

IRS Releases Clarifying FAQs on CARES Act Retirement Plan Relief

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Section 2202 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), enacted on March 27, 2020, provides for special distribution options and rollover rules for retirement plans and IRAs, and expands permissible loans from certain retirement plans. We have previously written on the [impact of the CARES Act on retirement plans](#).

The Internal Revenue Service (IRS) recently released a preliminary set of [frequently asked questions](#) (FAQs) clarifying how the IRS intends to interpret the relief provided under the CARES Act. The FAQs explicitly reference the IRS's prior guidance under [IRS Notice 2005-92](#)—which covered tax-favored treatment of distributions and plan loans under the Katrina Emergency Tax Relief Act of 2005 (KETRA)—as being instructive in how the IRS intends to apply the CARES Act's retirement plan relief. We have included certain KETRA examples and analysis below. The FAQs also indicate that the Treasury Department and IRS are formulating additional guidance on Section 2202 of the CARES Act that they expect to release in the near future, and anticipate that the guidance will apply similar principles as those found in Notice 2005-92, to the extent applicable.

The FAQs provide several clarifications, including:

- **Adoption of CARES ACT relief is voluntary**—the FAQs clarify that an employer is permitted to choose whether, and to what extent, to amend its plan to provide for coronavirus-related distributions (CRDs) and/or loans that satisfy the provisions of section 2202 of the CARES Act. Thus, for example, an employer may choose to provide for CRDs but choose not to change its plan loan provisions or loan repayment schedules. The FAQs do not make a distinction between section 2202 loan provisions that permit a short-term increase in loan limits and provisions that provide deferment of loan repayment.
- **Loan repayment suspension period**—the FAQs provide that if a loan is delayed under the plan for up to one year pursuant to section 2202 of the CARES Act, that any payments after the suspension period will be adjusted to reflect the delay and any interest accruing during the delay and points to Section 5.B of Notice 2005-92. That guidance describes a safe harbor that would result in a plan sponsor being deemed to comply with Internal Revenue Code Section 72(p) which governs when a loan is deemed to be a distribution. The safe harbor provides that loan repayments must resume upon the end of the suspension period, and that the term of the loan may be extended by the duration of such suspension period. If a plan suspends loan repayments during the suspension period, the suspension will not cause the loan to be deemed distributed even if, due solely to the suspension, the term of the loan is extended beyond five years. Interest accruing during the suspension period must be added to

the remaining principal of the loan. A plan would satisfy these rules if the loan is repaid after the suspension period by amortization in substantially level installments over the remaining period of the loan (i.e., five years from the date of the loan, assuming that the loan is not a principal residence loan, plus the suspension period).

Winston Takeaway: Unfortunately, the FAQs fail to clarify whether a similar safe harbor under the CARES Act would treat the suspension period as December 31, 2020 (which is the last date that loan repayments can be deferred for one year under Section 2022 of the CARES Act) or a later date beginning on and after March 27, 2021 based on the one-year anniversary of the period that loan repayments can be deferred for one year. Additional guidance on this as well as how loan repayments must be adjusted following the conclusion of the suspension period is needed.

- **Application of CARES Act to plans other than 401(k), 403(b), and governmental 457(b) plans**—under section 2202 of the CARES Act, a CRD is treated as meeting the distribution restrictions for a section 401(k) plan, section 403(b) plan, or governmental section 457(b) plan. For example, under section 2202 of the CARES Act, a section 401(k) plan may permit a coronavirus-related distribution, even if it would occur before an otherwise-permitted distributable event (such as severance from employment, disability, or attainment of age 59½). However, the FAQs clarify that the CARES Act does not otherwise change the limits on when plan distributions are permitted to be made. For example, a qualified plan that is a pension plan (such as a money purchase pension plan) is not permitted to make a distribution before an otherwise-permitted distributable event merely because the distribution, if made, would qualify as a coronavirus-related distribution. Further, a pension plan is not permitted to make a distribution under a distribution form that is not a qualified joint and survivor annuity without spousal consent merely because the distribution, if made, could be treated as a coronavirus-related distribution. The FAQ guidance cites to and generally tracks Section 2.A of Notice 2005-92 of the KETRA guidance. As a result, a pension plan would be able to treat a distribution as a coronavirus-related distribution, but it could not permit such a distribution unless the distribution would otherwise be available under the plan and applicable law.
- **Participants can treat certain plan distributions as CRDs without employer action**—even if an employer does not treat a distribution as coronavirus-related, a qualified individual may elect to treat a distribution that meets the requirements to be a CRD as coronavirus-related on the individual's federal income tax return, similar to how Katrina distributions were treated under KETRA and as described in Notice 2005-92. Under Notice 2005-92, a qualified individual was permitted to designate any qualifying distribution as a Katrina distribution, provided that the total amount received did not exceed \$100,000. Amounts in excess of the \$100,000 (for which a Section 72(t)(2) of the *Internal Revenue Code* exception did not apply) would be treated as an early distribution under the plan and the amount would (i) be subject to a 10% additional tax for early distributions, (ii) be included in the individual's income in the year of distribution (and not spread out over the three-year period), and (iii) not be eligible for the three-year retribution relief.

