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BENEFITS & COMPENSATION UPDATE

*By: Norman J. Misher, Allen J. Erreich, Judy M. Hensley, Chase B. Steinlauf, Ariel B. Woldar
and Charles C. Shulman*

Stimulus Package Includes Financial Relief for Retirement Plan Participants Affected by COVID-19

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") was signed into law. The CARES Act is a \$2-trillion stimulus package to combat the economic fallout of the coronavirus outbreak. In addition to direct payments to many Americans and emergency relief to struggling businesses, the CARES Act relaxes rules that apply to retirement savings in order to help address the impact of the outbreak on plan participants.

The following is a summary of the key retirement provisions in the CARES Act.

Coronavirus-Related Distributions

The CARES Act helps mitigate the immediate financial losses to employees affected by the coronavirus by providing an additional source of funds to participants through "coronavirus-related distributions" ("CRDs"), which qualify for special tax treatment discussed below. A CRD is a distribution of up to \$100,000 taken in 2020 from accounts under profit sharing plans (including employee elective deferrals under 401(k) plans) and IRAs of any participant who is affected by the coronavirus outbreak. The \$100,000 limit on CRDs applies to all CRDs

taken by the participant from all of his or her retirement accounts. Employers are required to monitor CRDs made to a participant under all plans maintained by the employer and its controlled group and prevent CRDs in excess of the \$100,000 limit.

Eligibility: CRDs are available only to a plan participant who is affected by the coronavirus outbreak, which, for purposes of the CARES Act, is a participant:

- who is diagnosed with coronavirus;
- whose spouse or dependent is diagnosed with coronavirus; or
- who experiences adverse financial consequences as a result of:
 - being quarantined;
 - being furloughed or laid off;
 - having reduced hours;
 - being unable to work due to lack of child care;
 - closing or reduced hours of a business owned or operated by the participant; or

- other factors determined by the Secretary of the Treasury.

Plan administrators may rely on the participant's certification that he or she satisfies the conditions necessary to be considered affected by the coronavirus outbreak.

Tax Treatment: Under the CARES Act, CRDs are afforded the following special tax treatment:

- *Permitted In-service Distribution:* CRDs are exempt from the tax code's rule that generally prohibit 401(k) plans from allowing in-service distributions prior to age 59½. CRDs are permissible in-service distributions, including from the participant's elective 401(k) and Roth deferrals.
- *Exemption from Early Withdrawal Penalty:* CRDs are not subject to the 10% early withdrawal penalty for distributions made prior to age 59½.
- *Stretched Period for Income Inclusion:* CRDs are included in the participant's income ratably over 3 taxable years (i.e., the 2020, 2021 and 2022 taxable years), unless the participant elects to include the entire CRD in the year of the distribution (i.e., the 2020 taxable year). The election must apply to all CRDs if the participant receives more than one.
- *Repayments Allowed:* Up until 3 years from the day after participants receive the distribution, participants may repay all or a portion of the CRD. The repayment must be made to a retirement plan of the participant that accepts rollover contributions. CRD amounts that are repaid are treated as a trustee-to-trustee rollover contribution and are not included in income. Repayments to IRAs are not counted toward the one-rollover-per-year limit applicable to IRAs.

The CARES Act leaves open significant questions as to the tax treatment of CRD repayments which are made after all or a portion of the CRD has already been included as taxable income to the participant. If subsequent guidance issued under the CARES Act were to use the same tax rules for CRDs as have been used for past disaster relief distributions, then CRD repayments would be treated as follows:

- Any repayments made before the filing date of the participant's 2020 tax return would reduce the amount of the CRDs otherwise to be included in income on the participant's 2020 tax return.
- Repayments made in 2021 after the participant files his or her 2020 tax return would reduce the amount of the CRDs otherwise to be included in income on the participant's 2021 return. If these repayments were to exceed the amount included in income for 2021, then the participant would be permitted to either carry the excess forward to the participant's 2022 tax return or apply the excess backwards by amending the participant's 2020 tax return.
- Repayments made in 2022 would reduce the amount of CRDs otherwise to be included in income on the participant's 2022 tax return. If the repayments were to exceed the amount included in 2022 income, then the participant would be permitted to apply the repayments to prior years by amending his 2020 or 2021 returns.

Plan Loans

Increased Dollar Limit: The CARES Act also provides relief to plan participants who are affected by the coronavirus outbreak (as determined under the same conditions described above for CRD distributions) by relaxing the rules that apply to plan loans in such a way as to

permit these participants to take out larger loans from their accounts. Under existing rules, plans are allowed to permit participants to take loans from their account up to the lesser of 50% of the vested account balance and \$50,000. However, for loans taken within 180 days after the enactment of the CARES Act (i.e., March 27, 2020), affected participants may take loans from their account up to the lesser of 100% of their vested account balance and \$100,000.

Delayed Repayment of Plan Loans: Affected participants who have a payment on a plan loan due between the date of enactment and December 31, 2020 (the "grace period") will be able to receive a 1-year extension. The 5-year mandatory repayment period that applies to most plan loans is tolled for the duration of the grace period. The CARES Act provides that the subsequent loan payments will be "appropriately adjusted" to reflect a 1-year extension and any interest which accrues during the 1- year extension.

Temporary Waiver of RMDs

The CARES Act provides relief to defined contribution plan and IRA participants by waiving minimum plan distributions that would otherwise be required to be made in 2020. The tax code requires that participants who attain a certain age must begin "required minimum distributions" ("RMDs") no later than the April 1 of the year following the year in which the participant attains that age and then continue to receive RMDs for each calendar year thereafter. (For purposes of this provision of the CARES Act, the relevant age is 70½.) The CARES Act waives RMDs that are due in 2020. If a participant was not required to take his or her

first RMD until April 1, 2020 but nonetheless took it prior to January 1, 2020, the participant does not receive the benefit of the waiver. Because RMDs are recalculated each year based on the account balance at year end, it appears that the waived distribution amount will be made up over future RMDs.

In contrast to the other retirement plan provisions in the CARES Act, this provision is not limited to those participants impacted by the coronavirus.

Plan Amendment Deadline

Tax-qualified retirement plans will need to be formally amended in order to take advantage of the relaxed rules provided by the CARES Act. The deadline for such amendments is the end of the first plan year beginning on or after January 1, 2022 or such later date as the Secretary of the Treasury sets.

Important Takeaways

Many of the relaxed rules provided by the CARES Act may offer employees much needed resources to help deal with the serious financial losses that the employees are experiencing as a result of the global coronavirus pandemic. For some employees the relief provided by these special rules may be the lifeline they need to weather this crisis. This is especially true for employers in sectors that are being hit hardest by the outbreak, such as airlines, hotels, restaurants, gyms, sports leagues and retailers, to name but a few. Employers who want their employees to be able to take advantage of this relief must act swiftly in response to this rapidly-evolving situation.

This update is not intended to provide legal advice with respect to any particular situation, and no legal or business decision should be based solely on its content.

If you have any questions about this update, please contact:

Norman J. Misher	212-903-8733	nmisher@rhtax.com
Allen J. Erreich	212-903-8769	aerreich@rhtax.com
Judy M. Hensley	212-903-8737	jhensley@rhtax.com
Charles C. Shulman	212-903-8687	cshulman@rhtax.com
Chase B. Steinlauf	212-903-8736	csteinlauf@rhtax.com
Ariel B. Woldar	212-903-8718	awoldar@rhtax.com

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