



CARES ACT ADMINISTRATIVE Q&As

COVID-19 DISTRIBUTIONS

There are two key aspects to COVID-19 distributions (referred to in the Coronavirus Aid, Relief, and Economic Security Act as coronavirus-related distributions: is a plan required to permit a COVID-19 distribution (i.e., is it a distributable event under the plan), and if it is optional for a plan, does that impact whether a participant can treat a distribution made for another reason as a COVID-19 distribution. For these purposes, a qualifying individual is defined as someone: 1. who is diagnosed with the virus (via test approved by CDC), 2. whose spouse or dependent is diagnosed with the virus, or 3. who experiences adverse financial consequences as a result of: quarantine, furlough, lay off, reduced hours, inability to work due to childcare, closing of business, or other factors as determined by the Secretary of the Treasury. The plan may rely on participant certification that those condition(s) are met.

With the release of IRS Notice 2020-50, the IRS updated who is considered a qualified individual to include someone: 1. Who experiences a reduction of pay (or self-employment income) or has a job offer rescinded or delayed due to COVID-19, 2. Who experiences adverse financial consequences due to the individual's spouse or a member of the individual's household being quarantined, being furloughed or laid off, or having work hours reduced due to COVID-19, being unable to work due to lack of childcare due to COVID-19, having a reduction in pay (or self-employment income) due to COVID-19, or having a job offer rescinded or start date for a job delayed due to COVID-19; or 3.who experiences adverse consequences due to closing or reducing hours of a business owned or operation by the individual's spouse or a member of the individual's household due to COVID-19.

The FAQs below deal with several key elements of the new distribution rules: eligibility & adoption, administration & reporting, participant notices, and distribution repayments.

Eligibility & Adoption

CD1: Is a COVID-19 distribution a required provision, or is this an optional plan provision?

A: It is optional for the plan. See below regarding the application to participants.

CD2: Is a COVID-19 distribution available to plan participants who meet the "qualified individual" requirements, regardless of any other plan or code restrictions?

A: The distribution can be made regardless of any other "plan" restrictions (if the plan sponsor does not want those restrictions to apply). As to "code" restrictions, the only exception in the CARES Act is that the restrictions on elective deferrals, QNECs, QMACs and ADP test safe harbor contributions do not apply. See the following questions.



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CD3: Can a business owner (a dentist) who is laying people off qualify for the distribution or participant loan option under COVID-19? He's not closing his business but is definitely feeling the effects of this. Is this an obvious area I am overlooking?

A: It seems you are asking about whether the dentist would be considered a qualified individual. The answer is yes. One of the criteria to be an eligible individual is that the individual experiences adverse financial consequences as a result of, among other items, "closing or reducing hours of business owned or operated by the individual."

CD4: Are terminated participants eligible for a COVID-19 distribution?

A: Yes. The treatment to an individual participant is independent from the treatment by the plan. In other words, it doesn't matter to the participant what the distributable event from the plan was. It may have been due to the plan permitting a COVID-19 distribution or due to another triggering event, such as termination of employment. If the participant is a qualified individual and receives a distribution in 2020, then the individual is entitled to treat the distribution as a COVID-19 distribution—there is no 10% additional tax; the amount can be included in income over three years; and there is a three-year repayment right.

CD5: Can participants take multiple COVID-19 distributions as long as they stay below the \$100,000 maximum?

A: Yes, provided the distributions are made before December 31, 2020.

CD6: Can DB plans (including cash balance plans) offer a COVID-19 distribution?

A: The CARES Act does *not* provide an exception to the distribution restrictions that apply to pension plans (e.g., money purchase plans and defined benefit plans). This does not mean that pension plans cannot include a COVID-19 distribution. But, because a stated event (such as becoming a qualified individual) is not a permissible distributable event in a pension plan, it means the ability to use the provision is much more limited.

For example, a cash balance plan does not permit any in-service distributions. Under the law, the plan could have included an in-service distribution at age 59½ (as permitted by the SECURE Act). The plan sponsor could permit a COVID-19 distribution to be made to those participants who are age 59½. This would be a limited in-service withdrawal provision.

