CARES Act and Economic Condition FAQs – Qualified Plans

On Friday, March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed. It includes several provisions intended to loosen restrictions on and reduce the tax consequences of distributions and loans from retirement plans. Please read our summary of the retirement plan impacts here.

A webinar was held for Newport clients on Wednesday, April 8, 2020 to review the CARES Act. The following are the FAQs from the webinar.

Additionally, the coronavirus has impacted the way we live and work. For many companies and organizations this has led to layoffs and furloughs. Following the CARES ACT FAQs are some supplemental FAQs we are receiving from clients regarding their retirement plan and participants in light of current economic conditions.

Please note: Newport will not provide legal advice. The information below is based on retirement plan rules and how they are generally applied. You should seek advice from your ERISA/employee benefits counsel on how retirement plan rules impact your specific plan.

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CARES Act

ELIGIBILITY

1. What qualifies a participant for the CARES Act provisions? Is the loss of a spouse's job a qualifying event?

The CARES Act provides that the following individuals are eligible for (i) coronavirus-related distributions, (ii) the larger CARES Act loan limits, and (iii) loan deferment:

- An individual who is, or whose spouse or dependents are, diagnosed with the coronavirus or with coronavirus disease (COVID-19) by a test approved by the Centers for Disease Control and Prevention, or
- An individual who is financially harmed by the coronavirus or coronavirus disease as a result of
  - being laid off, furloughed, receiving reduced work hours, or quarantined;
  - being unable to work because of a lack of child care;
  - having to close or reduce the operating hours of a business owned or operated by the individual; or
  - such other reasons as determined by the Secretary of the Treasury.

A spouse's job loss does not fall within the above; however, CARES allows plan administrators to rely on a participant's self-certification that he/she qualifies for the coronavirus-related distribution.

Note that plans are not required to offer CARES Act distributions or the larger loan limits available under the CARES Act.

2. Do you have to ask for proof from the participant that they qualify for the CARES Act? Is this a violation of HIPAA?

For the coronavirus-related distribution provisions, plan administrators may rely on the participant’s self-certification of qualification. For the loan provisions of the CARES Act, we are still awaiting guidance and clarification from the IRS, as the law was silent on this matter. Note that HIPAA does not prohibit a participant from sharing personal health information; it only prohibits health plans and health care providers from sharing an individual's health information without consent.

3. Are Money Purchase Plans impacted by the loan and coronavirus-related distribution (CRD) provisions?

Unlike other types of defined contribution plans, the CARES Act did not change the in-service distribution restrictions that apply to Money Purchase Plans. As a result, a participant may only receive a distribution from a Money Purchase Plan if he/she satisfies the plan's requirements for requesting a distribution. A participant who satisfies the plan's distribution requirements and is a qualified individual can treat the distribution as a CRD when filing his or her tax return. Money Purchase Plans can offer the larger loan limits available under the CARES Act and would be subject to the loan deferment provisions of the CARES Act.

CORONAVIRUS-RELATED DISTRIBUTIONS (CRD)

4. Does Newport have a unique form for the CRD?

Yes, the Coronavirus-Related Distribution Form is now available for plans offering this distribution. The form went live on the participant and plan sponsor website on April 6, 2020. It can be accessed using the Shortcut menu and selecting “Access Forms.”

5. Does a CRD allow participants to do a direct rollover into an IRA up to $100,000?

Plans do not have to offer a direct rollover option to a participant that requests a CRD. A participant who receives a CRD is permitted to roll the distribution over to an IRA if desired.

6. **Will Newport's recordkeeping system automatically exclude those assets not eligible to be taken in a CRD when processing a distribution?**

   Yes, our system is set up to omit excludable money types.

7. **If our plan does not currently offer in-service withdrawals, would we be required to offer them if we adopted the CRD provision?**

   No, the plan does not need to offer in-service withdrawals to adopt the CRD provision.

8. **Is the CRD option available from an Individual Retirement Account (IRA)?**

   Yes, the CRD provision applies to qualified plans such as 401(k) plans, tax-sheltered 403(b) annuity plans, governmental 457(b) plans, as well as IRAs and annuities.

9. **If a participant takes a CRD, do you have to let them pay it back over three years if they want, even if the plan does not allow loans?**

   Yes, the participant must have the opportunity to repay the distribution, if desired.

10. **Can employees make changes retroactively to withdrawals previously made?**

    The CRD definition covers any payments made during the 2020 calendar year, including those made between January 1, 2020, and March 27, 2020. So yes, employees may reclassify prior distributions as CRDs. Note that no taxes previously withheld can be reclaimed – if taxes withheld exceed the participant's tax liability, the participant may be eligible for a tax refund when they file their 2020 tax return.

