Compliance Alert

CARES Act - Summary

The intent of this summary is to provide plan sponsors with information about the CARES Act, or H.R. 748, Coronavirus Aid, Relief, and Economic Security Act, that was signed into law on March 27, 2020. In addition to a summary of the legislation, Lincoln has also provided information related to administrative issues or concerns that have arisen during this unprecedented period. Part One discusses the legislation's impact on defined contribution retirement plans and Individual Retirement Accounts (IRAs). Part Two provides additional administrative Q&A.

Due to the fact that guidance is still pending for recent SECURE Act changes and that similar provisions are included in the CARES Act, the information in this summary reflects good faith interpretations of the changes. Details about these provisions may change if additional guidance warrants.

Part one: CARES Act

Penalty-free withdrawals for coronavirus-related distributions (CRDs)

Brief summary – Eligible plans and IRAs may allow for a distribution either as an eligible, standalone distribution or as a hardship distribution. An individual who is impacted by coronavirus-related events may take one or more distributions that total $100,000 or less. A CRD withdrawal is not subject to mandatory withholdings. The individual may pay taxes over a three-year period and is not subject to an early distribution penalty. Amounts withdrawn under this provision may be repaid over a three-year period.

An individual may be eligible to treat a distribution as a coronavirus-related distribution if:

- The individual is diagnosed with the SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention.
- The individual's spouse or dependent (as defined in IRC Section 152) is diagnosed with the virus or disease.
- The individual experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, or having work hours reduced due to such virus or disease.
- The individual is unable to work due to lack of child care due to such virus or disease.
- Due to such virus or disease, the individual is unable to work or is working reduced hours due to the closing or reduced hours of the business that is owned or operated by the individual.
- Other factors as determined by the Secretary.
- For this purpose, an individual can self-certify that he or she meets these conditions.

Additional details about coronavirus-related distributions:

- This type of distribution is allowed from a 401(a), 401(k), 403(a), 403(b), or 457(b) governmental plan or from an IRA. However, note that these rules do not provide an eligible distribution event from a defined contribution pension plan (such as a money purchase pension plan). If a distribution is otherwise available in such plan then such distribution may be treated as a CRD for tax and recontribution purposes.
- An individual's limit is $100,000 from any plan or IRA. Plan administrators can rely on employee self-certification that they haven't attained the limit from other sources and that they qualify as being impacted. But, to comply with plan limits, the plan administrator is expected to take steps to ensure that the limit isn't exceeded in any one plan of the employer or in the aggregate from all plans maintained by a related employer.
- The distribution must be made on or after January 1, 2020, and before December 31, 2020.
- The distribution is not subject to mandatory withholding at the time it's taken (i.e., it's treated as though it's not an eligible rollover distribution).
- If permitted by the plan, it's treated as a distributable event from 401 plans that are not pension plans, 403(b) plans (including custodial accounts), and 457(b) governmental plans.
- It's not subject to the Section 72(t) 10% early distribution penalty.
- An individual can elect to pay the taxes "ratably" over three years.
- The distribution can be repaid over the three-year period that begins one day after the distribution is received.
- Such repayment will be treated as though it were a "60-day rollover" from the plan or IRA to any plan or IRA to which the individual is permitted to make rollover contributions.

Comments: Although 457(b) top hat plans are not included in the coronavirus-related rules discussed above, the 457(b) regulations define an unforeseeable emergency to include other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the Individual or the beneficiary. This definition would appear to cover the coronavirus situation.

Loans from Retirement Plans for Eligible/Qualified Participants

Brief Summary – New Loans: The rules for taking a "plan loan" from a retirement plan are updated to allow for a loan of up to 100% of the participant's vested balance, not to exceed $100,000. The increase in the loan amount is available beginning with the date of enactment, March 27, 2020 and ends September 23, 2020 (after 180 days), unless otherwise extended.

Brief Summary – Loan Payments: Loan Payments due on a loan that is active during the "qualifying period" may be delayed for up to one year and the payment schedule adjusted accordingly. The qualifying period begins March 27, 2020 (date of enactment) and continues through December 31, 2020.

Additional details on coronavirus-related plan loans and loan payments:

- The $50,000 loan limit is replaced by $100,000. Therefore, an individual who has a "highest outstanding loan balance" of $50,000 can potentially take an additional loan.
- The 50% limit is replaced by 100% of the vested account balance.
- Any new loan is subject to the plan's loan policy regarding the number of loans permitted. A plan

sponsor should consider whether to update its plan's policy to allow for additional loan(s) during this period.

