

Practice Update

Summary of Key Employee Benefits Provisions Under the CARES Act

March 27, 2020

By Beth Alcalde and S. Montaye Sigmon

The United States Congress passed the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act), on March 27, 2020. The CARES Act includes several employee benefit plan provisions impacting tax-qualified retirement plans and an additional limitation imposed on amounts of executive compensations that can be paid to key employees by companies that receive governmental loans for economic relief. The following is a summary of those relevant provisions:

Section 2202 – Addressing Special Rules for Use of Retirement Monies

Congress expanded the ability of individuals to access their retirement savings through their employer's tax-qualified retirement plans when they are personally impacted as a result of Coronavirus. Specifically, individuals may opt to distribute funds from their retirement account or take a loan from the Plan if the distribution or loan is related to the Coronavirus (as defined in the CARES Act and discussed below).

Distributions from Retirement Accounts

An individual personally impacted by the Coronavirus may make elect to take a distribution from his/her retirement account from his/her employer's tax qualified retirement plan of up to

Related People

Beth Alcalde
S. Montaye Sigmon

Related Work

Employee Benefits and
Executive
Compensation
Tax

Related Offices

Chicago
West Palm Beach

Coronavirus Resource Center

[Visit the Resource
Center](#)



\$100,000 (a COVID Distribution). The CARES Act confirms that a COVID Distribution will be considered to be a permissible and legitimate distributable event for purposes of Section 401(k) plans under the Internal Revenue Code of 1986, as amended (the Code), Code Section 403(b) plans, and governmental Code Section 457(b) plans. Importantly, a COVID Distribution will be exempt from the 10 percent early withdrawal penalty under Code Section 72(t).

Specific limitations apply to COVID Distributions which include:

1. The distribution must be taken between January 1, 2020 and December 31, 2020 to qualify.
2. The individual requesting such distribution must meet at least one of the following criteria:
 - a.) The individual 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; OR
 - b.) The individual's spouse or dependent (as defined in Code Section 152) is diagnosed with such virus or disease by such a test; OR
 - c.) The individual experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off or having work hours reduced due to such virus or disease, being unable to work due to lack of child care due to such virus or disease, or closing or reducing hours of a business owned or operated by the individual due to such virus or disease, OR
 - d.) Other factors as determined by the Secretary of the Treasury.

The plan administrator of the tax-qualified retirement plan is permitted to rely on an individual's self-certification that the individual satisfies one of the criteria listed above.

3. The \$100,000 overall limitation on COVID Distributions must be determined for a given employer on an aggregated controlled group basis as provided for under Code Section 414(b), (c), (m) and/or (o) by considering all COVID Distributions from all tax-qualified retirement plans within the controlled group.

Normally, retirement plan distributions are subject to immediate taxation and withholding. The CARES Act relaxes those requirements ***unless*** the individual chooses to instead be taxed all at once under the normal distribution and taxation rules. Pursuant to the CARES Act (and unless elected otherwise by the participant), the COVID Distribution will be included in gross income ratably over the three (3)-taxable year period beginning with such taxable year in which the COVID Distribution was taken.

As a corollary provision to the above, the CARES Act also anticipates that individuals taking COVID Distributions may want to return those retirement monies to their retirement accounts in order to place themselves back into the tax-deferred retirement financial position that they would be in had the COVID Distribution not been necessary. For individuals wanting to accomplish this objective, a COVID Distribution participant may, at any time during the three (3)-year period beginning on the day after the date on which the COVID Distribution was received, make one or more contributions (in an aggregate amount not to exceed the amount of such COVID Distribution) to an eligible retirement plan of which such individual is a beneficiary and to which a rollover contribution of such distribution could be made under Code Section 402(c), 403(a)(4), 403(b)(8), 408(d)(3), or 457(e)(16), as the case may be (note this does not mean the contribution must go back into

the same tax-qualified retirement plan from which it was taken).

The benefit to an individual who chooses to “recontribute” some or all of the prior COVID Distribution, is that the COVID Distribution recipient shall, to the extent of the amount of the recontribution made, be treated as having received the COVID distribution in an eligible rollover distribution (as defined in Code Section 402(c)(4)) and as having transferred the amount of the recontribution to the eligible retirement plan in a direct trustee to trustee transfer within 60 days of the distribution. Similar rules apply under Code Section 408(d)(3) if the amount is “recontributed” to an individual retirement plan.