LOANS

11. **Under the CARES Act, can a qualified individual request both a $100,000 distribution and a $100,000 loan?**

    Yes, there is nothing in the law preventing an individual who qualifies for both the distribution and the loan from taking advantage of both opportunities. However, the loan cannot exceed 100% of a participant's vested account balance, so taking a CARES Act distribution could impact the ability to take the maximum permissible loan, if it causes the participant's account balance to fall below $100,000.

12. **If a participant has a current loan, can they still ask for CARES loan or must they pay off the first loan?**

    Because plans are not required to offer the larger loans permitted under the CARES Act, plans likely have the ability to dictate the conditions under which the larger CARES loans are available. For example, if a plan's loan policy limits participants to one loan, then a participant who has already taken a loan would not be eligible for a second loan unless the plan's sponsor waived the "one loan" rule. The plan (and the plan's loan policy) will ultimately need to be amended to reflect how the loan provisions were administered.

13. **If we do not elect the CARES Act Loan Provisions, does the deferment of payments still apply for loan payments?**

    Based on the language in the law, we believe that the deferment of loan payments would still apply for qualified individuals.

14. **Do the CARES Act loan provisions apply to Roth 401k accounts?**

    Yes, the loan provisions apply to qualified plans (including Roth 401(k), 403(b) plans, and governmental 457(b) plans).

15. Does the deferment of loan payments only apply to new loans under the CARES Act?

No. A qualified individual may defer any loan repayments that are due between March 27, 2020, and December 31, 2020, even if the loan was taken before March 27, 2020.

16. Is Newport taking any independent action, or is it the requirement of the plan sponsor or TPA to alert Newport that a participant with an outstanding loan is a Qualified Individual?

Newport will rely on the plan sponsor or TPA to notify us whether a participant is a “Qualified Individual” for purposes of the loan provisions of the CARES Act.

17. What is your interpretation of the one-year suspension provision? Does the loan suspension timeframe end on December 31, 2020, or a year from when the loan was suspended? For example, if the participant starts suspending loan payments on June 1, 2020, will they be required to start repaying on January 1, 2021, or June 1, 2021?

We are still awaiting guidance from the IRS regarding this matter, as the language in the law is unclear. We will keep our plan sponsors and advisors updated as clarifying information becomes available.

18. Is the one-year deferral opportunity on loan repayments mandatory or optional?

A strict interpretation of the law’s language would imply that this is mandatory, regardless of whether the plan elects to offer the enhanced CARES Act loan provisions. However, we are still awaiting guidance from the IRS regarding this matter.

19. Is the plan required to have a loan program to participate in the CARES Act loan provision?

To properly administer any type of loan, we believe best practice would be to have a formal loan policy. However, a plan would not need to be amended to allow for loans before adopting the loan provisions of the CARES Act, so long as all amendments are adopted before the CARES Act deadline. The due date for these amendments is the last day of the first plan year starting on or after January 1, 2022 (i.e., December 31, 2022, for calendar year plans). Note that government plans have an additional two years beyond that.

20. Can participants continue to make loan payments even if the plan defers payments for all qualified individuals?

Most loan policies allow for loan pre-payment without penalty. It would depend on your plan’s loan policy, in addition to your payroll system’s capabilities, but participants who opt to continue to make payments even when not required, may be allowed to do so.

21. Can loan terms for new loans be extended to six years right away?

Theoretically, yes, if the borrower is a qualified individual and elects the maximum permissible repayment term. However, we are still awaiting guidance from the IRS as to how the one-year deferment should be administered.

REQUIRED MINIMUM DISTRIBUTIONS (RMD)

22. Does waiving the RMD requirement apply if someone has already taken an RMD this year?

Yes, these provisions apply to new RMDs starting in 2020, as well as to those who had started before this year.

23. Is the waiver of 2020 RMDs applicable to Traditional IRAs too?

Yes.

24. Can I only take part of my RMD for 2020?

Yes, participants may take a part of their required minimum distribution, so long as the plan sponsor permits partial withdrawals for payments that are not RMDs. The law only stipulates that minimum distributions are not required for the 2020 calendar year. We are awaiting additional guidance regarding how this provision may be administered.

25. Should Plan Administrators notify participants of the RMD provisions of the CARES Act?

We believe it would be best practice to notify and communicate with plan participants regarding their options. Newport is currently preparing RMD communication materials, which should be ready later this quarter for distribution to impacted participants.

COMPENSATION

26. Are the funds paid to an employee under the 'Families First Act' still subject to deduct 401k deferral selections? In other words, are wages paid under Families First 401k-eligible?

It depends on the definition of Compensation in the plan itself. Wages received under the Families First Act may be 401(k) eligible.

