Lions, Tigers, Bears and CARES – Retirement Plan Compliance

Aug 20, 2020

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Tax Law Defined™ Blog

Authors:

Alison M. Stemler

The IRS has now answered many of the new questions raised after the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) allowed employer 401(k) and certain other retirement plans to make distributions in 2020 to qualifying individuals impacted by the coronavirus (QIs) and to allow increased loan amounts and loan suspensions for QIs. Notice 2020-50 (Notice) also provides that if the special distribution rules are used, a participant can cancel nonqualified plan deferrals.

Our earlier client update described the employee benefits provisions of the CARES Act. This update focuses on the new guidance addressing expanded retirement plan distributions and loans, and action items for employers.

Coronavirus Related Distributions

Under the CARES Act, 401(k) plans can allow coronavirus related distributions (CRDs) of up to $100,000 to participants who are impacted by the coronavirus. A CRD is a distribution made on or after January 1, 2020 and before December 31, 2020 to a QI and includes in-service distributions to QIs who have not reached age 59½. In addition, any qualified plan, not just 401(k) plans, can make CRDs to QIs who are eligible for a distribution under the terms of the plan and applicable law.

The Notice contains a significant expansion of who is considered a QI to include a participant whose spouse or a household member has been quarantined, furloughed, or laid off, or whose work hours have been reduced. A participant is also now a QI if the individual or their spouse or household member's compensation has been reduced, or a job offer has been rescinded or the start date pushed back. A QI must experience adverse financial consequences as a result of one of these events that creates QI status, but the distribution is not limited to the amount of those financial consequences. An individual is also a QI if the individual, their spouse or dependent, or a household member has been diagnosed

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with coronavirus using a CDC-approved test, and in that case the financial consequences requirement does not apply.

The Notice allows QIs to self-certify QI status. Plans and their employer sponsors are not required to inquire or investigate the circumstances. The Notice includes a model certification that can be used. The model certification does not require the QI to state what circumstance creates their QI status, so employers can avoid asking questions that might create potential risks to the employer under employment or nondiscrimination laws. However, the Notice makes clear that participants cannot treat a distribution as a CRD unless they in fact are a QI.

In addition to allowing QIs access to a 401(k) distribution, CRDs have three significant tax benefits. CRDs are exempt from the 10% penalty on distributions before age 59½, taxes on the distribution can be spread over three years, and the individual can recontribute the CRD to an IRA or qualified plan within three years from the date the CRD is made and the CRD will then not be taxable.

One unanswered question was whether plans that don't allow CRDs under these new rules must still determine whether a distribution the participant may otherwise be able to take, such as a hardship distribution or in-service distribution after age 59½, is a CRD. A plan that does not allow CRDs can determine whether to apply the favorable CRD tax rules to a distribution otherwise allowed under the plan, or can instead apply normal withholding. A plan that allows CRDs will need to apply the special CRD tax rules. There is no 20% required withholding and the automatic rollover rules do not apply – instead, the individual must be advised of 10% voluntary withholding and provided an opportunity to elect a different percentage or no withholding.

Last but not least, the Notice includes detailed rules for individuals who take a distribution that qualifies as a CRD, whether or not the employer plan treated it that way. An 8915-E tax form will be issued for QIs to file with their personal tax return to report a CRD. The form will allow individuals to elect to have the entire distribution taxed in 2020, which some individuals may want to do if their tax rates are lower due to reduced earnings in 2020. But, the default

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will be taxation of 1/3 of the CRD in each of 2020, 2021 and 2022.

Coronavirus Loan Rules

The CARES Act allows plans to provide increased loan availability to QIs for loans taken on or after March 27, 2020 and *before* September 23, 2020. QIs can take loans up to $100,000, double the normal loan amount, and QI loans can be up to 100% of the participant's plan accounts, also double the normal 50% limit. The CARES Act also had a very confusing provision allowing QIs to suspend payments on a Plan loan that is outstanding on or after March 27, 2020. For these loans, payments due from March 27 to December 31, 2020 can be suspended and the loan re-amortized at the end of the period of suspension for the original loan term plus one year.

The Notice makes it clear that if loan payments have been suspended, they must begin again on the regular schedule in January 2021. There are numerous ways to interpret the provision about extension of the loan for one year, and the Notice acknowledges that there could be different methods of applying the rules. The Notice provides a "safe-harbor" method that is an acceptable way to apply the rules. Plans can re-amortize the balance due in January 2021, which must include interest on any suspended loan payments, for the period until the end of the original term of the loan plus one year. Loans can be re-amortized for this additional one-year period even if the loan payments were not suspended.

The Notice makes clear that plans are not required to allow suspension of loan payments or extension of the loan term. Plans can ignore these new rules and treat loans as becoming taxable as a deemed distribution if loan payments are not made timely under the terms of the plan and its existing loan policy. Interestingly, if a plan reports a deemed taxable distribution due to non-payment of a loan for a participant who is still employed and not eligible for an actual distribution, that distribution cannot be a CRD for which the favorable tax treatment will apply. If a plan loan goes into default when the participant is permitted to take a distribution, such as at

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termination of employment, the loan is treated as an actual distribution and can be a CRD and take advantage of the favorable tax treatment.

Cancellation of Nonqualified Plan Deferrals

The Notice also states that a participant who takes a CRD will be treated as having taken a hardship distribution for purposes of being eligible to cease any nonqualified plan salary reduction contributions for the rest of 2020. Nonqualified plan contributions must be ceased and not reduced or delayed if this provision is used.

Plan Amendments

Employers will need to keep track of when and how they implement CRDs and loan suspensions in their retirement plans so that these can be documented properly in plan amendments. Plan amendments for these plan changes are required by the last day of the plan year beginning in 2022, or the plan year beginning in 2024 for government plans.

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