- If the participant has an outstanding loan on or after the day of enactment, then any payment due between the date of enactment and December 31, 2020, may be delayed for up to one year.
- Subsequent repayments will be adjusted. For example, if payment #10 of 60 was due on April 20, 2020, then this payment will now be due on April 20, 2021 and payments 11-60 will also be delayed for one year past the original due date. (Thus, total repayment of the loan may occur one year later than the original 5-year repayment date for a 5-year loan.)
- "Eligible/qualified participant" has the same meaning as described above for coronavirus-related distributions.

Comments: It is unclear how loan repayments that are suspended for leave of absence (for example, due to a layoff) interact with the 1-year extension described above. Additional guidance or information is needed on loan payments that were due prior to enactment.

Required minimum distributions (RMDs)

Brief summary: 2020 RMD payments are not required. This includes payments due for calendar year 2019 (due to having a required beginning date (RBD) of April 1, 2020) provided the payment was not already made by December 31, 2019. If a payment was made after 2019, that payment may be treated as an eligible rollover distribution. Any beneficiary account (in which the participant died before his or her RBD) subject to the 5- or 10-year rule has a 1-year grace period.

Additional details about RMD payments for 2020:

- RMDs are not required to be taken for calendar year 2020 for defined contribution 401(a), 401(k), 403(a), 403(b), or 457(b) governmental plans or for IRAs. Top Hat 457(b) plans (plans for non-governmental employers) still must meet these requirements.
- If an individual's RBD is April 1, 2020, and an RMD for "distribution calendar year" 2019 was not made prior to January 1, 2020, the distribution is not required to be taken for 2020.
  - If such distribution was taken in 2020, then those amounts can be rolled over. The legislation updated 2009 suspension rules.
- RMD rules can be ignored for purposes of determining if the distribution is eligible for rollover.
- For those death benefits subject to the 5-year rule or the new 10-year rule, calendar year 2020 can be "ignored" (i.e., it doesn't count) in determining when the account must be fully distributed. This essentially provides a 1-year extension.

Department of Labor (DOL) granted authority to delay certain deadlines

Brief summary: The CARES Act includes language that allows the DOL to delay or extend certain deadlines required under ERISA. The DOL must act on the new rule. However, relief for ERISA filings (such as Form 5500) and certain notice requirements is anticipated. Information about such relief will be provided when it's available.

Plan amendments necessary to memorialize coronavirus emergency provisions

Brief summary: Similar to the deadlines for the SECURE Act, any amendments necessary due to the application of the CARES Act are due by the last day of the first plan year beginning on or after January 1, 2022, or such later date that may be declared (December 31, 2022, for calendar year plans). Governmental plans have an additional two years.

Comments: Plan sponsors and administrators should track any provisions that are elected.

Part two – Questions and answers (Q&A)

The information contained in this Q&A is based on our understanding of retirement plan rules. It is not intended as legal opinion or guidance. Plan sponsors should discuss these issues with their legal or tax advisors with regard to issues specific to their individual plan(s).

Distributions

Q1: Is a layoff or furlough considered a severance of employment for distribution purposes?

A1: A layoff usually means that an employee is temporarily relieved from duties. A severance of employment is generally defined to mean that there is no written or implied understanding that the employee will be rehired. Thus, unless the employee has been notified that his or her employment is terminated, these layoffs are not likely to be treated as a severance of employment for plan distribution purposes.

Q2: Can an individual who is affected financially by the coronavirus-related events request a distribution from his or her retirement plan or IRA?

A2: Yes, subject to the retirement plan's distribution provisions, effective with the enactment of the CARES Act, distributions may be made available to those affected by coronavirus-related events.

Plan sponsors need to let their retirement plan providers/recordkeepers know whether their plans should allow for these provisions and whether all contribution sources will be available (or if restrictions will apply to certain contribution sources). For example, the employer can allow withdrawals from matching contributions, but not non-elective contributions, for this purpose.

Q3: Is a CARES Act withdrawal the same as a hardship withdrawal?

A3: There are many similarities between the hardship withdrawal provisions in 401(k) or 401(a) plans, but the differences may require recordkeepers to create a unique distribution "event" in order report and track these withdrawals. For example, 403(b) plans using custodial accounts do not have the same hardship rules as 401(k) plans. In addition, these distributions may be easier to track for repayment purposes if they are handled as unique withdrawals.

Q4: How are spousal consent requirements affected by COVID-19-related events?

A4: For plans that are not subject to Qualified Joint & Survivor Annuity (QJSA) rules, the only government-required spousal consent applies to ERISA plans when a participant names someone other than his or her spouse as beneficiary for the plan. Otherwise, the plan sponsor can amend its plan and/or loan policy to suspend or remove spousal consent for distributions and loans.