DEFINED BENEFIT PLANS

27. Is anything being done for defined benefit plans that have such a decline for 2020 because of the market situation?

Under the CARES Act, the deadline for making any minimum required contributions (including quarterly contributions) that would otherwise be due during calendar year 2020 is extended until January 1, 2021. The contribution, when made, must be increased by interest from the original due date through the actual payment date, using the effective rate of interest under the plan for the plan year which includes the payment date. Also, for purposes of determining whether any of the restrictions on benefits or benefit accruals under Code Section 436 apply to a plan, the plan may use the adjusted funding target percentage (AFTAP) for the last plan year ending before January 1, 2020, as the AFTAP for plans years which include calendar year 2020.

CARES ACT – MISCELLANEOUS

28. When will participants be notified of any plan changes? Will Newport assist in providing notice to participants?

Newport has prepared a standard communication piece, which is available in your plan sponsor or advisor Message Center after logging in to newportgroup.com. We are here to assist if you need help disseminating this information to participants.

29. Which portions of the act will require a plan amendment to adopt?

All mandatory provisions will require an amendment; optional provisions (e.g., CRDs and larger loan limits) will also require an amendment to the extent the sponsor is adopting those provisions. The due date for these amendments is the last day of the first plan year starting on or after January 1, 2022 (i.e., December 31, 2022, for calendar year plans). Note that government plans have an additional two years beyond that.

30. Have they loosened the thresholds for partial plan terminations?

No, the thresholds for partial plan terminations remain the same.

Economic Conditions

LAY OFFS/TERMINATIONS/LEAVES OF ABSENCE

1. **We've been forced to lay off some of our employees; are they eligible to request distributions from the plan?**

   Most retirement plans permit a participant to request a distribution immediately upon termination of employment. Whether a layoff should be considered a termination of employment or a leave of absence depends on the facts and circumstances.

   Factors to consider include but may not be limited to;

   - the likelihood of re-employment
   - the expected duration of the layoff
   - whether the employee is receiving pay or other benefits from you during the period of layoff

   Newport is not able to help you determine whether an employee who is laid off is considered as having terminated employment. We will process all requests for termination/retirement distributions that have been properly submitted, provided the employee's records include a termination date. Be aware that approving a termination/retirement distribution when the participant has not actually terminated employment may adversely affect the qualified status of your plan.

2. **We've had to lay off a large number of employees. How does this affect our plan?**

   A large number of layoffs can result in the partial termination of your plan. If a partial termination occurs, the account balances of all affected employees must become 100% vested. A partial termination occurs if a significant number of employees (generally, 20% or more) are eliminated from your plan due to involuntary termination, even if termination occurs due to circumstances beyond your control, such as an economic downturn. For purposes of determining whether a partial termination has occurred, layoffs are generally treated as involuntary terminations of employment. Please consult with your ERISA counsel if you are concerned about a possible partial termination of your plan.

3. **We've terminated some employees who have outstanding loan balances. What happens to the loans?**

   Most loan policies require any outstanding loans to be repaid shortly after termination. Under those policies, loans that are not repaid are required to be reported as taxable income. The employee will owe income taxes on the outstanding balance of the loan(s), and may also owe a 10% early payment penalty tax on the outstanding balance(s), if he or she is under the age of 59-1/2. However, the employee will be able to avoid paying taxes and penalties if the loan is reported as a "qualifying loan offset" and the employee rolls over cash equal to the outstanding loan balance into an IRA by the due date (including extensions) for filing his or her tax return for the year the offset occurs.

   - If a terminated employee requests a distribution of his or her entire vested account balance, the outstanding balance of the loan will automatically be reported as a "qualifying loan offset."
   - If a terminated employee does not request a distribution of his or her entire account balance, the loan will become taxable when it goes into default (generally, at the end of the calendar quarter following the calendar quarter that the last loan payment was made). If directed by you, Newport will offset the loan from the participant's account at the time it defaults and it will be reported as a "qualifying loan offset."

   Newport provides quarterly loan reports that show loans with payments that are more than 30 days past due. If you want us to report a defaulted loan as a "qualifying loan offset," please review these reports regularly and provide direction to us to offset loans as they go into default.

4. **Some of our employees are taking, or have been placed on, a leave of absence. Are they eligible to request a distribution from the plan?**

   An employee on a leave of absence is not eligible for a termination/retirement distribution. The employee may be eligible to take a loan from the plan, or may qualify for an in-service distribution (based on the provisions of your plan).

