

401(k) Distribution and Loan Opportunities Under the COVID-19 Stimulus

Client Update Article

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The Coronavirus Aid, Relief, and Economic Security Act (CARES ACT) was passed by President Trump to combat the economic impact of Covid-19. While the CARES Act provides a number of advantageous tax provisions, one in particular may be helpful to those affected by COVID-19 with a retirement savings plan. Under the CARES Act certain participants can take a coronavirus-related distribution up to \$100,000 from their retirement plan. The advantage under the new legislation stems from avoidance of the normal 20% federal income tax withholding. Moreover, the distribution will be exempt from the 10% early withdrawal penalty that typically applies to a participant under the age of 59.5. Additionally, if the distribution can be repaid to the plan within three years, the taxpayer will obtain tax-free rollover treatment without regard to the typical plan limits. Or, if the distribution is not repaid, the individual can recognize ordinary income tax on the distribution over a three-year period that begins when the individual takes the distribution, as opposed to having the entire amount taxed at ordinary income in the tax year the distribution was received.

However, similar to other provisions passed under the CARES Act, the 401(k) distribution is also subject to limitations. First, only certain individuals qualify for the distributions. This includes taxpayers who have personally, or through a spouse or dependent have (1) been diagnosed with Covid-19, or (2) have experienced adverse financial consequences as a result of layoffs, furloughs, or reduced hours due to the virus and/or employer decisions to close or reduce business hours of operation. Similar to most new legislation, we assume the CARES Act will be no stranger to ambiguities and questions requiring further governmental guidelines. However, as of March 28, 2020, we can provide the following details regarding the 401(k) distribution and loan provision:

- Any such distribution must be processed and distributed by December 31, 2020;
- All contribution sources (e.g., 401(k) deferrals and employer matching contributions) are generally available for these distributions;
- The distributions are subject to income tax withholding at 10% unless the participant elects a different percentage;
- The plan administrator can rely on an employee's certification that the employee is eligible for the distribution; and
- We believe the employer who sponsors the plan can choose not to allow these distributions.

Aside from the new distribution rules, the CARES Act also enables qualifying 401(k) participants to either borrow up to \$100,000 from their retirement plan or borrow up to 100% of their vested account balance, both of which are double the normal limit. The CARES Act will also allow more flexibility for repayment on these loans if certain conditions are met. The participant will be allowed to delay repayment up to one year. From an employer standpoint, if the participant is authorized by their employer to receive a loan, the employer's plan will need to reflect the new loan option.

Finally, the CARES Act is suspending "required minimum distributions" (RMDs) for individuals who reach the age of 70.5. Under previous law, taxpayers age 70.5 and up were required to make a minimum distribution from their qualified retirement plan. Now however, the CARES Act allows retirement plans to suspend the RMD payments that would otherwise be required to be made in the calendar year 2020. The goal behind the relief is to allow retirees the ability to avoid taking withdrawals from depleted retirement accounts and allow the market to recover before taking such distributions.

The tax advisors here at The Center for Financial, Legal and Tax Planning, Inc., (The Center) are analyzing the CARES Act in real time. Our mission is to break down all aspects of the legislation and provide up-to-date information on the 880 pages of legislation. If your business has been affected by Covid-19, or if you have questions on the CARES Act please reach out to the Center to ensure you're maximizing every opportunity available to your business.