Let's assume the plan sponsor wants to permit COVID-19 distributions, and Jolene is an eligible individual who is age 63. Jolene could receive a COVID-19 distribution from the plan. Because Jolene is over age 59½, she would not have been subject to the 10% additional tax for early distributions. She would be able to treat the distribution as a COVID-19 distribution and include the distribution in income over three years, and she would be entitled to a three-year repayment period.

CD7: Is a COVID-19 distribution permitted from an ESOP, since typically an ESOP has more restrictive distribution requirements than a profit sharing or 401(k) plan?

A: The SECURE Act does not provide an exemption for required distribution restrictions that apply to ESOPs. Thus, an ESOP may provide for a COVID-19 distribution provided it does not violate any other statutory distribution restrictions.



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CD8: Can a custodial 403(b)(7) arrangement permit a COVID-19 distribution?

A: Congress intended to allow custodial 403(b)(7) arrangements to make COVID-19 distributions. However, the law contains a typo, and hopefully the IRS can address this without the need for a technical correction to the law. The problem is the law provides that a COVID-19 distribution will not violate IRC §403(b)(7)(A)(i). This should be subsection (ii), not (i). The correct reference was used in all the prior disaster relief provisions, so this is clearly a typo.

CD9: Do defaulted loans count as COVID-19 distributions?

A: Yes, assuming the loan in the participant's account is being offset by the loan (that is a distribution), if it happens during 2020 and the individual is a qualified individual. If the individual is not a qualified individual, then the individual still has until the due date of the filing of their tax return (4/15/21) to complete a rollover of the defaulted amount.

CD10: How much reduction in hours is needed to be considered "impacted by COVID-19" and thus an eligible individual? We have a client that reduced some employees by only four hours (full time employees), and others all the way to half their usual time.

A: The law does not provide any specific parameters, so all we can say is that it would be good-faith interpretation. For a full-time employee, a four-hour reduction per week could equate to a 10% reduction in pay. One could reasonably conclude that this is an "adverse financial consequence" within the meaning of the law.

CD11: Does a participant need to exhaust loan options before taking a COVID-19 financial hardship distribution? Can a participant take both a COVID-19 loan and a COVID-19 hardship distribution?

A: No, a participant does not need to exhaust loan options first and, yes, a participant can obtain both. The COVID-19 distribution is not a hardship distribution—it is a new distributable event. The plan does not need to offer hardship distributions to add the COVID-19 provision. Therefore, it is not subject to the hardship distribution rules, such as having to exhaust other options. Even if it were subject to the hardship rules, under the SECURE Act, a loan is no longer a prerequisite for obtaining a hardship distribution.

CD12: If an IRA owner currently taking substantially equal payments under IRC §72(t)(4) (to avoid the 10% additional tax for early distributions) takes additional money out of an IRA as a COVID-19 distribution, will it be treated as change that would result in the imposition of the 10% tax?

A: The IRS clarified in Notice 2020-50 that taking a COVID distribution would not be considered a modification of the substantially equal payments under IRC §72(t)(4).

CD13: Can a COVID-19 distribution be made from a SIMPLE IRA without being subject to the 25% additional tax?

A: Yes. SIMPLE IRAs are included in the definition of an eligible plan. The Act provides that the IRC §72(t) additional tax doesn't apply if a COVID distribution is made from an eligible plan. Because the 25% additional tax for early distributions from a SIMPLE IRA is part of IRC §72(t), the penalty would not apply if a COVID-19 distribution is made from a SIMPLE IRA.



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CD14: I interpret the COVID-19 distribution to be a one-time opportunity. In essence, a participant can take all they want at once as opposed to being able to take \$25k now and additional money later in the year if needed. Do you concur?

A: No. If permitted by the plan, a participant could take out multiple COVID-19 withdrawals as long as the \$100,000 limit is not exceeded.

CD15: As far as the In-Service withdrawal, the new rules allow for a maximum of \$100K, can the plan sponsor set a maximum of \$40K?

