COVID-19 and Employee Benefit Plans

Congress and IRS Provide Taxpayer Relief under Certain Plan Rules Due to Pandemic

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At a Glance

To help mitigate the financial crisis created by the COVID-19 pandemic, the federal government has issued a plethora of guidance over the last several months related to employee benefit plan operation and administration. This article highlights several key provisions of the CARES Act and subsequent IRS guidance impacting employee benefit plans and their participants including expanded retirement plan distribution opportunities; increased retirement plan loan options; waiver of required minimum distributions; and liberalized cafeteria plan rules.

The COVID-19 pandemic has impacted most facets of life, including employee benefit plan operation and administration. The Coronavirus Aid, Relief, and Economic Security (CARES) Act,[1] which was signed into law this past March, provides for substantial financial and administrative relief to participants, sponsors, and administrators of certain employee benefit plans. After enactment of the CARES Act, the Internal Revenue Service clarified and expanded upon the relief offered in the new law. The new guidance relaxes the generally rigid regulatory scheme surrounding employee benefit plan operation and administration.

This article highlights key provisions of the CARES Act and subsequent IRS guidance impacting employee benefit plans and their participants including expanding retirement plan distribution opportunities; increasing retirement plan loan options; waiving required minimum distributions; and liberalizing cafeteria plan rules. This article is intended to provide a starting point for plan sponsors and administrators to utilize when evaluating operational and administrative compliance challenges during the COVID-19 pandemic. However, it is by no means a substitute for detailed review and analysis of plan documents in conjunction with the lengthy and comprehensive issued guidance.

Expanded retirement plan distribution opportunities

CARES Act § 2202(a) permits a plan sponsor of an "eligible retirement plan" (which includes certain retirement plans meeting certain requirements under Internal Revenue Code §§ 401, 403, 408, and 457)[2] to temporarily expand the circumstances under which certain participants may take distributions without incurring an early distribution penalty under Code § 72(t). Distributions cannot be taken by a participant from an eligible retirement plan prior to age 59½ without the participant's incurring an early distribution penalty (generally 10 percent).[3] Distributions from an eligible retirement plan are typically included in the distributee's gross income in the year of distribution. CARES Act § 2202 (as clarified and expanded upon in IRS Notice 2020-50) provides relief from those two tax rules for "qualified individuals" who obtain a "coronavirus-related distribution." Under circumstances described below, the 10 percent additional penalty of Code § 72(t) may be avoided, the distribution may be reported in gross income ratably over three years, and/or the funds may be restored into a retirement fund within a three-year period beginning on the day after the date on which the distribution was received.[4]

A coronavirus-related distribution (CRD) is any distribution (or distributions) not exceeding $100,000 from an eligible retirement plan to qualified individuals (as defined below) on or after January 1, 2020, but prior to December 31, 2020.[5] An eligible retirement plan may permit an individual to take a CRD from his or her plan account if:

1) He or she is diagnosed with COVID-19;

2) His or her spouse or dependent is diagnosed with COVID-19; or

3) He or she experiences adverse financial consequences resulting from certain circumstances.

IRS Notice 2020-50 details these circumstances as:

A) The individual is quarantined, furloughed, laid off, or has reduced hours due to COVID-19;

B) The individual is unable to work because of lack of childcare due to COVID-19;

C) The individual who owns or operates a business must close or reduce operating hours of the business;

D) The individual has his or her pay reduced, a job offer rescinded, or the start date for a job delayed due to COVID-19; or

E) The individual's spouse or member of the household suffers any of the four circumstances outlined above.

An individual meeting either 1, 2, or A-E—a "qualified individual"—may qualify for a CRD.[6] The CARES Act does not modify the rules governing when distributions are permitted to be made from an employer's retirement plan. Thus, for example, a qualified pension plan is not permitted to make a distribution before a distributable event (e.g., obtaining normal retirement age) merely because, if made, the distribution would be a CRD.

A plan sponsor providing CRDs has until the last day of the first plan year that begins on or after January 1, 2022, (or January 1, 2024, with respect to government plans) to amend its plan in order for it to be considered to have operated in accordance with its terms in the interim.[7] When implementing the CRD provisions, plan sponsors are generally permitted to choose any reasonable procedure for identifying which distributions qualify as CRDs so long as similar treatment is afforded to plan participants receiving similar distributions. The guidance permits plan administrators to rely upon an individual's certification that he or she is a qualified individual so long as the administrator does not have actual knowledge to the contrary.

