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Q&A

CARES Act: Some things to consider regarding loans and distributions

The Coronavirus Aid, Relief, and Economic Security (CARES) Act permits increased access to retirement plan loans and in-service withdrawals in response to participants' need for cash in this time of economic crisis created by coronavirus (COVID-19). The CARES Act offers tax concessions so that plan participants have access to the savings within their qualified retirement plan without being subject to an additional 10% early withdrawal tax.

The following Q&As are intended to provide helpful insights for plan participants to think about as they consider whether or not these coronavirus-related loans and in-service distributions are right for them.

Qualified retirement plans are complex and distributions can have tax implications. These insights are not intended to provide guidance or advice. Plan sponsors and participants should seek tax and legal counsel to understand all aspects of the law.

Participant considerations

1. Which is better, a withdrawal or a loan?
If you believe you will stay with your current employer for the next 5 years, taking a loan may be more advantageous due to the fact that you have the ability to repay the loan (with interest), and consequently, there will be a lesser impact on your retirement savings. However, whether you are taking a loan or a withdrawal, keep in mind that when plan assets are sold to create cash for distributions, you realize the gain or loss on those investments, and the market has experienced greater volatility lately due to the economic effects of the coronavirus.

However, if you take a loan, then lose your job, you will default on the loan. If you default on the loan, the remaining outstanding amount will be taxable in the year of the default (and the additional 10% early withdrawal tax may also apply).

If you are worried that you will lose your job, then a coronavirus-related withdrawal may be more advantageous. Coronavirus-related withdrawals are not subject to the additional 10% early withdrawal tax that is generally applicable to in-service distributions before age 59.5, and the recognition of income will be spread out over three tax years (unless you elect otherwise). Also, you are permitted to repay this withdrawal over three years.

2. What else should I consider when determining the best way to access funds to get me through this time?
Have you exhausted all other sources of income outside of your retirement savings?

3. Under what provision can I take the most money from the plan?
Loans are normally limited to the lesser of $50,000 or 50% of the participant's vested account. Coronavirus-related loans are subject to increased loan limits of the lesser of $100,000 or 100% of the participant's vested account, so long as those loans are taken before September 23, 2020.

Coronavirus-related distributions are also limited to $100,000. However, a "regular" hardship distribution is limited to an amount "necessary to satisfy an immediate and heavy financial need." If you have an exceedingly large plan account, you may be able to receive a distribution from the plan in excess of $100,000 if you seek a "regular" hardship withdrawal, so long as you otherwise qualify. It would be important, though, to consider what impact such a large withdrawal would have on your retirement readiness, especially considering that, unlike the coronavirus-related distribution, it cannot be paid back into the plan.

Note that this type of "regular" hardship withdrawal

would be subject to income tax in only the single year of the distribution, and would also be subject to the additional 10% early withdrawal tax if you are under age 59.5.

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