For plans that are subject to QJSA rules, spousal consent is required in order to request a distribution or loan. Guidance is needed before allowing distributions or loans to be made without spousal consent. Lincoln will provide updated information as it becomes available.

Loans

Q5: Is a layoff or furlough treated as a leave of absence for purposes of loan repayments?

A5: As described above, the CARES Act provides an extension for loan payments for anyone affected by a coronavirus-related event.

If an employee was laid off or furloughed prior to the enactment date, then payments may also be suspended under the leave of absence (LOA) rules. For the LOA to allow loan payments to be suspended:

1. The participant is not being paid by the employer (or being paid less than the loan payment)
2. The suspension does not exceed one year
3. Payments begin immediately upon return from leave

Additional information is needed to address how the two provisions interact. Lincoln will provide updates when they're available.

Q6: Can an employer unilaterally suspend payroll deducted loan payments without the employee's consent?

A6: We suggest that the employer take such action only at the request of the employee.

Q7: Can an employer suspend payroll-deducted loan payments at the request of the employee?

A7: Yes. It would be best if the employee is not being paid or if the employee certifies that he or she is affected by coronavirus-related events. This way, payments can be suspended (or postponed) for up to one year without the loan becoming taxable. However, the employer can follow the employee's instructions to revoke his or her payroll deduction authorization.
Please note: Participants who fully revoke consent may be restricted from taking a new loan at a later date due to this action.

Q8: What if loan payments are made by payroll deduction and an employee who is on an unpaid leave wishes to continue to make payments?

A8: Please contact your Lincoln representative.

Q9: If a participant has an outstanding defaulted loan (i.e., the loan was deemed taxable but not offset), is this loan considered outstanding for purposes of taking new loans?

A9: Yes. Relief has not been given to loans that defaulted prior to the date the CARES Act was enacted. As noted above, loan payments that were due prior to the enactment date may be eligible for suspension if the employee met the "leave of absence" requirements. Please keep in mind that a deemed loan continues to count as an outstanding loan until such time as the loan can be offset (i.e., the participant attains a distributable event under the plan). In addition, if the deemed loan has not been repaid or offset, any subsequent loans must be repaid via payroll deduction; however, payroll deduction may be set up to start later under the CARES Act rules.

Q10: If the plan/loan policy allows for only one loan to be outstanding and the participant already has an active loan, can the participant take a new loan under the new CARES Act rules?

A10: The plan must continue to follow the terms of its loan policy. However, the plan sponsor may elect to change its loan policy during this period to allow for additional loans.

Contributions to retirement plans

Q11: Has the deadline to fund 2019 plan year employer contributions (other than elective deferrals) been extended?

A11: For employers that are required to file their company's tax returns by April 15, 2020 (either normal deadline or with extension), the filing deadline and the contribution deadline were extended to July 15, 2020. Additional relief will be required for those with deadlines other than April 15, 2020.

Additional information on the normal deadline to fund employer contributions is provided in a separate bulletin. Please refer to our Employer Contribution Deposit Deadlines bulletin.

The deadline for nonprofit organizations to fund contributions is 9½ months after the end of the plan year (October 15, 2020, for a plan year ending December 31, 2019).

Q12: If the plan makes matching or other employer contributions on a pay period basis in 2020, does the employer need to continue to fund these contributions each pay period?

A12: While the employer is expected to fund employer contributions that have accrued, there are separate rules concerning when these amounts must be contributed to the plan. For example, amounts that accrue for a December 31, 2020, plan year-end are not required to be funded until 2021. Please refer to our Employer Contribution Deposit Deadlines summary for more information.

Q13: What if the employer is concerned about its ability to make any type of employer contributions this year?

A13: Different rules apply for different plan types for purposes of reducing or suspending employer contributions. Please refer to our Reduction or Suspension of Employer Contributions in a Defined Contribution Plan summary for more information.

Q14: If the employer has an automatic enrollment provision in its plan, is the employer required to continue to administer this provision?

A14: If the employee is receiving compensation as defined in the plan, then yes, the employer should continue to administer the plan as written. An automatic deferral is still an elective deferral, and the employee should decide whether to stop (or not start) deferrals by updating his or her deferral agreement (or completing a new affirmative salary reduction agreement) to reduce or suspend deferrals to the plan.

If an employer amends the plan to suspend the automatic enrollment program and later wishes to reinstate it, the employer should discuss the reinstatement and its effects on the overall program with its recordkeeper.

Plan compensation

Q15: Are wages paid while an employee is on layoff or furlough considered wages for plan contributions (i.e., deferrals and employer contributions)?