A plan sponsor opting to permit CRDs will provide qualified individuals the potential ability to receive tax relief related to such distributions such as exclusion from the 10 percent additional penalty of Code § 72(t); the option to include the CRD in gross income ratably over three years; and the option to recontribute the funds distributed back into a retirement fund (in which case, amounts recontributed will generally not be

included in gross income) within a three-year period beginning on the day after the date on which the CRD was received.[8] A plan is not required to allow any recontributions of CRDs.

Expanded retirement plan loan opportunities

CARES Act § 2202(b), as augmented by IRS Notice 2020-50, permits plan sponsors to allow qualified individuals to take an enhanced plan loan from the retirement plan.[9] Certain retirement plans may permit a participant to take a loan from his or her retirement account. Typically, loans are limited to an amount that is the lesser of $50,000 or 50 percent of the participant's vested accrued benefits.[10] CARES Act § 2202(b) increases the maximum loan amount to $100,000 or 100 percent of the qualified individual's vested accrued benefit for loans made on or after March 27, 2020, and before September 23, 2020.[11]

The CARES Act also provides relief to qualified individuals with outstanding loans from a qualified employer plan on or after March 27, 2020.[12] Employers may allow any such loan with a due date between March 27, 2020, and December 31, 2020, to have its due date delayed for up to one year even if that extends the loan term beyond the normal five-year maximum limit set forth in Code § 72(p).

IRS Notice 2020-50 provides a safe harbor for employers regarding implementation of the loan repayment suspension provisions. Under the safe harbor, a qualified employer plan will be treated as satisfying the requirements of Code § 72(p) if a qualified individual's obligation to repay the loan is suspended under the plan for any period beginning not earlier than March 27, 2020, and ending not later than December 31, 2020, also referred to as the suspension period. Loan repayments are required to resume after the conclusion of the suspension period, although the term of the loan may be extended by up to one year from the date the loan was originally due to be repaid. Interest accruing throughout the suspension period must be added to the outstanding principal of the loan. A plan satisfies these rules if the loan is reamortized and repaid in substantially level installments over the remaining period of the loan. If the plan permits a suspension period that is less than the maximum suspension period described above, the employer may subsequently extend the suspension period, but not beyond December 31, 2020. IRS Notice 2020-50 clarifies that there may be additional reasonable ways to administer CARES Act § 2202(b) outside of the safe harbor.

A sponsor must amend its plan by the deadline described above for CRDs in order for participants to take advantage of this temporary loan relief. As with CRDs, the administration of a qualified employer plan may rely on a certification that the individual satisfies the conditions to be a qualified individual and therefore qualifies for enhanced loan treatment unless the administrator has actual knowledge to the contrary.

Waiver of required minimum distributions

CARES Act § 2203 amends Code § 401(a)(9) by adding subparagraph (I), which provides a temporary waiver of 2020 required minimum distributions (RMDs) for certain defined contribution plans and IRAs.[13] The waiver also applies to 2019 RMDs for any individual who had a required beginning date of April 1, 2020, that was not paid in 2019. Special relief is provided in IRS Notice 2020-51 with respect to rollover distributions for certain RMDs made in 2020. The rollover deadline has been extended to the later of August 31, 2020, or the typical 60-day deadline for purposes of RMDs already made in 2020 that were not required.

IRS Notice 2020-51 also contains a sample plan amendment which provides employers with two options for implementing the 2020 RMD waiver and three options for recontribution of 2020 RMDs. The notice reiterates the CARES Act requirement that any plan amendment must be adopted no later than the last day of the first plan year beginning on or after January 1, 2022, (January 1, 2024, for governmental plans). It further explains that the amendment must reflect the plan operations beginning with the amendment's effective date. This amendment must be in writing and signed and dated by the employer; preapproved plan sponsors cannot adopt RMD amendments on behalf of adopting employers.[14] Under IRS Notice 2020-51, plan amendments may not eliminate an optional form of benefit.