A: Yes

CD16: What is the maximum aggregate amount an eligible participant can take from their plan? I've heard \$100K and \$200K (max withdrawal and max loan).

A: A participant may take a loan and a distribution up to \$100,000 each (if the plan provisions allow).

Administration & Reporting

CD17: Do you know if there will be a new 1099-R code to identify COVID-19 distributions?

A: The IRS provided, in Notice 2020-50, that a plan could have used either code 2 (early distribution, exception applies) or distribution code 1 (early distribution, no known exception). For the new child/adoption distributions, the instructions to Form 1099-R indicate that code 1 should be used. Ultimately, the proper tax handling will be the responsibility of the individual when he or she files his or her income tax return (the individual can designate that the exemption from the 10% additional tax applies and will be able to elect whether to include the distribution in income over three years). This is similar to how 60- day rollovers are handled.

CD18: If a COVID-19 distribution is not considered an eligible rollover distribution, and therefore it does not have mandatory 20% income tax withholding, should the withholding be 10% instead (with the ability for the participant to waive it upon request)?

A: Yes.

CD19: Do you believe that forms such as the 8915-B would be utilized for tax reporting purposes of the COVID-19 distributions?

A: Yes. There will be a new Form 8915-E that will be available before the end of 2020. Once available, the IRS will post the forms on their disaster distributions and repayments web page at <https://www.irs.gov/forms-pubs/about-form-8915-a-and-8915-b>.

CD20: If a COVID-19 distribution is taken and the individual elects to pay the taxes over three years, how is that accomplished? Do they report one-third of the distribution on their tax return each year?

A: Yes, per IRS Notice 2020-50.



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Participant Notices

CD21: For furloughed employees, how do we communicate their options for a COVID-19 distribution (similar to the IRC §402(f) notice) regarding distributions?

A: While an IRC §402(f) notice is not required, we anticipate the service providers who create the 402(f) notice will create a form that is suitable. There is no one standard for the industry at present, and the IRS has not indicated whether it intends on providing a sample notice.

CD22: How do we notify participants about the voluntary withholding rules?

A: While an IRC §402(f) notice is not required, plans are required to provide participants with a notice of withholding to allow them to elect to have something other than 10% withholding (Form W-4P is used for that purpose). One of the penalties that was increased by the SECURE Act was for failures to provide a notice of voluntary withholding.



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Repayments

CD23: Will participants have to prove they took a COVID-19 distribution in order to repay it to a plan within three years?

A: IRS Notice 2020-50 states that an administrator of an eligible retirement plan may rely on the individual's certification that the individual satisfies the conditions to be a qualified individual in determining whether the distribution was a COVID-19 distribution, unless the administrator has actual knowledge to the contrary.

CD24: Relating to the repayment of a COVID-19 distribution over the three-year window, where can we find guidance as to how the taxes will be handled in 2020 and 2021 if they do not repay the distribution back until the last possible date? Have they provided guidance that the participant will need to file amended returns? Or was that just a "possible" handling?

A: The IRS addressed the details of how the repayment provisions will work in Notice 2020-50. The notice states that it can be paid back in one or more payments to not exceed, in total, the amount of the distribution. The IRS requires that the distribution either be taxable over the three-year period or in the year of the distribution. Upon repayment, a form will need to be completed and the tax return(s) for the year(s) that the distribution was included in income amended and refiled.

CD25: We have terminated employees who already took a distribution of their account after January 1, 2020, but prior to March 27, 2020. Could these distributions qualify as COVID-19 distributions so that they have the ability to repay it in three years and not be subject to 10% additional tax? If so, how would that work from a 1099-R standpoint? And is the client required to contact these individuals with a notice of their rights?

A: Yes, the distributions could be treated as COVID-19 distributions if they are qualified individuals. The law does not mandate that the plan notify the participants, although some providers may wish to do so as a matter of goodwill. Ultimately, participants may become aware of these rights when they file their tax returns for 2020. Regarding the 1099-R, see the questions in the Administration and Reporting Section of these Q&As.

