Flashpoint: Coronavirus Relief from Congress – The CARES Act

On Friday, March 27, 2020, the House passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), a massive relief bill for those suffering as a result of the Coronavirus pandemic, which was passed earlier in the week by the Senate. As the bill is the result of significant negotiations between both parties and the White House, it is expected the President will promptly sign it into law.

Besides the generalized financial relief afforded to individuals, as well as loans and other concessions for businesses, the bill includes the following provisions to help participants and plan sponsors of retirement plans:

Coronavirus-Related Distributions

The bill permits "coronavirus-related" distributions of up to $100,000 without the application of the additional 10% premature distribution tax to a "qualified individual" who meets any of the following tests:

- The participant has been diagnosed with the virus (as confirmed by a CDC-approved test);
- The participant's spouse or dependent has been diagnosed with the virus; or
- The participant has suffered financially from the pandemic because:
    - The participant was laid off, furloughed, quarantined, or had hours reduced;
    - The participant cannot work due to the unavailability of child care because of the pandemic; or
    - The participant's own business has had to close or reduce hours.

There may be other categories of people eligible for a hardship distribution, as may be outlined in the future by the Treasury. The Act permits the Plan Administrator to rely on the participant's certification that s/he qualifies for the distribution. Distributions would also be available for beneficiaries of deceased participants and for alternate payees.

While the distribution is exempt from the 10% penalty tax, it is still subject to ordinary income tax. Affected participants may spread the taxes over a three-year period, and may repay all or part of the distribution to the affected plan or any plan that can accept rollovers within such period. Such repayment is treated as a tax-free rollover of the funds to the plan and is not adjusted for

earnings. Following procedures developed in connection with very similar relief for major hurricanes, participants who repay distributions can file an amended return to recover tax paid on income reported in earlier years.

The bill permits any "eligible retirement plan," including qualified plans, IRAs, 403(b) plans and governmental 457(b) plans, to make a coronavirus-related distribution. The bill makes it clear that the provisions in Code sections 401(k), 403(b), and 457(b) that limit distributions will not be violated by coronavirus-related payments, but provides no such relief for defined benefit or money purchase plans (which cannot make in-service distributions prior to age 59-1/2).

The coronavirus-related distributions are not eligible rollover distributions, which means that they are not subject to the 20% mandatory withholding on such distributions. Such rules provide for 10% withholding that is waivable by participants (while keeping in mind that taxes will ultimately be due within the three-year window, unless the distribution is repaid as permitted in the law). Remember to give participants a notice that they can waive the withholding, because failure to provide that notice after the SECURE Act is subject to a $100 penalty per participant, up to a maximum of $50,000.

Loan Limit Increases and Delays in Repayment

Section 72(p) is modified to permit loans of up to 100% of a qualified individual's vested account or benefit, up to $100,000. This provision covers loans made during the next 180 days. Furthermore, any loan payment due on any outstanding loan between the date of enactment and December 31, 2020, is delayed up to one year. The five-year repayment period is also extended for one year. Interest accrues on the loan during the delay period.

It is important that service providers and plan sponsors are vigilant to ensure that participant loans are not reported on Form 1099R as in default during this extended repayment period. It is likely that most recordkeeping systems are programmed to recognize when historical default events occur.

Because of the uncertainty about how repayment of coronavirus-related distributions will be handled, and the tax impact of such repayment, it may be advisable for participants to take loans first. As the repayments may be delayed as discussed above, the immediate effect is the same (i.e., the participant gets money in pocket), but the repayment ramifications are clear. If the participant ultimately terminates employment within the year, the loan can be converted to a distribution at that time.

Required Minimum Distribution Requirements for 2020

Required minimum distributions (RMDs) due in 2020 are not required from defined contribution qualified plans, 403(b) plans, IRAs, and governmental 457(b) plans. For the most part, the statutory provision tracks WRERA relief for 2009 RMDs, with one important exception: If the required beginning date was in 2020 (i.e., April 1, 2020), and the plan hasn't already distributed the first RMD, that RMD is waived as well. If the RMD is due to death, the five-year maximum distribution period is determined disregarding 2020.

This guidance should prevent affected participants having to liquidate deflated investments during this period, permitting them time to recover value. Furthermore, the 2021 distributions will be based on the values at December 31, 2020, so that the RMDs at that time should be lower unless the market recovers.

Single Employer DB Funding Delay

The due date for any required contributions to defined benefit plans (including quarterly contributions) during 2020 is extended to January 1, 2021. The minimum amount is increased by the plan's rate of interest for the interim period. Furthermore, the plan sponsor is permitted to consider the AFTAP for 2020 to be the same as it was for the last plan year ending before 2020.

Despite this relief, service providers should consider having discussions with clients regarding options for freezing future accruals or, for defined contribution plans with hard-wired contributions, adding last day employment requirements, to prevent a possible overwhelming funding obligation in the following year should the market and the economy fail to rebound.

DOL Authority to Postpone Deadlines

The CARES Act gives the DOL authority under ERISA to delay deadlines due to public health emergencies. This will hopefully give rise to some extensions of Form 5500 filing deadlines.

Remedial Amendment Period Extended to 2022

The plan does not have to be amended to conform to operations that are undertaken under these rules until the end of the 2022 plan year (or such later date as the Secretary of the Treasury provides) and anti-cutback relief is provided, if needed. Governmental plans have until 2024. The amendment must be retroactively effective and match what was actually done in the interim. Therefore, it is important that good records are kept in the interim and, when service providers take over plans in the coming years, they gather the information necessary to prepare an accurate amendment.

