

April 1, 2020

Retirement and Pension Provisions in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act)

Congress provides a variety of tax incentives for employers to offer retirement plans and for individuals to save for their retirement. In addition, a number of restrictions exist to ensure that retirement funds are used for retirement purposes. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act; P.L. 116-136) contains several provisions that affect pensions, retirement plans, and Individual Retirement Accounts (IRAs). Among other provisions, the CARES Act includes an exemption to the 10% tax penalty for early withdrawals from retirement accounts for individuals affected by COVID-19, one-year relief from Required Minimum Distributions (RMDs) for all retirement plan account holders, and a delayed due date for employer contributions to private-sector defined benefit (DB) pension plans.

Withdrawals and Loans from Retirement Plans

Individuals can save for retirement by contributing to tax-advantaged defined contribution (DC) accounts (e.g., 401(k) plans) and IRAs. Employers often match some or all of an employee's contributions to DC accounts.

To discourage pre-retirement withdrawals, the Internal Revenue Code (IRC) generally imposes a 10% penalty on the taxable amount of early withdrawals, which are withdrawals before an individual reaches age 59½, dies, or becomes disabled. The penalty does not apply if the reason for the distribution is listed in 26 U.S.C. § 72(t).

Individuals who make early withdrawals are subject to rules that vary by plan type, the circumstances warranting a withdrawal, and plan-specific rules. IRAs generally have fewer restrictions on early withdrawals than DC plans. For example, individuals may withdraw funds from an IRA for any reason—though generally with a penalty—but pre-retirement withdrawals from a DC account (1) must be allowed by the plan and (2) must generally be on account of an employee's financial hardship (referred to as a *hardship distribution*).

Loans are not permitted from IRAs. DC plans may—but are not required to—allow participants to borrow from their accounts. Loans may be preferred to early withdrawals because amounts borrowed can be repaid to the individual's account. However, in the case of a DC plan loan default (e.g., following job loss, the borrower fails to repay the outstanding loan balance by the deadline for that year's tax return), the loan balance must be included in taxable income and a 10% tax penalty applies. Provisions for DC plan loans under current law and regulations include the following:

- The maximum loan amount is the lesser of half of the participant's vested account balance or \$50,000.
- Loans must be repaid in level installments over five years. Longer terms are permitted if loans are used for the purchase or construction of a principal residence.

COVID-19 Related Distributions Exempt from 10% Tax Penalty

Section 2202 of the CARES Act exempts qualified individuals affected by COVID-19 from the 10% early withdrawal penalty for distributions (1) up to \$100,000 and (2) taken from January 1, 2020, and before December 31, 2020. Qualified individuals are individuals (1) who tested positive for COVID-19 or those with a spouse or dependent who tested positive for COVID-19, (2) facing financial difficulties due to being quarantined, furloughed, laid off, or unable to work due to lack of child care or reduced work hours as a result of COVID-19, or (3) whose business closed or reduced hours as a result of COVID-19. Plan administrators may rely on employees' certifications as proof that they are qualified individuals.

Qualified individuals must include the amount distributed in their taxable income; however, they can report it as income either in the year received or equally over a three-year period. In addition, part or all of the distribution can be repaid to a qualified retirement plan within three years of receiving the distribution. Amounts that are repaid are treated as a trustee-to-trustee rollover (as if they were made directly from one financial institution to another, otherwise individuals might violate rules on rollovers or contribution limits).

Nonqualified individuals may have the option to take a hardship distribution on account of a federally declared disaster, although this may vary based on whether their (1) state of residence qualifies for individual assistance under the disaster declaration and (2) retirement plan allows for such distributions. Nonqualified individuals may be subject to the 10% early withdrawal penalty on the amount distributed.

Loan Rules Modified for Qualified Individuals

Section 2202 of the CARES Act modifies rules governing DC plan loans for qualified individuals. Qualified individuals are defined in the same way as above. The following provisions apply:

- The maximum loan balance for loans taken within 180 days of the bill's enactment (March 27, 2020) is increased to the lesser of the participant's entire vested account balance or \$100,000.

- For new or existing loans, the due dates for payments due on or after the bill's enactment through December 31, 2020, are extended by one year. Subsequent payments are also delayed by one year.

