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IRS Releases FAQs Clarifying CARES Act Loan & Withdrawal Relief

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The IRS has issued eagerly anticipated pre-guidance clarifying certain aspects of the CARES Act's withdrawal and loan relief provision applicable to retirement plans (the "New FAQs"). This article expands on our prior summaryof the statutory provisions.

Additional Guidance Anticipated

The New FAQs indicate the IRS' intention to release additional guidance in the near future. Importantly, the IRS indicates that the new guidance will generally apply the principles of Notice 2005-92 (the KETRA Notice), which interpreted sections 101 and 103 of the Katrina Emergency Tax Relief Act of 2005 ("KETRA"), to CARES Act section 2202. KETRA, passed as relief for victims of Hurricane Katrina, enacted withdrawal and loan relief provisions very similar to those found in the CARES Act.

Optional v. Mandatory

The New FAQs clarify that all of the loan and withdrawal relief provisions of CARES Act section 2202 are **optional** for employers to adopt, and that employers can adopt some relief provisions without having to adopt them all. However, the IRS notes that an otherwise-qualifying employee may treat an otherwise-qualifying distribution that has been made in accordance with the plan's terms as a qualifying distribution for purposes of their individual taxes, regardless of whether or not the plan treated it as a qualifying distribution. The IRS directs plan sponsors' attention to section 4.A of the KETRA Notice for additional guidance on this point.

CARES Act Section 2202 Relief in a Nutshell

Section 2202 of the CARES Act contains three principal items of relief:

1. Certain employer-sponsored retirement plans and IRAs ("Eligible Plans") may permit certain participants affected by COVID-19 ("Eligible Individuals") to take special distributions of up to $100,000, which are given favorable tax treatment and which may be voluntarily recontributed back to the same or a different Eligible Plan ("CARES Withdrawals" and "CARES Recontributions", respectively).
2. Eligible Plans may permit Eligible Individuals to take out loans of up to $100,000 (increased from $50,000 under existing law), using up to 100% of the Eligible Individuals' account balances as collateral (as opposed to 50% under prior law) ("CARES Loans").
3. Eligible Plans may permit Eligible Individuals to defer certain loan repayments for up to 1 year ("CARES

Loan Deferment").

Eligible Individuals

The CARES Act, as clarified by the New FAQs, defines Eligible Individuals to include persons:

- Who are 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;
- Whose spouse or dependent is diagnosed with SARS-CoV-2 or with COVID-19 by a test approved by the Centers for Disease Control and Prevention;
- Who experience 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;
- Who experience 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
- Who experience adverse financial consequences as a result of closing or reducing hours of a business that they own or operate due to SARS-CoV-2 or COVID-19.

The New FAQs note that the IRS has the power to expand the list of categories of Eligible Individuals, and that it is currently reviewing public comments on that topic.

The CARES Act permits plan administrators to rely on employees' self-certifications that they are Eligible Individuals for purposes of determining whether a distribution qualifies a CARES Withdrawal. The New FAQs clarify that self-certification is not allowed if the administrator has actual knowledge to the contrary, and provide further that an individual may treat a distribution as a CARES Withdrawal for purposes of their individual taxation only if they actually qualify as an Eligible Individual.

The CARES Act does not state that self-certifications may be relied upon for purposes of eligibility for CARES Loan or CARES Loan Deferment relief. The New FAQs do not clarify this point.

Eligible Plans

The CARES Act does not have a unified definition of an Eligible Plan. In general, the CARES Act allows a distribution from the following plan types, once made, to be treated as a CARES Withdrawal:

- IRAs
- IRC section 401(a) qualified plans
- IRC section 403(a) annuity plans
- IRC section 403(b) annuity contracts
- IRC section 457(b) eligible deferred compensation plans that are maintained by IRC section 457(e)(1)(A) eligible employers

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However, the CARES Act allows only the following plan types to permit a CARES Withdrawal to be made notwithstanding the regular restrictions on plan distributions:

- IRC section 401(k) plans
- IRC section 403(b) plans
- Governmental IRC section 457(b) plans
- The federal government's Thrift Savings Plan

(Thus, for example, a distribution from a qualified pension plan could be treated as a CARES Withdrawal, but that same pension plan could not permit a CARES Withdrawal to be distributed unless it could otherwise be distributed in accordance with the plan terms and applicable law. The New FAQs direct plan sponsors' attention to section 2.A of the KETRA Notice for more guidance on this point.)

And, the CARES Act includes the following plan types for purposes of the CARES Loan and CARES Loan Deferment provisions:

- IRC section 401(a) qualified plans
- IRC section 403(a) annuity plans
- IRC section 403(b) annuity plans
- Government plans

CARES Withdrawals

A CARES Withdrawal is a distribution that is made from an Eligible Plan to an Eligible Individual between January 1, 2020, to December 30, 2020, up to an aggregate limit of $100,000 from all plans and IRAs.