Other Coronavirus-Related Issues

We have all been inundated by calls about the ability of plan sponsors to terminate contribution obligations and of participants to get funds out of the plan. FBLC has held off on publishing guidance, as we were hoping that the Treasury and DOL would act to provide some relief. As that relief has yet to materialize, let us provide information about where we stand at this time.

Contribution Requirements for Pension Plans and "Hard-Wired" Profit-Sharing and Matching Contributions

Currently, the normal anti-cutback rules apply for legally or plan-mandated contributions. Therefore, once participants have fulfilled the requirements to get a contribution, the contribution – at least through such date – is required. This means that 2019-related relief must come from the government. For 2020, if the plan has a last day employment requirement, or if the number of required hours are such that employees have not yet worked a sufficient number to be entitled to a contribution, the contribution can be cut back or eliminated.

Safe Harbor 401(k) Plan Suspension or Modification

Safe harbor contributions can be suspended midyear if one of two conditions applies:

- The plan provided a notice containing the "maybe not" language at least 30 days prior to the beginning of the plan year, advising participants that the safe harbor contribution might be suspending during the year; or

- The plan sponsor is operating at an economic loss for the plan year.

If the contribution is suspended, participants must be given a 30-day advance supplemental notice (so the contribution requirement continues until 30 days after the notice is given), and the plan must pass ADP testing. The plan will not be able to take advantage of the top-heavy exemption for the year.

Check out Treas. Reg. section 1.401(k)-3(g) for more information and for what the notice must contain.

We have been asked whether, if things improve, the employer can reinstate the safe harbor during the same year in which it was suspended. There is no clear guidance on this, and this has produced quite the controversy in our "quarantine" offices. We are all reasonably uncomfortable with doing this if the "economic loss" reason is what caused the suspension to begin with. As the regulations provide that the loss must be for the plan year, the idea of having a loss for a period and not for another period during the year concerns us. On the other hand, if the plan had a 3% nonelective contribution safe harbor and the reason for the suspension was the "maybe not" notice, and if there was also a "maybe" notice issued, it may be possible to restart the safe harbor later in the year, so long as the safe harbor contribution is provided for the entire year. Again, there is a risk to doing this, and whether to undertake that risk is the plan sponsor's decision. There is no question, however, that, if the plan provides for a safe harbor matching contribution, the exit out of safe harbor status will be a one-way trip for 2020.

Distributions

If a participant does not qualify for the coronavirus-related distribution options discussed above (or if the employer does not want to provide these distributions), then the participant must qualify for a hardship distribution or a termination distribution. This has also raised questions.

First, is there a difference between termination of employment and layoffs, furloughs, suspensions, or whatever other synonym for "get the heck out of here" you want to use? The answer is: it is not clear. The IRS has historically reviewed termination-related distributions on a facts-and-circumstances basis. So, what we recommend is that you look for signs of actual employment termination, such as eligibility for unemployment, access to COBRA, and no apparent guarantee of rehire. If a business says, "We are closing until April 15," that may not appear to give rise to a termination of employment. On the other hand, a business stating, "We are closing our doors and we don't know what will happen next," that edges closer to bona fide terminations.

Service providers should discuss this with plan sponsors to assess what they believe is the proper treatment in light of the facts of their individual situation.

Hardships

The regulations to section 401(k) were changed last year to permit safe harbor hardship distributions if there is a declared FEMA emergency that permits individual assistance. Our review of the FEMA website indicates that not all states have been provided with the "individual assistance" eligibility. If your state has been given this individual assistance, then the plan can permit this type of hardship distribution. Normally, this would be part of the hardship amendment most document sponsors are providing. If there is not an individual assistance declaration, hardship distributions can still be made to 401(k) and 403(b) participants under the non-safe harbor rules, and plans can be amended before the last day of the plan year to use those rules.

Correction of 402(g) Excess NOT Extended

The FAQs posted by the IRS in Notice 2020-18 address mostly tax-related questions. However, Q&A 19 clarifies that any correction required to comply with Code section 402(g) has not been extended. Therefore, all 2019 excess elective deferrals must be distributed no later than April 15, 2020.

Don't Forget About the Partial Plan Termination Rules

It has probably been a long time since many service providers have had to deal with the partial plan termination rules. As a quick reminder of the current status of these rules: a partial plan termination generally is deemed by the IRS to occur when 20% of total plan participants are terminated for reasons other than routine annual turnover. For example, a large fast food operation may experience annual turnover of 30% historically. This would not necessarily trigger a partial plan termination. However, if more than 20% of total plan participants are terminated due to the current state of emergency caused by the coronavirus, that presumably would trigger a partial plan termination.

Partial plan terminations mean that affected plan participants – that is, those who terminate employment – must become 100% vested. Review IRS Rev. Ruling 2007-43 for a refresher.

Many practitioners are asking about the status of the partial termination if the employer rehires the workers. The 20% test creates a presumption that a partial termination has taken place, but facts and circumstances can be used to show that a partial termination, in fact, has not occurred. Again, there is a risk here, because we don't have IRS guidance in relation to the current crisis. If the employer wants certainty, amend the plan to provide full vesting for participants terminating this year.

Good News – No New Audits Initiated

Who doesn't love a bit of good news these days? IR-2020-59 was published March 25, 2020, from the IRS and affirms that the IRS will not be initiating any new audits or examinations during this difficult period, unless there are extenuating circumstances. The IRS will, however, be watching the statute of limitations on open audits, and taking action to get the statute extended before it expires.

Best Wishes from FBLC

We wish you all the best during this difficult time. Please let us know if there is anything we can do to help you. We will continue to keep our eyes open, looking for any guidance from IRS/DOL and get that information to you ASAP. All of our lawyers are working remotely during this crisis. Please stay healthy!

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