IRS guidance in disaster relief situations, including (but not limited to) the following points relevant for employers and plan sponsors.

- CRDs may be made available as a new in-service distribution event prior to age 59 ½ under certain elective deferral plans, and can apply to most qualified employer nonelective and discretionary contributions under those plans, but may not be made available as a new distribution event in certain other plans (such as money purchase plans or defined benefit pension plans prior to normal retirement age or another eligible distribution event; for those and other plans, other legal limitations on the ability to take in-service withdrawals will still apply).

- The special tax treatment afforded to CRDs (which may be designated by a qualified individual) is independent of whether a plan permits CRDs as a new distribution event, and a qualified individual's designation of a distribution as a CRD for purposes of taking advantage of the special tax treatment may differ from a plan administrator's designation of that distribution.

- If a qualified individual is eligible to designate a distribution as a CRD, the amount that may be so designated (*i.e.*, up to $100,000 in the aggregate) is not limited by the individual's need for funds arising from the event that gives rise to their qualified individual status.

- For purposes of determining the $100,000 limit when designating CRDs under a plan, a plan administrator need only consider amounts taken from all applicable plans sponsored by the employer maintaining the plan and members of its controlled group (within the meaning of Section 414(b), (c), (m) or (o) of the Code) and need not consider any other amounts that employee might take from plans not maintained by that employer or members of its controlled group (*e.g.*, IRAs, or plans of unrelated employers).

- Under the CARES Act, plans that do not otherwise allow rollover contributions do not need to be amended to accept recontributions of CRDs. (However, the IRS stops short of saying whether plans that otherwise allow rollover contributions may, nonetheless, choose to exclude recontributions of CRDs,[2] and instead simply states that it anticipates that most eligible retirement plans will accept recontributions of CRDs.)

Finally, Notice 2020-50 also provides guidance to individuals who take CRDs relating to their individual tax treatment and reporting of such distributions (*e.g.*, income inclusion over 3 years) as well as any subsequent recontribution of the CRDs to an eligible retirement plan – a discussion of which is beyond the scope of this alert.

This alert is for general informational purposes only and should not be construed as specific legal advice. If you would like more information about this alert, please contact one of the following attorneys or call your regular Patterson contact.

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[2] We note however, that Treasury Regulation Section 1.401(a)(31)-1 Q/A 13 suggests that a plan can limit the circumstances under which it will accept a rollover contribution.