CARES Act – ESOP Impacts

The Coronavirus Aid, Relief, and Economic Security (CARES) Act signed on March 27, 2020, includes several provisions intended to loosen restrictions on and reduce the tax consequences of distributions and loans from retirement plans. Also included are rules waiving required minimum distributions from defined contribution plans for the calendar year 2020.

Please review the attached summary of the CARES Act for all retirement plans as a starting point to understanding these provisions. As you can imagine, there are many unique issues for ESOP plan sponsors.

A plan is not required to offer Coronavirus-Related Distributions. So an ESOP sponsor could choose to allow these distributions from the 401(k) plan but not from the ESOP due to pressures on the repurchase obligation created by the impacts of the Coronavirus.

If the company chooses to offer the distributions from the ESOP, then the following are just some of the issues that should be considered:

- Can the distribution be limited to a participant's other investment account in the ESOP?
- If the distribution will be allowed out of a participant's company stock account, how is that distribution funded—recycle, redemption, re-leverage?
- The Act provides that a participant is allowed to repay the distribution over a three year period. This repayment will be similar to a rollover contribution. The rollover could be made into another qualified plan but if the plan sponsor wants to allow the participant to roll back into the ESOP, the ESOP will need to allow for rollovers into the plan. The plan sponsor will also need to consider how the rollover funds will be invested if made to the ESOP. Will the rollover be re-invested into company stock? When and how will that occur?

We may not have black and white answers to all of the questions that may arise. However, there are not any provisions in the CARES Act that would override all of the other regulatory requirements imposed on ESOPs. In other words, any contributions made to the ESOP to recycle shares will be subject to the company and individual contribution limitations. Any redemption of shares must satisfy the requirements of the prohibited transaction exemption, specifically the requirement for an updated valuation.

The subject of an updated valuation may arise even if you are not considering implementing Coronavirus-Related distributions and/or proceeding with a stock redemption. We have received questions regarding the prudence of an interim valuation before processing distributions from your ESOP in light of the economic effects of Coronavirus. As you can imagine, this situation is different for every plan. Newport's ESOP Practice cannot provide legal or tax advice. We do, however, recommend that you consider reviewing your specific circumstances with your legal counsel and valuation professional.

NEWPORT
retirement services

In addition to considering Coronavirus-Related Distributions, now may be the time to review the provisions of your plan concerning regular distributions made to former plan participants. Depending upon the language in your plan document and distribution policy, there may be flexibility on the form and method of payments to these former plan participants, which may be adopted and avoid violation of the anti-cutback rules. These changes may be beneficial in reducing cash required to process your year-end distribution payments.

The CARES Act also includes increased participant loan limits and mandatory deferment of loan payments, as described in the attached. Most stand-alone ESOPs do not allow participant loans and are not required to begin to offer participant loans now.

We know these are uncertain times, and we want to help you navigate that uncertainty as it relates to your ESOP. Please contact your client service manager if you would like to discuss the above and other issues in more detail.