For example, Section 1.C of Notice 2005-92 permitted a qualifying individual to designate the following types of distributions as Katrina distributions: (i) periodic payments and required minimum distributions received by a qualified individual from an eligible retirement plan during the statutory Katrina emergency period; (ii) any distribution received by a qualified individual as a beneficiary; and (iii) a reduction or offset of a participant's account balance in order to repay a plan loan, as described in Q&A-9(b) of § 1.402(c)-2 of the Treasury Regulations ("Other Katrina Distributions").^[1]

Winston Takeaway: Based on the FAQs, it appears that the IRS intends to permit qualified individuals to characterize distributions similar to Other Katrina Distributions described above, that would otherwise meet CRD requirements, as a CRD for purposes of their federal tax returns.

- **Examples of a "qualified individual" for purposes of CRDs and loan relief**—the FAQ identifies the below examples as clearly meeting the definition of "qualified individual" under Section 2022 of the CARES Act:
 - A participant is diagnosed with the virus SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention (CDC);
 - A participant's spouse or dependent is diagnosed with SARS-CoV-2 or with COVID-19 by a test approved by the CDC;

- A participant experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off, or having work hours reduced due to SARS-CoV-2 or COVID-19;
- A participant experiences adverse financial consequences as a result of being unable to work due to lack of child care due to SARS-CoV-2 or COVID-19; or
- A participant experiences adverse financial consequences as a result of closing or reducing hours of a business that the participant owns or operates due to SARS-CoV-2 or COVID-19.

Winston Takeaway: The FAQs note that the Treasury Department and the IRS are reviewing comments from the public requesting expansion of the list of factors that are currently used in determining whether an individual is a “qualified individual” as a result of experiencing adverse financial consequences.

- **Clarification on CRDs Repayment Options**—generally, under the CARES Act, a qualified individual may repay all or part of the amount of a CRD to an eligible retirement plan, provided that they complete the repayment within three years after the date that the distribution was received. If repaid, the CRD will be treated as though it were repaid in a direct trustee-to-trustee transfer so that the participant does not owe federal income tax on the distribution. The IRS provides the following example:

If, for example, you receive a coronavirus-related distribution in 2020, you choose to include the distribution amount in income over a 3-year period (2020, 2021, and 2022), and you choose to repay the full amount to an eligible retirement plan in 2022, you may file amended federal income tax returns for 2020 and 2021 to claim a refund of the tax attributable to the amount of the distribution that you included in income for those years, and you will not be required to include any amount in income in 2022.

The FAQs note that the IRS anticipates that eligible retirement plans will accept repayments of coronavirus-related distributions. The repayment would be treated as a rollover into the plan. However, the FAQs note that eligible retirement plans are not generally required to accept rollover contributions and that if a plan does not accept any rollover contributions, the plan would not be required to change its terms or procedures to accept repayments.

Winston Takeaway: Employers considering offering CRDs should review their plan documents with counsel and recordkeepers to confirm that qualified individuals will be able to repay their CRDs to the plan.