With respect to repayments of the COVID Distributions, please note that we anticipate that the Treasury Secretary will be issuing additional guidance on how to reconcile any recontribution amounts for tax purposes on Form 1040. Under normal circumstances, any taxable eligible rollover distribution paid from an employer-sponsored retirement plan is subject to a mandatory income tax withholding of 20 percent, even if the participant intends to roll it over later; the 20 percent withholding does not apply to trustee-to-trustee transfers. Here, the COVID Distributions will not be treated as eligible rollover distributions, so the mandatory 20 percent withholding would not apply.

Again, under normal circumstances, if the participant rolls his/her distribution into an eligible retirement account and wants to defer tax on the entire taxable portion, the participant must add funds from other sources equal to the amount withheld such that the full distribution is rolled over. The rollover of the entire distribution (including withheld taxes) allows the participant to secure a refund of those previously paid taxes on his/her Form 1040. Accordingly, the inference in the CARES Act is that a participant who takes a COVID Distribution will eventually – over a three-year

period – be able to place themselves in their original tax-deferred retirement position by repaying the COVID Distribution in total into an eligible retirement plan account and receiving back any taxes previously paid on the COVID Distribution. At this time, it is not clear how those remitted taxes will come back to the COVID Distribution participant, but we anticipate that it would occur through a future refund on his/her Form 1040 following recontribution.

Loans from Retirement Plans

Further, the CARES Act, for a very limited period of time, relaxes certain qualified plan loan provisions, as well as expands access to retirement monies through loans.

1. With respect to loans from qualified employer plans, Code Section 72(p)(2) generally provides that the maximum amount a plan can permit as a loan is the lesser of (a) \$50,000 or (b) the greater of \$10,000 or 50 percent of the participant's vested account balance. Under the CARES Act, if an individual takes a Coronavirus-related loan *during the one hundred eighty (180) day period starting on the date of enactment*, the maximum amount that a tax-qualified retirement plan can permit as a loan is increased to the lesser of (a) \$100,000 or (b) the greater of \$10,000 or 100 percent of the participant's vested account balance.

2. If an individual is personally impacted by the Coronavirus and has an outstanding loan (on or after the date of the enactment of the CARES Act) from a tax-qualified employer retirement plan with a due date for any repayment during the period from the date of the CARES Act's enactment through December 31, 2020, such due date for any repayment shall be delayed for one (1) year and any subsequent repayments with respect to the loan shall be appropriately adjusted to reflect this legislative delay in the due

date (including any interest accruing during such delay). Additionally, for purposes of determining the five (5)-year loan period and the term of a loan, the one (1)-year delay period shall be disregarded.

Unlike a COVID Distribution which will be taxable upon receipt, a qualified plan loan is not taxable so long as the required repayment terms are met by the participant without a subsequent default.

For plan sponsors wishing to adopt these changes and make them available under their tax-qualified retirement plan, so long as the particular plan being amended has been operated as if such amendment had been in effect since the date of the enactment of this Act (or pursuant to the effective date of regulations issued by the Secretary of the Treasury), the plan can be amended with retroactive effect as late as the last day of the first plan year beginning on or after January 1, 2022 or such later date as the Treasury Secretary may prescribe (for governmental plans, the plan can be amended up to two years after the deadline that applies to non-governmental plans).

Section 2203 – Addressing Temporary Waiver of Required Minimum Distribution Rules

The CARES Act provides for a temporary waiver of required minimum distributions under Code Section 401(a)(9) for the period from January 1, 2020 through December 31, 2020. This specifically includes required minimum distributions that were otherwise required to be made in calendar year 2020 because (a) the participant's required beginning date has occurred, and (b) such required minimum distribution was not otherwise made before January 1, 2020. For years after calendar year 2020, for purposes of determining any relevant period of time under Code Section 401(a)(9) (i.e., life expectancy or minimum distribution period), the required beginning date for any individual and any five (5)-year period otherwise applicable under Code

Section 401(a)(9) shall disregard the 2020 calendar year.

Further, if all or any portion of a distribution during 2020 is treated as an eligible rollover distribution, but would not be so treated if the required minimum distribution requirements had applied in the 2020 calendar year, such portion of such distribution shall then not be treated as an eligible rollover distribution.

For plan sponsors wishing to adopt these changes and make them applicable under their tax-qualified retirement plan, so long as the particular plan being amended has been operated as if such amendment had been in effect during the entire period beginning on the effective date stated for the amendment and ending on December 31, 2020, the plan can be amended as late as the last day of the first plan year beginning on or after January 1, 2022 with retroactive effect (for governmental plans, the plan can be amended as late as the last day of the first plan year beginning on or after January 1, 2024).

