CARES Act – Important Changes to 401k or other Retirement Plans

Coronavirus-Related Plan Distributions
Coronavirus-Related Plan Distributions and Loans, RMD Waivers, Qualified Disaster Relief Payments and Student Loan Assistance

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As a growing number of the workforce is being affected by the COVID-19 pandemic, employers are raising several benefit related questions, particularly with respect to financial assistance available to employees. The Employee Benefits Group at Hanson Bridgett will be providing updated information on possible issues arising in the benefits area through Benefits Alerts and postings on Hanson Bridgett's Online COVID-19 Resource Center. Regulatory and legislative changes are occurring rapidly, and we will make every effort to keep our clients informed of new developments occurring in this area as they occur.

Below are answers to some of the most frequent questions received thus far related to new rules for distributions and loans available from retirement plans, and other types of financial assistance available to employees. Of course, your particular benefit plan provisions may impact the answer to some of these questions. Please feel free to reach out to your contact in the Employee Benefits Group with more specific questions about your benefits issues.

Additional resources for employee benefit plan sponsors regarding COVID-19 related issues can be found at the following websites:

IRS Coronavirus Tax Relief
U.S. Department of Labor Coronavirus Resources
CalPERS COVID-19 Webpage

Question 1: Can employees receive a loan or distribution from their 401(k) or other defined contribution retirement plans on account of expenses related to COVID-19?

Answer 1: Yes.

Coronavirus-Related Plan Distributions

Under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), enacted on March 27, 2020, an employee can receive a coronavirus-related distribution from their retirement plan of up to $100,000 any time in 2020. These
distributions are exempt from the 10% early withdrawal penalty, can be included in the employee’s income tax over three years, and are not subject to mandatory 20% withholding for “eligible rollover distributions.”

To qualify for this type of distribution, the employee must certify that either:

- the employee, or their spouse or dependent, was diagnosed with COVID-19 by a test approved by the Centers for Disease Control and Prevention (CDC), or
- the employee is experiencing adverse financial consequences related to COVID-19 as a result of:
  - being quarantined;
  - being furloughed, laid off, or having reduced work hours;
  - being unable to work due to lack of child care;
  - closing or reducing hours of a business owned or operated by the employee; or
  - other factors as determined by the Secretary of the Treasury.

Plan sponsors can rely on an employee’s self-certification that the employee meets the conditions for a coronavirus-related distribution.

Coronavirus-related distributions are available from 401(k), 403(b), and governmental 457(b) plans. The aggregate amount of coronavirus-related distributions received by an employee from all plans maintained by an employer (and any member of any controlled group that includes the employer) cannot exceed $100,000.

Coronavirus-related distributions may be repaid to the plan within three years. Amounts repaid are treated as a rollover contribution to the plan and are not subject to the annual contribution limit.

Plans sponsored by private-sector employers must be amended by the end of the 2022 plan year to provide for coronavirus-related distributions retroactively; governmental plan sponsors have until the end of the 2024 plan year to amend their plans.

**Participant Loans from Retirement Plans**

The CARES Act provides two COVID-19 related provisions for loans from retirement plans for participants who meet one of the conditions described above for coronavirus-related distributions: an increase in the maximum loan amount, and the ability to delay repayment of existing plan loans.

Plan sponsors may permit participant loans taken on or before the date that is 180 days after enactment of the CARES Act, or September 23, 2020, up to a maximum amount of $100,000 or 100% of the participant’s account balance (increased from $50,000 or 50% of their account balance).

In addition, participants with outstanding loans may delay repayments that would otherwise be due between the date of enactment of the CARES Act, March 27, 2020, and December 31, 2020, for one year, with the maximum repayment period of the loan also extended for one year.

Plans that allow coronavirus-related loans or the loan repayment relief described above will require a retroactive plan amendment by the end of the 2022 plan year or, for governmental plans, by the end of the 2024 plan year.

In addition to the plan loan provisions in the CARES Act, employees may be eligible for a general purpose loan from their retirement plan under existing plan provisions. 401(k) and other defined contribution
retirement plans that permit participant loans generally do not limit the purpose for which a loan can be taken, although there may be restrictions on the number of loans available from the plan at any one time, and the amount of any loan, the repayment period, and other loan terms must comply with IRS rules for participant loans from retirement plans.