- **Tax Treatment of CRDs for Plans**—the payment of a CRD to a qualified individual must be reported by the eligible retirement plan on Form 1099-R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. This reporting is required even if the qualified individual repays the CRD in the same year. The IRS expects to provide more information on how to report these distributions later this year; however, the FAQ points to prior KETRA guidance, specifically Section 3 of Notice 2005-92. There, the IRS indicated that a Katrina distribution may be recorded using distribution codes 1 or 2 in box 7 of Form 1099-R. In addition, under the KETRA guidance, a plan administrator was required to reasonably conclude that the recontribution to the eligible retirement plan was eligible for direct rollover treatment. Pursuant to Section 3.B of Notice 2005-92, plan administrators were able to rely on the reasonable representations of a qualified individual with respect to meeting the criteria for having received a Katrina distribution in the first place.
- **Tax Treatment of CRDs for Participants**
 - **If a participant does not repay the CRD**—the distributions generally are included in income ratably over a three-year period, starting with the year in which the participant receives the distribution. For example, if the participant receives a \$9,000 CRD in 2020, the participant would report \$3,000 in income on their federal income tax return for each of 2020, 2021, and 2022. However, the participant has the option of including the entire distribution in their income for the year of the distribution. For each year that a CRD is reportable in income, and regardless of whether a participant is otherwise required to file a federal income tax return for the applicable year, the participant would use Form 8915-E (which is expected to be available before the end of 2020) to determine the amount of any CRD includible in income for a year.

- **If a participant repays the CRD**—the tax-treatment on CRDs will vary depending on when a CRD is repaid. As a general rule, if all or a portion of the CRD is recontributed prior to the date the participant timely files their tax return (i.e., after the due date, including extensions) for the year that the distribution amount or a portion thereof is to be reflected in the participant's gross income, then the distribution amount or portion thereof related to that year is not includible in the participant's income. Depending on the size and timing of the repayment, the participant may be able to carry backwards or forwards the repayment amount in the years in which the participant must record income for the distribution. In some instances, this will require amending prior tax returns and filing an amended Form 8915-E. The FAQ provides the following examples directly or by reference to Notice 2005-95:
- **Example 1**—If a participant receives a CRD in 2020 and they choose to repay the full amount to an eligible retirement plan on March 31, 2021, no portion of the CRD is includible in income for the 2020 tax year if they report the amount on Form 8915-E and timely file their 2020 tax return on April 9, 2021. The same result occurs if the participant timely files for an extension for their 2020 tax return and timely files the return by the extended deadline. See *Section 4.D of Notice 2005-92, Examples 1 and 2.*
- **Example 2**—If a participant receives a CRD on December 15, 2020, and elects out of the three-year ratable income inclusion on Form 8915-E and includes the entire amount in their gross income in their 2020 tax return, then if the participant recontributes the entire CRD on or before December 15, 2023, the participant will need to file an amended return for the 2020 tax year, reflecting the amount of the recontribution and the reduction of the participant's gross income by the amount of the CRD. See *Section 4.D of Notice 2005-92, Example 3.*
- **Example 3**—If a participant receives a CRD of \$15,000 in 2020 and they choose to include the distribution amount in income over a 3-year period (2020, 2021, and 2022), and they choose to repay the full amount to an eligible retirement plan in 2022 after they have timely filed their 2021 tax return, they may file amended federal income tax returns for 2020 and 2021 to claim a refund of the tax attributable to the amount of the distribution that they included in income for those years, and they will not be required to include any amount in income in 2022. In addition, they will likely need to file an amended Form 8915-E for years 2020 and 2021. See *Q&A 7 of the FAQ and Section 4 of Notice 2005-92 generally.*

Additional examples can be found in Section 4 of Notice 2005-92.

Until further guidance is released by the IRS and Treasury Department, the FAQs and KETRA guidance clarify how the IRS intends to interpret the retirement plan relief provided under Section 2022 of the CARES Act.

Please contact a member of the Winston & Strawn Employee Benefits and Executive Compensation Practice Group or your relationship attorney for further information.

^[1] Please note that any amount described in Q&A-4 of §1.402(c)-2 of the regulations is not permitted to be treated as a Katrina distribution, including corrective distributions of excess contributions under § 415, excess elective deferrals under § 402(g), excess contributions under § 401(k), and excess aggregate contributions under § 401(m); loans that are treated as deemed distributions pursuant to § 72(p); dividends paid on applicable employer securities under § 404(k); and the costs of current life insurance protection.

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