IRS Notice 2020-51 also provides transition relief related to the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 change to the required beginning date for RMDs. By way of background, § 114 of the SECURE Act[15] increased the age associated with the required beginning date for RMDs from 70½ years old to 72 years old. The transition to the new beginning date occurred on January 1, 2020, so anyone turning 70½ years old in 2020 is not subject to RMDs until age 72. A plan distribution made in 2020 to a participant who reaches age 70½ in 2020 that would have been an RMD without the change in the required beginning date to age 72 under the SECURE Act is not required to be treated as a direct rollover subject to mandatory withholding or the Code § 402(f) notice requirement. This transition relief is helpful to plan administrators and recordkeepers who improperly characterized distributions as RMDs because they were unable to update their systems and processes before January 1, 2020.

Cafeteria plan relief

The IRS released three important pieces of guidance allowing plan sponsors to amend their Code § 125 cafeteria plans to provide employees with increased flexibility for elected benefits, account balances, and reimbursable expenses.

IRS Notice 2020-29 provides temporary relief in response to the COVID-19 pandemic by providing flexibility with respect to mid-year election changes during calendar year 2020 outside of the typical rigid confines of Treasury Regulations § 1.125-4, and extended reimbursement periods.[16]

Midyear election changes

An employer has discretion to amend its cafeteria plan to permit midyear election changes. With respect to employer-sponsored health coverage, the cafeteria plan can be amended to allow an employee to make a new election if the employee initially declined to elect employer-sponsored health coverage; revoke an existing election and make a new election to enroll in different health coverage sponsored by the same employer; and revoke an existing election provided that the employee attests in writing that the employee is enrolled, or will immediately enroll, in other health coverage not sponsored by the employer.

For health flexible spending account (health FSA) and dependent care assistance program (DCAP) coverage, the cafeteria plan can be amended to allow an employee to revoke an election; make a new election; and decrease or increase an existing election applicable to a health FSA or DCAP.

Extended reimbursement periods

A plan sponsor may also amend its cafeteria plan to permit employees to apply unused amounts remaining in a participant's health FSA or DCAP account as of the end of a grace period or plan year ending in 2020 to pay or reimburse expenses incurred for the same qualified benefit through December 31, 2020.

IRS Notice 2020-33 permits a cafeteria plan to reflect indexing for inflation by permanently increasing the limit of unused amounts remaining in a health FSA as of the end of a plan year which may be carried over to pay or reimburse a participant for medical care expenses incurred during the following plan year. Specifically, the notice permits a plan sponsor to increase the current maximum $500 carryover amount for a plan year to an amount equal to 20 percent of the maximum salary reduction contributions under Code § 125(i) for that plan year in regard to unused amounts in the health FSA. Thus, the maximum unused amount from a plan year starting in 2020 that can be carried over to 2021 is $550 (20 percent of $2,750, the indexed 2020 limit under Code § 125(i)).[17]

CARES Act § 3702 expands the list of expenses reimbursable through health FSAs, health savings accounts, Archer medical savings accounts, and health reimbursement arrangements to include certain over-the-counter drugs, medicine without a prescription, and menstrual care products beginning January 1, 2020.[18]

Conclusion

Since March, the CARES Act and the IRS have provided changes in employee benefits laws and guidance allowing employer-plan sponsors to give (and plan participants to receive) some financial relief in response to the economic difficulties caused by the COVID-19 pandemic. Additional clarifying details related to the issues described in this article are set forth in the cited official guidance. Plan sponsors and administrators should consult with their legal counsel to determine application of the various pieces of tax-related guidance to ensure appropriate compliance. ■

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ENDNOTES

1. 15 USC 116.
2. The term is defined in 26 USC 402(c)(8)(B) as provided by 26 USC 72 note (2020) (Tax-Favored Withdrawals from Retirement Plans).
3. 26 USC 72(t).
4. *Id.*
5. 26 USC 72 note (2020) (Tax-Favored Withdrawals from Retirement Plans).
6. 26 USC 72 note (2020) (Tax-Favored Withdrawals from Retirement Plans) and IRS Notice 2020-50.
7. IRS Notice 2020-50.
8. *Id.*
9. 26 USC 72 note (2020) (Loans from Qualified Plans).
10. 26 USC 72(p).
11. 26 USC 72 note (2020) (Loans from Qualified Plans).
12. *Id.*
13. 26 USC 401(a)(9)(I).
14. *Id.*
15. 26 USC 401(a)(9).
16. IRS Notice 2020-29.
17. IRS Notice 2020-33.
18. 26 USC 223(d)(2).