### Hardship Distributions and Unforeseen Emergency Withdrawals

Coronavirus-related distributions are different from hardship distributions under 401(k) plans and unforeseen emergency withdrawals from 457(b) plans. Hardship distributions from a 401(k) plan, if permitted under the plan, can be made only if necessary to satisfy an immediate and heavy financial need. For plans incorporating the IRS “safe harbor” events that are deemed to be made on account of an immediate and heavy financial need, a hardship distribution is allowed for expenses for (or necessary to obtain) medical care (as defined in Internal Revenue Code section 213(d)), if the recipient of the medical care is the participant, or a spouse, dependent or a named beneficiary under the 401(k) plan. Hardship distributions are taxed in the year taken, cannot be repaid to the plan, and are limited to the amount necessary to meet the financial need.

On March 22, 2020, the COVID-19 emergency was declared a major disaster in California under Section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (“Stafford Act”), which made federal funding available for crisis counseling for affected individuals in all areas of the state of California. Under new regulations issued by the IRS last year, the “safe harbor” events for a hardship distribution include expenses and losses (including loss of income) incurred by a participant on account of such a disaster, provided that the participant’s principal residence or principal place of employment at the time of the disaster was located in an area designated by the Federal Emergency Management Agency (FEMA) for individual assistance with respect to the disaster. Now that the COVID-19 emergency has been declared a major disaster in California under Section 401 of the Stafford Act, for which individual assistance related to the disaster is available, such hardship distributions can be permitted for participants who live or work in California. If not currently provided for in their plan, employers can amend their plan to provide for such hardship distributions before the end of the plan year.

Employees who participate in a 457(b) plan may qualify for an “unforeseen emergency” distribution, if permitted under the plan, in the case of a severe financial hardship of the participant or beneficiary resulting from an illness, including the need to pay for medical expenses. A distribution for an unforeseen emergency may be made only to the extent the emergency cannot be relieved through reimbursement or compensation from insurance or otherwise, or by liquidation of the participant’s assets, unless the liquidation of assets would itself cause severe financial hardship. Like hardship distributions, unforeseen emergency distributions are taxed in the year taken, cannot be repaid to the plan, and are limited to the amount necessary to meet the financial need.

**Question 2:** Does the CARES Act affect required minimum distributions (RMDs) from retirement plans?

**Answer 2:** Yes. Under the CARES Act, a temporary waiver of required minimum distributions (RMDs) from defined contribution plans, including 401(k), 403(b) and governmental 457(b) plans, applies for 2020. This includes 2020 RMD payments for individuals already receiving RMD payments and individuals who would have received their first RMD payment in 2020. Plans that provide a waiver of 2020 RMD payments will require a plan amendment by the end of the 2022 plan year, or, for governmental plans, by the end of the
2024 plan year.

**Question 3:** What other types of financial assistance can employers provide to their employees to address the COVID-19 pandemic?

**Answer 3:** Employers can provide employees with qualified disaster relief payments, and student loan assistance.

**Qualified Disaster Relief Payments**

Because the COVID-19 pandemic is a federally declared disaster, employers can make qualified disaster relief payments to employees under Internal Revenue Code (Code) section 139. These are payments to reimburse or pay “reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster” and are not treated as taxable wages for federal tax purposes. For purposes of California payroll taxes, such payments are not subject to income tax withholding, but are subject to withholdings for unemployment insurance, employment training tax and state disability insurance (unless the payment is related to the death of an employee).

According to IRS guidance regarding qualified disaster relief payments, employers do not need to require that employees substantiate the expenses for which the payments are used, so long as the payments are:

- Reasonably expected to be commensurate with reasonable and necessary personal, living, or family expenses that employees incur as a result of the disaster;
- Paid to compensate individuals for expenses that are not compensated for by insurance or otherwise; and
- Not intended to reimburse the cost of nonessential, luxury, or decorative items and services.

Accordingly, employees are not required to account for actual expenses incurred because of the disaster, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred. No dollar limit applies to qualified disaster relief payments, and non-discrimination rules do not apply. However, qualified disaster relief payments cannot be for income replacement, so payment amounts should not be tied directly to compensation.

While a written disaster relief payment plan document is not required under Code section 139, employers should maintain sufficient records of all payments that are made, in order to support the tax treatment of those payments. This could be met by adopting a simple form that employees complete to document the amount and purpose of the payment, including confirmation that the employee’s expenses are associated with the COVID-19 emergency and are not reimbursable by insurance.

**Student Loan Assistance**

Under the CARES Act, employers with educational assistance programs under Code section 127, such as tuition reimbursement plans, can make tax-free payments to reimburse an employee, or pay directly to the lender on behalf of the employee, amounts to repay a qualified student loan, up to the maximum of $5,250. This applies for student loan payments made before January 1, 2021, for loans that qualify for a tax deduction under Code section 221, although the deduction is not available to the extent an employer reimburses or makes loan payments under this provision.