

IRS FAQs Addressing Distributions and Loan Relief Available Under the CARES Act

The Internal Revenue Service (IRS) on May 4, 2020, released a series of Frequently Asked Questions (FAQs) addressing the distribution and loan provisions included in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The IRS also noted that additional guidance addressing the provisions of the CARES Act will be forthcoming. The following are key takeaways for plan sponsors:

Coronavirus-Related Distributions

The [CARES Act permits sponsors of qualified retirement plans](#) to permit eligible individuals to receive distributions of up to \$100,000. An "eligible individual" is someone diagnosed with COVID 19, someone whose spouse or dependent is diagnosed with COVID 19 or someone who experiences adverse financial consequences due to furlough, layoff, quarantine, school or child care closure or business closure. The FAQs provide additional clarification regarding these Coronavirus Related Distributions (CRDs). Further, while additional specific guidance regarding these distributions will be forthcoming, the FAQs provide that the IRS expects the tax treatment of such distributions to be similar to that of distributions issued following Hurricane Katrina, as addressed in IRS Notice 2005 92.

- **Distributions Considered a CRD:** Plan sponsors may add an additional distribution option for individuals eligible for a CRD. Additionally, the FAQs clarify that any distribution received by an eligible individual from January 1, 2020 through December 31, 2020, is considered a CRD. However, plan sponsors are not required to classify distributions as CRDs. Instead, participants can treat any distribution as a CRD on their federal income tax returns, provided the distribution otherwise qualifies as a CRD.

Accordingly, it seems eligible individuals who receive a hardship distribution, an in service distribution or a distribution at retirement are eligible for the preferential tax treatment available for CRDs, provided the total distributions received do not exceed \$100,000.

Additionally, the FAQs confirm that, while distributions from money purchase plans and defined benefit plans may be considered CRDs, the CARES Act does not provide relief from such plans' early distribution restrictions. Accordingly,

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an eligible individual is not permitted to receive a CRD from these plans absent a distributable event, such as severance from service or attainment of age 59 1/2.

Due to these restrictions, many recordkeepers have prohibited money purchase plans and defined benefit plans from implementing CRDs. These restrictions may also extend to money purchase assets held in converted money purchase plans. However, eligible individuals receiving a distribution from these plans can treat the distribution as a CRD on their federal income tax return.

- **Individuals Eligible for a CRD:** The FAQs provide that the IRS is currently reviewing public comments asking that eligibility for CRDs be expanded. *We expect this to be addressed in more detail in forthcoming guidance.*

Additionally, the FAQs clarify that a plan sponsor may rely on a participant's self certification regarding his or her CRD eligibility, *unless* the plan sponsor has actual knowledge to the contrary.

- **Taxation of a CRD:** The FAQs confirm that a CRD is not subject to the federal early withdrawal penalty. Responsibility for reporting the distribution as taxable income lies with the participant. A participant may either include the entire distribution in his or her taxable income in the year of the distribution, or pay the tax incrementally over a three year period.

Additionally, the FAQs provide that the \$100,000 limit applies to the taxpayer, not to the plan or plan sponsor. However, plan sponsors must ensure that participants do not receive CRDs exceeding a *total* of \$100,000 from all plans sponsored by the same plan sponsor or within the same controlled group.

- **Repayment of a CRD:** A participant may repay all or a portion of the CRD to an eligible retirement plan within three years of the date of the distribution. There is no obligation to repay any portion of the CRD.

Based on IRS Notice 2005 92, this repayment option is not expected to extend to payments not otherwise eligible for rollovers, such as periodic payments paid over a period of more than 10 years or required minimum distributions. While hardship distributions are not typically eligible for rollover treatment, a hardship distribution treated as a CRD is expected to be eligible for repayment.

Additionally, because repaid CRDs are to be treated as rollover contributions, plans that do not permit rollover contributions are not required to accept the



repayment of CRDs.

Amounts repaid are not included in a participant's taxable income. Accordingly, if a participant receives a distribution in 2020 and fully repays the distribution in 2022, the distribution would not be included in the participant's gross income for 2020, 2021 and 2022. As a result, a participant could refile his or her taxes from the prior years to adjust those years' reported gross income. Based on IRS Notice 2005 92, participants may also be eligible to carry forward the repayment and reduce their taxable income in future taxable years.

Plan Loan Relief

The FAQs clarify that plan sponsors are not required to implement either the increase in the allowable loan amount and loan repayment relief for eligible individuals are optional to implement. *We expect this to be addressed in more detail in forthcoming guidance.*

Required Minimum Distribution Waiver

The FAQs did not provide any additional guidance regarding the CARES Act's required minimum distribution waiver.

If you have any questions about the CARES Act and the potential impact these legal changes could have on your benefit plans, please contact your Reinhart attorney.

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