CD26: If someone takes a COVID-19 distribution, can he or she repay it into another eligible vehicle (e.g., took a distribution from a plan and wants to repay into an IRA)?

A: Yes. A COVID-19 distribution is technically an eligible rollover distribution and can be rolled over (which the law refers to as a repayment) to any vehicle that is permitted (and willing to) accept rollovers.

CD27: When COVID-19 distributions are being paid back, can repayments be pretax payments directly through the plan?

A: Repayments are handled in the same manner as a rollover contribution.



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CD28: How does the plan handle the repayment? Is it treated as a rollover? If so, is it a related or unrelated rollover for top-heavy purposes?

A: The plan would handle the repayment as though it were a direct rollover. If it is rolled back into the same plan that made the distribution, it is a related rollover (see Treas. Reg. §1.416-1 Q&A T-32).

CD29: On the repayment of COVID-19 distributions, would the repayments be reported directly on the 1040 line 4d?

A: Yes, they are reported on line 4d. Form 8915-E must also be completed and attached to the filing.

CD30: I got the impression that if a participant takes a COVID-19 distribution, the participant will receive a 1099-R in 2020 for the full amount of the distribution. If the participant chooses to repay some or all back, he or she will have to amend prior tax returns to spread the taxable amount over the three-year period. Is that accurate?

A: Not quite. There are two issues here. First, the participant must elect whether to include the entire amount in income in 2020 or spread it in income over three years. Second, how the repayment is handled will depend on when the repayment(s) is made. If the individual repays the total amount prior to filing the tax return for 2020, then an amended return is not required. If the participant repays an amount after a tax return was filed, then an amended return will be required. IRS Notice 2020-50 provides details on how these rules apply.

CD31: Does repayment of COVID-19 related distributions by a participant need to be by payroll? Or can a participant pay it back via other means?

A: It does not have to be via payroll. It can be like any other rollover into the plan.

CD32: Can a COVID-19 distribution from a Roth account be repaid so that future investment earnings on the amount repaid can be tax-free when withdrawn?

A: Yes. Normally, amounts attributable to a Roth account can only be rolled over by means of a direct rollover (i.e., a trustee-to-trustee transfer). The CARES Act provides that COVID-19 distribution repayments are treated as direct trustee-to-trustee rollovers.

CD33: I have a participant who is laid off and wants to roll his balance out of his 401(k) and into his IRA; he doesn't want a cash distribution. This doesn't appear to be part of the CARES Act. It is more to free up cash, not give the ability to do a rollover. Am I understanding this correctly?

A: If by "laid off" you mean that there has been a severance of employment, then the amount may be directly rolled to an IRA assuming the plan permits distributions on severance of employment. You are correct that this is not part of the CARES Act.



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CD34: Can a COVID-19 distribution be directly repaid (i.e., rolled over) to any IRA or other plan?

A: Yes. While the COVID-19 distribution is intended to provide “relief,” it does not prohibit an individual from immediately repaying the distribution to an IRA. Unlike a regular eligible rollover distribution, however, a plan is not required to offer a participant receiving a COVID-19 distribution with a direct rollover option. The plan could require that the participant receive an actual distribution, which the participant could then repay to the IRA or other plan.

CD35: Can an individual take a COVID-19 distribution from a pre-tax account and then repay it to a Roth IRA and pay the tax over three years?

A: There are differing opinions on this. But we believe the answer is “no.” You can’t convert amounts to Roth outside of a plan or IRA. The conversion would need to happen with the plan or IRA, and it would therefore not be a COVID-19 distribution.

CD36: If a participant took an RMD earlier in the year and is outside the 60-day rollover window, could it be treated as a COVID-19 distribution and therefore be repaid within three years?

A: Yes, but this would only be an option if the participant is a qualified individual. The IRS, in Notice 2020-51, provided an extension of the 60-day rollover requirement to August 31, 2020, to accommodate the retroactive effective date of the CARES Act provision.



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