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Stimulus Legislation Allows Access to Retirement Funds to Mitigate Covid-19 Financial Impact

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As part of the Congressional effort to address the financial fallout from the Covid-19 pandemic, the just-enacted Coronavirus Aid, Relief, and Economic Security Act (the CARES Act)[1] provides retirement savings tax relief and access to retirement benefits. Here is a summary of some of the most important of those provisions.

CORONAVIRUS — RELATED DISTRIBUTIONS

The CARES Act creates a new category of employer qualified plan distributions and IRA distributions (coronavirus-related distributions) that are made to individuals during 2020 who fall into one of the following categories:[2]

- They are either diagnosed with coronavirus disease or with having the virus that causes the disease pursuant to a CDC approved test;
- Their spouse or dependent is diagnosed with the disease or the virus. Dependent includes not only children, but also other family members who can be claimed as dependents on one's tax return;
- They experience adverse financial consequences as a result of:

  (1) being quarantined, being furloughed or laid off, or having their "work hours reduced" due to the virus or disease;

  (2) being unable to work due to lack of childcare due to the virus or disease;

  (3) closing or reducing hours of a business owned or operated by the individual due to the virus or disease; or

  (4) other factors as determined by the Secretary of the Treasury.

Note: Presumably, the phrase "due to the virus or the disease" will be broadly interpreted by the IRS to mean any business that is closed or has reduced hours after January 2020.

Coronavirus-related distributions may be made from 401(k) plans and other defined contribution plans that are permitted to make in-service distributions. Defined benefit plans, including cash balance plans, and money purchase pension plans may not make coronavirus-related distributions.

ELIMINATION OF EARLY DISTRIBUTION PENALTY TAX FOR CORONAVIRUS — RELATED DISTRIBUTIONS

Section 72(t)[3] imposes a penalty tax on distributions from employer qualified retirement plans and IRAs to individuals who have not attained age 59½.

Under the CARES Act, the §72(t) tax does not apply to aggregate coronavirus-related distributions of up to $100,000, which are received by an individual

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[1] Pub. L. No. 116-136.

[2] CARES Act, §2202(a)(4)(A).

[3] All section references herein are to the Internal Revenue Code of 1986, as amended (the "Code"), or the Treasury regulations promulgated thereunder, unless otherwise indicated.

during 2020, from employer qualified retirement plans or from IRAs.[4]

Note: Although not likely to have much practical importance, given $100,000 available under the coronavirus-related distribution exemption, it is noted that §72(t) already has other exemptions that could apply, most notably (subject to specified conditions) distributions used to pay medical expenses and health insurance premiums.

INCOME TAX TREATMENT OF CORONAVIRUS — RELATED DISTRIBUTIONS

Unless they elect otherwise, individuals who receive a coronavirus-related distribution will include the amount of the distribution ratably in their gross income, in 2020, 2021, and 2022, thereby partially deferring the taxation of the distribution.[5] Although this is potentially good news to a cash-strapped person, it is useful to keep in mind that 2020 is likely be a year in which the person receiving the distribution has depressed income, and the deferral into future years may increase the amount of tax on the distribution.

The CARES Act also, helpfully, provides that coronavirus-related distributions from employer qualified retirement plans are not subject to required income tax withholding.[6] A coronavirus-related distribution cannot be rolled over tax-free to another employer qualified retirement plan or IRA.[7]

REPAYMENT OF CORONAVIRUS — RELATED DISTRIBUTIONS

The CARES Act gives the recipient of a coronavirus-related distribution three years, beginning on the day after the date on which the distribution was received, to repay the distribution in one or more contributions to an eligible retirement plan, which include IRAs and employer qualified retirement plans.[8]

Note: It does not appear that a repayment contribution has to be made to the IRA or employer qualified retirement plan from which the coronavirus-related distribution was received.

Note: The CARES Act treats the repayment as if it were a tax-free transfer to the recipient eligible retirement plan. In light of the three-year period in which to make the repayment, this means that an individual might have to file an amended tax return for the year or years that the distribution was included in gross income, if the distribution is repaid in a later year.

RELAXATION OF RULES APPLICABLE TO PARTICIPANT LOANS

Participants may borrow up to the lesser of $50,000 or 50% of their vested qualified retirement plan benefits. Loans in excess of that amount are treated as taxable distributions. The CARES Act increases these limits to allow nontaxable plan loans up to the lesser of $100,000 or 100% of a participant's vested plan benefits.[9]

Plan loans are required to be repaid over five years (or over a longer period, if the loan is used to acquire a principal residence) with level amortization of the loan over the term of the loan.[10] A missed payment, which is not timely cured, results in the outstanding balance of the loan being taxed to the participant. Although it is permissible for a plan to allow a cure period that ends on the last day of the calendar year following the calendar year in which the missed payment occurs, in many instances, this will not help someone who has been terminated or furloughed.

The CARES Act provides relief to individuals who qualify to receive a coronavirus-related distribution and have a plan loan, which is outstanding on or after the CARES Act goes into effect.[11] It does so by delaying, for one year, any loan payments that are due between the date the Act goes into effect and the end of 2020.

Note: One issue raised by the one-year repayment delay is what happens if an employee takes a distribution of their benefits during the one-year period, which for terminated employees is often going to be the case. A distribution of plan benefits typically triggers the taxation of a loan secured by those benefits.

WAIVER OF 2020 REQUIRED MINIMUM DISTRIBUTIONS

The I.R.C. requires that a required minimum distribution (RMD) be made annually from qualified employer retirement plans and from IRAs to individuals who have attained age 72 and to beneficiaries following the death of a plan participant or the death of the owner of an IRA.[12]

The CARES Act waives the requirement that RMDs be made from IRAs and qualified employer re-

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[4] CARES Act, §2202(a).

[5] CARES Act, §2202(a)(5)(A).

[6] CARES Act, §2202(a)(6)(B).

[7] CARES Act, §2202(a)(6)(B).

[8] CARES Act, §2202(a)(6)(B).

[9] CARES Act, §2202(b)(1).

[10] CARES Act, §2202(b)(2); §72(p)(2).

[11] CARES Act, §2202(b)(2)(A).

[12] *See generally* §401(a)(9).

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tirement plans (other than cash balance and other defined benefit plans) in 2020.[13]

Note: Legislation passed in 2019 (the SECURE Act) increased the RMD required beginning date from April 1 following the calendar year in which a person turns age 70½ to April 1 following the calendar year in which a person turns age 72.[14] This change is effective for individuals who attain age after 70½ after December 31, 2019. This means that, if an individual attained age 70½ in 2019, but did not take their first RMD in 2019, they would be able to defer their first RMD for a year.

[13] CARES Act, §2203(a) amending §401(a)(9).

[14] Pub. L. No. 116-94, Division O, §114.

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Pursuant to Notice 2020-23, which was issued on April 9, 2020, amounts that were distributed from an IRA or a qualified employer retirement plan between February 1, 2020, and May 15, 2020, including amounts that but for the CARES Act would be RMDs, are eligible for tax-free rollover treatment until July 15, 2020. It is expected that further guidance regarding the rollover of 2020 RMDs, along the lines of the guidance in Notice 2009-82, which implemented a similar legislative waiver of the RMD requirements in 2009, will be forthcoming in the near future.

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