

Much anticipated guidance in the form of IRS Notice 2020-50 (the “Notice”) was released by the IRS on Friday, June 19, 2020. The notice provides new guidance as well as clarifies some details in the CARES Act, specific to coronavirus related distributions and loans.

Who is a qualified individual?

Since the passing of the CARES Act (the “Act”) a common question has been asked: “am I a qualified individual for purposes of a coronavirus related distribution (CRD) if my spouse was laid off, or had to close a business, due to COVID-19?”. Under the Act, a participant was only a “qualified individual” if they were impacted financially, but not if their spouse was the one impacted. Many assumed this was an oversight in the drafting of the Act. The Notice expands the definition of “qualified individuals” for purposes of taking a coronavirus related distribution or loan under the CARES Act. The expanded definition says a “qualified individual” includes someone who experiences adverse financial consequences because of a:

- Reduction in pay or self-employment income due to COVID-19
- Job offer rescinded or start date delayed due to COVID-19
- Participant’s spouse (or member of household) is quarantined, furloughed, laid off, or has work hours reduced due to COVID-19, or is unable to work due to lack of childcare due to COVID-19 or has a job offer rescinded or start date is delayed due to COVID-19
- Closing, or reduced work hours, of a business owned or operated by the spouse (or member of household) due to COVID-19

For this purpose, a “member of the household” is someone who shares the individual’s principal residence. The Notice also indicates that, although the employer can accept the participant’s self-certification that they may meet the definition of a “qualified individual” (unless they have actual knowledge to the contrary), the participant will need to report this on their tax return as well. The IRS included a sample certification in the Notice that can be used by the employer for this purpose.

Must the employer plan offer CRDs for a participant to treat a distribution as a CRD?

The Notice clarifies that any person who is a “qualified individual” can claim any distribution as a CRD if it is taken in 2020. This assumes the participant has a triggering event to take a distribution in the first place. There are some exceptions to this statement—distributions that are to correct 415 failures, excess contributions (including ADP/ACP testing failures) and deemed distributions of defaulted loans, among others, are not eligible for treatment as a CRD.

However, an RMD taken in 2020 that was not required due to CARES, as well as a hardship distribution taken for an unrelated expense, can be treated as a CRD. A loan offset amount may also be treated as a CRD to spread taxation out over three years, or to repay it within three years and avoid taxation. If a participant is separated from service, or has an option to take an in-service distribution, the participant can claim this distribution as a CRD if they are a “qualified individual”.

How will a CRD be reported to the IRS by the plan and by the participant?

The qualified plan must report the distribution on IRS Form 1099-R. The Notice indicates that the payor can use any applicable code, including either a Code 2 (early distribution, penalty exception applies) or Code 1 (early distribution, no known exception). The Participant will attach Form 8915-E to their tax return for the year of the distribution to indicate if the total amount of distribution will be included for tax purposes for 2020, or if it will be spread ratably over three years (one-third in each year beginning in 2020).

If the participant decides to repay any portion of the distribution over the three year period beginning the day after the distribution, the Notice outlines how the recontribution will impact their taxable income for each year depending on when the repayment is made relative to when they claimed the taxable income. Examples are included in the Notice to help illustrate this for the taxpayer. Any amount repaid will reduce their taxable income for the year of the repayment. If the repayment exceeds the amount of the distribution claimed for that year, the excess can be carried forward or backwards too. If the full distribution is repaid, the distribution will be tax free, but an amendment to the participant’s tax return may be required.

When must payments resume on a CAREs loan if suspended?

The Act says that any payments due between March 27, 2020 and December 31, 2020 may be suspended for one year for a “qualified individual”. In addition, the Act permits the term of the loan to be extended for one year. But this has led to much speculation regarding how the suspension is applied. The Notice includes a “safe harbor” approach but acknowledges there may be additional reasonable ways (if more complex) to administer the loan suspension.

The safe harbor approach is to re-amortize the outstanding balance and accrued interest after the suspension period ends on December 31, 2020. Therefore, payments would resume in January and would include level payments over the remaining term. The term can also be extended one year beyond the maximum term that the loan originated with. For example, a loan originally taken April 1, 2020 with payments suspended beginning in July of 2020, if following the safe harbor approach, would be reamortized and payments would resume in January 2021, and the loan term would end by March 31, 2026 (six years after the origination date). The loan payments would be in an amount sufficient to fully amortize the loan balance from January of 2020 to March of 2026.

Is that all?

The Notice provides background information on all provisions relating to CRDs and loans under the CARES Act, including clarifying text to better understand the intent of the Act. Although much of what was included was already widely understood, the items noted in this article will greatly help the industry navigate the administration of CRDs and loans, as well as help us to address our client’s concerns.