Section 2206 – Income Exclusion for Certain Employer Payments of Student Loans

Code Section 127 provides an exclusion from the gross income of an employee amounts paid or incurred by his/her employer for educational assistance to the employee (e.g., books, tuition expense, etc.) if certain requirements are met. The CARES Act adds an exclusion for payments made by an employer to an employee or the employee's lender of principal or interest on an employee's qualified education loan (as defined in Code Section 221(d)(1)). The employer's payment must be made after the CARES Act's enactment, but before January 1, 2021. To the extent the employer pays a portion of the employee's student loan under this new provision, the student will be denied a corresponding deduction (i.e., double benefit) under Code Section 221.

Section 3608 – Single-Employer Pension Plan Funding Rules

For single-employer defined benefit pension plans that are required to make a minimum required contribution (determined under Code Section 430(a)), the CARES Act permits a delay in making the required contribution. For minimum required contributions which would otherwise be due under Code Section 430(j) (including quarterly contributions) during the 2020 calendar year, the CARES Act now effectively moves the due date for such minimum required contributions to January 1, 2021 with a corresponding increase in such minimum required contribution for interest accruing during the period between the original due date of the contribution and the actual payment date. The interest accrued is calculated using the effective rate of interest dictated by the plan for the plan year which includes the actual payment date.

Further, for purposes of Code Section 436, plan sponsors are also allowed to elect to treat the plan's adjusted funding target attainment percentage (AFTAP) for the last plan year ending before January 1, 2020, as the AFTAP for plan years which include the 2020 calendar year.

Section 4004 – Limitation on Certain Employee Compensation

Section 4003 of the CARES Act approves emergency relief to provide liquidity to eligible businesses, States, and municipalities related to losses incurred as a result of Coronavirus. The Treasury Secretary is authorized to make loans, loan guarantees, and other investments in support of such eligible businesses, States, and municipalities that do not, in the aggregate, exceed \$500 billion and provide the subsidy amounts necessary for such loans, loan guarantees, and other investments in accordance with the provisions of the Federal Credit Reform Act of 1990 (each a Relief Loan).

Certain types of eligible businesses are subject to qualifying restrictions for purposes of receiving a Relief Loan. Eligible businesses subject to qualifying restrictions include: (a) passenger air carriers, eligible businesses that are certified under Part 145 of Title 14, Code of Federal Regulations, and approved to perform inspection, repair, replace, or overhaul services, and ticket agents (as defined in Section 40102 of Title 49, United States Code); (b) cargo air carriers; (c) businesses critical to maintaining national security; and (d) any eligible business that receives a loan, loan guarantee, or other investment as part of a program or facility that provides direct loans (collectively, the Conditional Businesses).

Under Sections 4003(c) and 4004 of the CARES Act, in order for a Conditional Business to receive a Relief Loan, the Conditional Business must agree to certain provisions including (among other things) that during the period beginning on the date on which the Relief Loan agreement is executed and ending on the date that is one (1) year after the date on which the loan or loan guarantee is no longer outstanding:

1. No officer or employee of such Conditional Business whose total compensation exceeded \$425,000 in calendar year 2019 (other than an employee whose compensation is determined through an existing collective bargaining agreement entered into prior to March 1, 2020) shall: (a) receive from the Conditional Business total compensation which exceeds the total compensation received by the officer or employee from the Conditional Business in calendar year 2019; or (b) receive from the Conditional Business severance pay or other benefits upon termination of employment with the Conditional Business that exceeds twice the maximum total compensation received by the officer or employee from the Conditional Business in calendar year 2019; and

2. No officer or employee of the eligible business whose total compensation exceeded \$3,000,000 in calendar year 2019 may receive total compensation in excess of the sum of (a) \$3,000,000, plus (b) 50 percent of the excess over \$3,000,000 of the total compensation received by the officer or employee from the Conditional Business in calendar year 2019.

For purposes of these limitations, the term “total compensation” includes salary, bonuses, awards of stock, and other financial benefits provided by the Conditional Business to an officer or employee of the Conditional Business.

These compensation limitations are effective as soon as the applicable loan or loan guarantee is granted.

This information is intended to inform firm clients and friends about legal developments, including recent decisions of various courts and administrative bodies. Nothing in this Practice Update should be construed as legal advice or a legal opinion, and readers should not act upon the information contained in this Practice Update without seeking the advice of legal counsel. Prior results do not guarantee a similar outcome.