A15: If the amounts being paid are treated as wages for W-2 purposes, then these amounts are usually treated as compensation for retirement plan purposes. For example, if an employer provides an employee with paid vacation leave, then the vacation pay is generally included. Payments made during a coronavirus-related leave would usually be treated as a form of paid leave.

A plan's definition of plan compensation may exclude a variety of definitions of compensation. Plan sponsors should review each plan's compensation definition and review any exclusions of compensation that are currently defined. Plans may be updated to exclude certain compensation; however, such amendment generally must be in place before the compensation is paid or before the employee accrues a benefit. If the plan is a safe harbor plan, such changes may affect the safe harbor status for the year.

Q16: Instead of layoff, is plan compensation affected if the employee is terminated (i.e., has a severance from employment)?

A16: In addition to any exclusions that affect plan compensation, there are rules that affect how payments made after severance of employment are treated. If the payments are treated as regular pay then they are generally included if paid within 2½ months, or, if later, if paid by the end of the plan year in which the severance occurred.

Q17: If the plan sponsor does make payments during a layoff or furlough, can the employer choose not to deduct salary deferrals from this pay?

A17: If the payments being made are considered wages, then the decision to defer or not should be left to the employee. An employee who does not want deferrals deducted should change his or her deferral election to 0%. However, an employer can suspend deferrals by amending the plan to:

1. Suspend all deferrals until the plan is amended to reinstate the deferrals, or

2. Exclude layoff or furlough pay from the definition of compensation (for deferrals and/or employer contributions).

It is not recommended that the employer take this type of action without amending the retirement plan. For 403(b) plans subject to universal availability, this can be an additional issue.

Q18: What is a qualified disaster relief payment? Is it compensation for plan purposes?

A18: Qualified disaster relief payments, for this purpose, are non-taxable amounts paid by an employer to help an employee during a qualified disaster. Because these amounts are excluded from income, they aren't included in compensation for plan compensation.

For information purposes, a qualified disaster relief payment is one that is made by an employer to offset the reasonable costs incurred as a result of a qualified disaster to the extent that such amounts are not otherwise compensated or reimbursed by insurance or by another party. Additional information can be found in Internal Revenue Code Section 139 and Revenue Ruling 2003-12.

Q19: An employer is considering paying its employees who are on a coronavirus-related leave; however, it wants to treat this as a payroll advance and have employees repay these amounts when they return to work. Is this compensation for plan purposes?

A19: This type of payment appears to essentially be a loan to the employee. Loans are not generally considered income (or compensation) to an employee unless the loan is "forgiven" or is otherwise not repaid. Lincoln suggests that the employer discuss this with its legal or tax advisor.

It is important to know before these amounts are paid whether the payments are considered plan compensation or not and to take steps, if necessary, to amend the plan's definition of compensation accordingly.

Q20: If an employee suspends (or is suspended from) making elective deferrals to an employer-sponsored plan in 2020, can the employee "catch up" in a future year?

A20: Unless further guidance or legislation is issued, an employee is subject to the current deferral limits, including any existing catch-ups. Since this is an unknown, employees are encouraged to review their deferral elections for 2020 when they return to active employment.

Miscellaneous

Q21: Partial plan termination – Can layoffs or furloughs result in a partial plan termination for vesting purposes (i.e., require full vesting for affected participants)?

A21: Certain rules apply to a retirement plan if an employer reduces its workforce by a certain amount or percentage. A partial plan termination may occur when a significant number of participants are terminated (generally 20%). Unless the layoffs become permanent, it is not likely that a partial plan termination occurred. This situation should be monitored and may need to be revisited if the events continue into 2021 and no additional guidance or relief is granted. Please refer to our Partial Plan Termination summary for more information.

Q22: Fiduciary duties – During a financial crisis or other turbulent times, what should a plan sponsor keep in mind from a plan fiduciary perspective?

A22: While current events may be difficult for an employer from a business perspective, it is critical to keep in mind the fiduciary duties and responsibilities associated with the retirement plan(s).

During times of financial crisis or other emergency situations, we believe it is prudent for a plan sponsor to make sure it continues to look out for the best interest of its plan participants. Therefore, continuing to conduct regular retirement plan/investment/fiduciary meetings seems to be a best practice.

Q23: What if an employee is too busy with day-to-day operations or other concerns and does not have time for our regular fiduciary meetings?

A23: We suggest that the fiduciaries/plan committee attempt to comply with the meeting date requirements as outlined in its policies and procedures and consider alternate options (such as Skype, conference call, or others).

Please contact your Lincoln representative if you have questions about impacts to your plan.

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