CARES Withdrawals are generally subject to taxation ratably over a three year period, but an employee could elect to include the entire distribution as 2020 income. For example, if a given employee receives a $9,000 CARES Withdrawal in 2020, they could report $3,000 in income on their federal income tax returns for each of 2020, 2021, and 2022.

Early distributions from qualified retirement plans (for example, hardship distributions before the age of 59½) are generally subject to a 10% additional tax. CARES Withdrawals are exempt from this additional tax provision.

CARES Withdrawals may be recontributed to any Eligible Plan within three years after the date the CARES Withdrawal was received, and the amount of any CARES Recontribution may be excluded from income. The IRS clarifies that this exclusion may operate retroactively—thus, for example, if a CARES Withdrawal distributed in 2020 were repaid in 2022, the recipient could file amended returns for 2020 and 2021 to claim a refund of the tax attributable to CARES Withdrawal amounts that were later recontributed (and no amount of the CARES

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Withdrawal would need to be included in 2022). The IRS directs plan sponsors' attention to certain examples in the KETRA Notice for further guidance on these provisions.

The New FAQs clarify that CARES Recontributions will generally be treated as rollover contributions. If an Eligible Plan does not ordinarily accept rollover contributions, the plan will not be required to accept CARES Recontributions.

Eligible Individuals may report CARES Distributions and CARES Recontributions on Form 8915-E (which the IRS expects to make available by the end of 2020). The IRS directs Eligible Individuals' attention to section 4 of the KETRA Notice for further guidance on this point.

Eligible Plans should report CARES Distributions on Form 1099-R. The IRS directs plan sponsors' attention to section 3 of the KETRA Notice for further guidance on this point.

CARES Loans

The CARES Act permits Eligible Plans to increase the maximum loan amount available to Eligible Individuals from $50,000 to $100,000 for loans that are issued between March 27, 2020, and September 22, 2020. In addition, up to 100% of the participant's account may be used as collateral for a CARES Loan (only 50% could be used as collateral under prior law). The New FAQs direct plan sponsors' attention to section 5.A of the KETRA Notice for further guidance.

The KETRA notice generally restates the increase in loan limits provided under KETRA, but footnote 3 of the KETRA Notice references a Department of Labor non-enforcement policy that it will not treat the increased limits as violating ERISA's adequate security and reasonably equivalent basis requirements in ERISA section 408(b)(1) and 29 CFR 2550.408b-1 that might otherwise make CARES Loans prohibited transactions under ERISA. The Department of Labor announced a similar policy in EBSA Disaster Relief Notice 2020-01 for the increased loan limits of the CARES Act, which we discuss here

CARES Loan Deferment

The CARES Act permits Eligible Plans to delay the due date by one year for any repayment that is otherwise due between March 27, 2020, and December 31, 2020. The New FAQs direct plan sponsors' attention to section 5.B of the KETRA Notice for further guidance, but do not provide additional guidance beyond summarizing the statutory provisions of the CARES Act.

The KETRA Notice section referenced by the New FAQs offered a safe harbor (the "KETRA Safe Harbor") for applying the loan suspension period:

1. The plan had to suspend loan repayment obligations during a period beginning no earlier than and ending no later than the loan suspension period identified in KETRA, which was from August 25, 2005, to

December 1, 2006, a period of greater than one year (the "Suspension Period").

2. Loan repayments had to restart upon the end of the Suspension Period.
3. The plan could extend the maximum permissible term of the loan (generally five years except in the case of certain home loans) by up to the total length of the Suspension Period.
4. Interest must have continued to accrue during the Suspension Period and have been added to the remaining principal.
5. The loan (including additional accrued interest) could be reamortized at the end of the Suspension Period such that all subsequent payments would be level.
6. If an employer initially selected a Suspension Period that would end prior to the maximum end date permitted by the safe harbor, the employer could later extend the Suspension Period up to the maximum end date permitted by the safe harbor.

If the KETRA Safe Harbor requirements were met, then a plan would not be treated as failing the requirements of IRC section 72(p) (which generally exempts qualifying loans from being treated as deemed distributions) as a result of the suspension, even if loan repayments were suspended for more than one year.

The New FAQs do not indicate if the IRS intends to offer a similar safe harbor under the CARES Act. Even if the IRS does offer a similar safe harbor, it is not clear whether the IRS would require the suspension period to end on December 31, 2020 (the last date under CARES Act section 2202 for which loan repayments are eligible to be deferred for one year), or on March 27, 2021 (the one-year anniversary of the first date on which repayments could be suspended for one year pursuant to CARES Act section 2202), or some other date. In addition, if the IRS requires the suspension period to end on December 31, 2020, it is not clear whether the IRS would nonetheless permit a plan to commence the old repayment schedule on January 1, 2021, but choose to re-amortize on the one year anniversary of the initial loan suspension, rather than January 1, 2021 (these questions did not arise under KETRA because the KETRA window for loan repayment dates eligible for deferment relief exceeded one year, whereas the CARES Act window is shorter than one year).

For more information about how the CARES Act's relief provisions apply to your benefit plans, please contact a member of the Kilpatrick Townsend Employee Benefits Team.