Qualified Retirement Plans – New, More Flexible, "Coronavirus Rules"

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As a general proposition, qualified retirement plans must not pay benefits until retirement, termination of employment, or similar events. However, there are opportunities for participants to access their accounts while they are still employed by the plan's sponsor (in a defined contribution plan, including hardship distributions and loans) or to access their benefits (in a defined benefit plan.) Congress expanded the opportunities for "in-service" distributions in the CARES Act to cover distributions related to the coronavirus crisis.

CARES now permits participants in tax-qualified defined contribution plans (such as 401[k], money purchase pension, 403(b) and 457(b) plans) to take "**coronavirus-related distributions**" of up to $100,000 (or their vested account balance, if less.) Note that the $100,000 limit is per individual, in the aggregate, from all plans.) Plan sponsors may, but are not required to, add coronavirus-related distributions to their plans.

The retirement plan will not be treated as violating any tax rules that would otherwise prohibit an in-service distribution (for example, the rule that 401(k) salary reduction contributions cannot be distributed before age 59 ½ or termination of employment.

A "**coronavirus-related distribution**" must meet the following requirements:

Be made in 2020,

From an "eligible retirement plan" (a 401(a) plan, a 403(a) plan, a 403(b) tax-deferred annuity, an individual retirement account or annuity, or a 457(b) eligible deferred compensation plan of a governmental employer but not from a 457(b) plan of a tax-exempt employer), and

Related Services

Employee Benefits

Be made to an individual who meets one or more of the following:

- Is diagnosed with SARS-CoV-2 or COVID-19 by a test approved by the Centers for Disease Control, or
- whose spouse or dependent (as defined in Code Section 152) is so diagnosed, or
- who experiences adverse financial consequences by reason of being quarantined, furloughed or laid off or having work hours reduced due to coronavirus, or
- is unable to work due to lack of childcare due to the coronavirus, or
- is a small business owner or operator which is closed or reduces hours of the business due to the coronavirus, or
- such other factors determined by the Secretary of the Treasury or the IRS.

The plan administrator may rely on the employee's certification that his or her situation is "coronavirus related".

A coronavirus-related distribution is not subject to the usual rules about the special rollover notice, withholding, and mandatory IRA rollover rules that apply to eligible rollover distributions.

Taxation and Possible Repayment of CV-Related Distributions.

- CV-related distributions are not subject to the 10% excise tax otherwise generally imposed on distributions prior to age 59 1/2.
- Income from a coronavirus related distribution may be reported ratably over three years beginning with the taxable year of distribution.
- Also, any individual who receives a coronavirus-related distribution may, at any time during the 3-year period beginning on the day after the distribution was received, repay the distribution to the plan or to another qualified plan or IRA in which the recipient participates and that would accept rollover contributions.

The rules for coronavirus-related distributions are not limited to defined contribution plans. However, in the absence of further guidance from the IRS, it appears that distributions from money purchase pension plans or defined benefit plans are not allowed if the participant is under age 59 ½. Also, only a defined benefit plan that allows non-annuity distributions (lump sums or installments) could permit a one-time coronavirus-related distribution. (DB plans could be amended to so provide, but that could have an effect on both cash flow and funding requirements.)

A retirement plan will need to be amended to provide for these special distribution rules. See the discussion below on "Plan amendment timing" for the extended period in which to adopt such amendments.

401(k) Hardship distributions

Hardship distributions are common in 401(k), 403(b) tax-deferred annuities (for non-profits and public school employers), and 457(b) eligible deferred compensation plans (for governmental employers and non-profits). The Tax Code prohibits these plans from offering in-service distributions before age 59 ½, death, or plan termination. However, in-service distributions in the case of "hardship" (elaborately defined) are also permitted, if the plan so provides.

With President Trump's declaration on March 28 that the COVID-19 pandemic is a federal disaster, hardship distributions based on financial hardship resulting from the pandemic meet the "safe harbor" definition of hardship. As a result, plans can make hardship distributions for corona virus-related reasons without any amendment, even if the financial hardship does not fit any of the other hardship distribution reasons such as paying medical expenses. *Nevertheless, hardship distributions are subject to the 10% early distribution penalty and are limited to the amount needed to meet the financial need (plus taxes).* For this reason, plan sponsors may wish to add the "coronavirus-related distribution" provision to their plans.

Profit-Sharing Plans - in-service distributions:

In-service distribution rules for profit-sharing plans that don't include a 401(k) feature are less restrictive. Depending on the terms of the plan, amounts may be distributed to participants, in-service, after the monies have been in the plan as little as two years, or after five years of participation, or at a stated age. Plans may be amended to add such terms.

Taxation of in-service distributions; waiver of 10% early withdrawal penalty

Hardship distributions or other in-service distributions are subject to federal (and if applicable, state) income tax. Congress waived the 10% penalty that would ordinarily apply to distributions paid before age 59 ½, for "coronavirus-related distributions," as defined above. For this reason, plan sponsors should quickly adopt (and promptly publicize) the special coronavirus distribution rules to save participants 10% on the amount of their distributions in 2020 that are coronavirus-related.

These distributions are subject to 10% federal income tax withholding, unless the participant elects a different (greater or lesser) amount of withholding

Plan loans—current rules

If the plan permits, participants may borrow from their qualified plan accounts. The current limit (prior to CARES Act) is (1) the greater of $10,000 or ½ the vested, with a $50,000 maximum. Participant loans generally must be repaid in at least quarterly installments, and over not more than five years. A plan is permitted to allow a grace period if a participant fails to make a plan loan payment. The ordinary rule is that the grace period ends at the end of the calendar quarter following the quarter in which the participant failed to make the payment. For example, if participants are not being paid while on "coronavirus leave" (so there are no current salary reduction payments), the participants would have to make up for the missed payments (with a personal check, e.g.) by June 30, 2020.