5. **What should I do if an employee on a leave of absence has an outstanding loan?**

   If an employee with an outstanding loan is on an unpaid leave of absence, or on a leave of absence where his or her pay (after income and employment tax withholdings) is less than the required loan payments, the employee may be allowed to suspend loan payments for up to a year, if permitted by your plan's loan policy. When the leave ends or the one-year period has run (whichever occurs first), loan repayments must resume, and the remaining outstanding balance of the loan must be repaid by the maximum permitted loan period (generally, 5 years from the date the loan was originally made). Interest on the loan continues to accrue during any suspension period. If you suspend loan payments for an employee on a qualifying leave of absence, please make sure you have updated his or her employment status to LOA. When the employee returns to work, or the one-year period expires, please contact your Newport account manager for help in reinstating loan payments and re-amortizing the loan, if available under your plan's loan policy. Newport is not able to re-amortize loans without direction from you.

EMPLOYER CONTRIBUTIONS

6. **Our company is experiencing financial difficulties as a result of the coronavirus. Can our plan's safe harbor contributions be reduced or suspended?**

   Safe harbor contributions can be reduced or suspended if

   - Your company is operating at an economic loss, or
   - In your annual safe harbor notice, you included language advising employees that you could reduce or suspend safe harbor contributions and that no reduction or suspension would be made sooner than 30 days after they are notified of any reduction or suspension. This language is included in the annual safe harbor notice that Newport provides for your review and use.

7. **What steps must be taken if we want to reduce or suspend our plan's safe harbor contributions?**

   To implement a reduction or suspension, the following must occur:

   - the plan must be amended to reduce or eliminate the safe harbor contribution formula and to provide that the plan will satisfy the ADP test (and, if applicable, the ACP test) using current-year data
   - employees must receive a notice that explains the reduction/suspension, tells them how to make changes to their contribution elections, and includes the effective date of the reduction/suspension
   - after the notice to employees is provided, the employees must have a reasonable opportunity to change their contribution elections

   The reduction or suspension cannot be effective sooner than the later of:

   i. the day the plan amendment is adopted, or
   ii. 30 days after the employee notice is provided. In addition, safe harbor contributions must be made with respect to any contributions made through the effective date of the reduction or suspension.

   If you need to reduce or suspend your safe harbor contributions, please submit a plan amendment request to Newport at least 45 days before the desired effective date of the reduction/suspension. Newport will prepare drafts of the amendment and the supplemental notice for your review.

8. **We don't have safe harbor contribution provisions. Can we reduce or eliminate a "regular" match or profit sharing contribution provision?**

   In general, employers can reduce or eliminate a non-safe-harbor contribution provision. However, participants may have a protected right to anticipated benefit accruals. Discuss any desired changes to contribution formulas with your employee benefits counsel.

MISCELLANEOUS

9. **Can my employees apply for a financial hardship distribution for expenses/losses incurred as a result of the coronavirus?**

   The rules for financial hardship distributions have not changed. Hardship distributions are allowed for the following reasons:

   - if the employee has unreimbursed deductible medical expenses
   - is in danger of being evicted from his or her home or having the mortgage on that home foreclosed
   - needs to pay for post-secondary education for employee and/or dependents
   - funeral expenses for employee and/or dependents
   - needs funds to purchase a home
   - has expenses related to casualty losses
   - ***has expenses or losses (including loss of income) on account of a disaster declared by the Federal Emergency Management Agency (FEMA), provided the employee lives or works in an area designated by FEMA for individual assistance with respect to the disaster***

   As of April 6, 2020, 45 states have been declared as major disaster areas related to the coronarvirus, and in 10 of those states (New York, Washington, California, New Jersey, Louisiana, Florida, Texas, Illinois, Michigan, and Massachusetts), individuals are eligible for crisis counseling. However, it isn't clear whether individual crisis counseling equals "individual assistance" under the safe harbor hardship distribution rules. If you have employees who live or work in those 10 states, we recommend that you speak with your ERISA counsel for guidance.

   For updated information on the affected states, go to https://www.fema.gov/disasters and select “Major Disaster Declaration” under Declaration Type.

10. **If employees are required to receive paid leave under the Emergency Family and Medical Leave Expansion Act and the Emergency Paid Sick Leave Act (the "Acts"), do they get credit for hours of service during the leave? Does the paid leave count as compensation under our plan?**

    Employees are required to receive credit for up to 501 hours of service for periods during which they are paid but not performing services. As a result, they would generally get credit for hours of service for periods of paid leave under the Acts. The paid leave is taxable compensation that is required to be reported on Form W-2 and is subject to income tax withholding and thus, would count as plan compensation as defined in most retirement plan documents. If the paid leave qualifies as plan compensation, deferral elections would apply to the paid leave and the paid leave would be considered in calculating employer matching and non-elective contributions. Consult with your outside counsel for specific advice regarding paid leave, hours of service crediting, and plan contributions.

If you have any questions, please contact your Newport representative.

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