Required Minimum Distributions

Required Minimum Distributions (RMDs) are annual withdrawals that individuals with certain retirement accounts are required to begin making after reaching a certain age. The RMD assures that tax-deferred retirement accounts established to provide income during retirement are not used as permanent tax shelters or as vehicles for transmitting wealth to heirs. Failure to take the RMD results in a tax penalty equal to 50% of the amount that should have been distributed.

The RMD for a year is calculated by dividing (1) the account balance at the end of the immediately preceding calendar year by (2) the distribution period provided in the applicable Internal Revenue Service (IRS) Life Expectancy Table.

RMD rules apply to DC accounts (such as 401(k), 403(b), and 457(b) accounts) and traditional IRAs. RMDs do not apply to Roth IRAs, but do apply to Roth 401(k) accounts. Individuals must take their first RMD by April 1 of the year following the year in which they turn age 72 (or age 70½ for those who turned 70½ before January 1, 2020; the SECURE Act, passed as part of the Further Consolidated Appropriations Act, 2020, (P.L. 116-94) increased the age at which RMDs must begin from 70½ to 72). Participants (other than individuals who own 5% or more of a company) in employer-sponsored plans who are still working past the age of 72 can delay distributions until April 1 following the year that they stop working (if the plan allows).

RMDs Suspended for 2020

Section 2203 of the CARES Act suspends RMDs for 2020. A special rule applies the RMD suspension to individuals who took their first RMD from January 1, 2020, to April 1, 2020. Individuals who received their RMDs in 2020—prior to the enactment of the CARES Act—may be able to roll over these amounts to IRAs or other retirement plans if rollover rules are followed. Among other requirements, rollovers must be completed within 60 days of the distribution. The CARES Act does not contain a provision for individuals to recontribute their distributions already received in 2020.

Single-Employer Pension Plan Funding

Single-employer DB pensions are plans sponsored by one employer for the benefit of its employees. Sponsors of these plans are required to contribute to their plans each year. In general, the amount of the required contribution is equal to the value of benefits earned by participants in the year plus a share of any prior years' plan underfunding (e.g., from decreases in the value of plan investments or changes to plan assumptions). Failure to make the full contribution may result in an excise tax.

Plans with funding levels below specified levels must restrict certain benefits under 26 U.S.C. § 436. For example,

if a plan is less than 60% funded, it may not provide benefits that have been promised in the event of a plant closing, referred to as shutdown benefits.

Contribution Due Date Delayed and Plans May Use 2019 Funding Percentage

Section 3608 of the CARES Act allows contributions that are due in calendar year 2020 to be made with interest on January 1, 2021.

Section 3608 of the CARES Act also allows plans to use the funding percentage for the 2019 plan year rather than the 2020 plan year (which would likely be lower) in determining whether plans must impose benefit restrictions.

Expanded Authority for the Secretary of Labor to Delay Deadlines

Private-sector pension plans face a variety of deadlines to meet the requirements of the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406). Section 518 of ERISA (29 U.S.C. § 1148) gives the Secretary of Labor the authority to delay, for up to one year, any action required under ERISA in the case of a presidentially declared disaster or a terroristic or military action.

Authority to Delay Deadlines for Public Health Emergency

Section 3607 of the CARES Act expands the events that allow the Secretary of Labor to delay deadlines under ERISA to include a public health emergency declared by the Secretary of Health and Human Services.

Application of Charity Pension Funding Rules

Certain cooperative and charitable organizations—such as agriculture, electric, and telephone cooperatives and certain 501(c)(3) charities—may follow special pension funding rules. These plans are referred to as Cooperative and Small Employer Charity (CSEC) plans. P.L. 113-235 expanded the definition of CSEC plans to include plans maintained by any employer that meets several criteria. It appears that the Boy Scouts of America Master Pension Trust is the only plan that has met these expanded criteria.

CSEC Plan Definition Expanded

Section 3609 of the CARES Act expands the definition of CSEC plans to include a charitable organization whose “primary purpose is providing services with respect to mothers and children,” and has been in existence since 1938. It appears that March of Dimes fulfills this requirement. It is unclear whether any other charities meet the definition.

For More Information

- CRS In Focus IF11472, *Withdrawals and Loans from Retirement Accounts for COVID-19 Expenses*

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