A plan may also allow participants to skip loan payments if they are on a leave of absence during which their pay is less than the loan payment amount. A participant has up to a one year leave to make no payments, but when the participant returns to work, the unpaid loan installments must either be paid at the end of the loan's original end date, or the loan payments must be re-amortized to spread the unpaid installments over the remaining loan term.

If the participant fails to make up missed loan payments, the participant will be taxed on the entire unpaid balance of the loan, plus interest, as if the loan were a distribution on the end of the grace period or at the end of the leave. The deemed distribution is subject to federal and state income tax and the 10% early withdrawal penalty (unless the deemed distribution can meet the coronavirus-related distribution exception).

If your plan does not currently allow the grace period or forbearance during leaves of absence, the plan loan rules (which may be in the plan document or in a separate loan policy) should be amended. Also, participants should be notified that they may not have to make loan payments while they are out on coronavirus leave.

Also, if your plan requires payroll deduction loan payments, and the third party administrator can accept individual payments, you may wish to amend the loan policy to allow payments by check or ACH.

CARES Act changes to plan loan rules—

If the loan is to a person with a CV-related need (as if it were a CV-related distribution, see above) and the loan is made during the 180 days after enactment of CARES (that is, by September 22, 2020)--

- The loan limit maximum is increased to $100,000.
- The limit of ½ the vested account balance becomes 100% of the vested account balance.
- Plan sponsors may, but are not required to, add coronavirus-related loans to their defined contribution plans (whether the plan currently permits loans or not.)

Also, loan payments on existing loans to plan participants which are due during 2020 are delayed for one year, and the loan's final due date is delayed by one year, for a person with a CV-related situation. (Subsequent payments are adjusted for principal and interest. Also, the resulting extension of the original 5-year payback period is permitted.) It appears this one-year loan repayment delay is mandatory, but that is not entirely clear at this time.

On April 29, 2020, the U.S. Department of Labor issued guidance (jointly with the IRS) raising the coronavirus-related loan limit to 100% of the participant's account balance, and approving the one year delay in loan repayments, pursuant to the CARES Act rules. This provides relief from otherwise applicable DOL rules which would have prohibited implementation of these parts of the CARES Act.

Required minimum distributions

The 2019 "SECURE ACT" pushed back the date by which participants must start distributions from retirement plans from age 70 ½ to age 72 (or termination of employment, if later, for all but 5% owners of the plan sponsor--who must start on April 1 of the year following the year they turn age 72, even if they are still working). However, some participants are already receiving minimum required distributions, and some participants would be scheduled to start required minimum distributions in 2020.

The CARES Act waives required minimum distributions from defined contribution plans (including IRA's and 457(b) plans) scheduled in calendar 2020 for the same reason that Congress adopted similar legislation suspending the 2009 required minimum distributions—those distributions might require a substantial hit on retirement accounts whose value is low due to current market declines. In 2009, plans could allow participants to elect to waive the 2009 required minimum distribution, or the plans could either automatically pay them or automatically not pay them. It is likely the IRS will adopt similar rules for the 2020 required minimum distributions.

Plan amendment timing

If a plan is operated in compliance with any of the coronavirus-related distribution rules, the new loan rules and the required minimum distribution waiver for 2020, the plan need not be amended for those provisions until the end of the plan year beginning on or after January 1, 2022 (January 1, 2024, for governmental plans).

INFORMATION FOR EMPLOYERS:

Defined Benefit Plan Funding Relief:

CARES permits the deferral of certain employer contributions to defined benefit plans. In general, sponsors of single-employer defined benefit plans may defer funding for 2020, including quarterly contributions, until January 1, 2021. Ultimately, the contributions must be paid with interest.

The delay in payment applies only to "minimum required contributions" under Internal Revenue Code Section 430(a). It does not apply to contributions required for other reasons such as certain transactions, debt, or special agreements.

Also, relative to determining possible benefit restrictions for the 2020 plan year, a plan sponsor may elect to apply the plan's 2019 funded status (the "adjusted funding target attainment percentage"), thus potentially avoiding restrictions.

Spousal consents to distributions and participant notices

With most people encouraged (or required) to stay home, it may be difficult for plans required to pay benefits in the form of the qualified joint and survivor annuity (QJSA) to get proper waivers of that form of payment. The participant's spouse must consent in writing to the waiver of the QJSA before a plan representative or notary. There may be ways to accomplish this without requiring participants to wait until plan representatives and notaries return to work and the spouse is able to leave the house to meet with one of them, but creativity may be required. Michigan has now published rules for remote notarization of documents (requiring video conferencing) which can facilitate spousal consents.

In addition, plan notices which sponsors might have distributed in person may have to be mailed even though no one is at work (at the plan sponsor's or the third party administrator's office). Some notices can be delivered electronically in some circumstances but existing rules generally limit electronic delivery to either those who work at computers or those who have agreed to receive notices electronically. If employees are working on computers remotely, plan sponsors would be able to deliver plan notices to them on their computers at home. But for employees who aren't working on computers at home and have not given permission to get notices on a home computer, mail delivery will be required unless the Department of Labor creates special exceptions during this health crisis.

Please contact us soon to implement the beneficial changes for your plan participants.

Best wishes during this challenging time.

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