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Withdrawals and Loans from Retirement Accounts for COVID-19 Expenses

The economic repercussions of COVID-19 could reduce Americans' economic security; in response, individuals may view their retirement accounts as a source of funds to help meet current expenses. They may be able to withdraw from their defined contribution (DC) retirement accounts (such as 401(k) plans, 403(b) plans, and the Thrift Savings Plan (TSP)) or from their traditional or Roth Individual Retirement Accounts (IRAs). In addition, DC plans may allow participants to borrow from their accounts.

Withdrawals from Retirement Accounts

In general, withdrawals from DC plans are not allowed until retirement. However, DC plans may allow individuals to withdraw funds for a financial difficulty, referred to as a *hardship distribution*. Withdrawals from traditional or Roth IRAs are allowed for any reason.

Individuals who take a hardship distribution from a DC plan or withdraw from an IRA (1) must include the taxable portion of the distribution in that year's taxable income and (2) may face a 10% penalty on the amount withdrawn. The penalty is meant to discourage the use of retirement account funds for preretirement purposes. The penalty does not apply if the individual is aged 59½ years or older, or if the reason for the distribution is listed in 26 U.S.C. §72(t).

Loans from DC Plans

Loans may be preferred to early withdrawals because (1) proof of financial hardship is not required, and (2) amounts borrowed are repaid to the individual's account. However, in the case of a loan default (i.e., following job loss if the borrower fails to repay the outstanding loan balance by the deadline for that year's tax return), the loan balance must be included in taxable income, and a 10% tax penalty applies. Loans are not permitted from IRAs.

Hardship Distributions Under Current Law and Regulations

Provisions for hardship distributions under current law and regulations include the following:

- DC plans may allow—but are not required to offer—hardship distributions.

- If DC plans allow hardship distributions, the plan document must specify which situations qualify as hardship.

- Individuals must demonstrate that they are experiencing immediate and heavy financial need to take a hardship distribution and that the amount withdrawn does not exceed the financial need.

- Certain distributions are deemed to be made on account of immediate and heavy financial need. The individual does not have to demonstrate financial need if the distribution is for one of seven specified situations (26 C.F.R §1.401(k)-1(d)(3)(B)).

- Among other reasons, these deemed hardship distributions include

    - tuition, fees, and other expenses for the next 12 months of post-secondary education (this appears to exclude student loan repayments),

    - certain medical expenses in excess of 7.5% of adjusted gross income that would be deductible under 26 U.S.C. §213(d),

    - payments necessary to prevent eviction or foreclosure for a principal residence,

    - burial and funeral expenses for an individual's parent, spouse, child, or dependent, and

    - expenses and losses due to a disaster declared under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (P.L. 93-288), "provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA [the Federal Emergency Management Agency] for individual assistance with respect to the disaster."

Hardship Distributions for COVID-19 Related Expenses

It is unclear whether distributions for COVID-19 related expenses would be allowed under the hardship distribution regulation for disaster assistance. The regulation specifies that hardship distributions are allowed for employees in an area designated for individual assistance as a result of a FEMA disaster declaration. In response to COVID-19, President Trump issued an emergency declaration under the Stafford Act. In addition, FEMA indicated that the "declaration does not make direct financial assistance available to individuals." A number of states have received disaster declarations, although it is unclear if individual assistance has been approved for these states. For more information on the emergency declaration issued by President Trump in response to COVID-19, see CRS Insight IN11251, *The Stafford Act Emergency Declaration for COVID-19*.

Loans Under Current Law and Regulations

Provisions for DC plan loans under current law and regulations include the following:

- DC plans may allow—but are not required to offer—loans.
- The maximum loan amount is the lesser of half of the participant's vested account balance or $50,000.
- Loans must be repaid in level installments over five years. Longer terms are permitted if the loans are used for the purchase or construction of a principal residence.

Policy Options

Congress and the Internal Revenue Service (IRS) have several policy options that could provide relief for COVID-19 related withdrawals and loans.

Congress Could Exempt COVID-19 Related Expenses from the 10% Penalty

Congress could allow for distributions from retirement plans for COVID-19 related expenses and exempt distributions for such expenses from the 10% penalty that applies to early withdrawals. In some instances, as part of past disaster relief, Congress allowed for penalty-free distributions to individuals affected by natural disasters. Congress also allowed these individuals to (1) include the distribution in taxable income spread over a three-year period and (2) recontribute the distribution amount to their retirement account. Additionally, Congress has allowed plans to amend plan documents retroactively. Disaster distributions have been generally defined as distributions in a specific geographic area. COVID-19 related distributions could similarly be defined, or limited to individuals with specified expenses or circumstances, or such distributions could be unrestricted.

Congress Could Adjust Loan Requirements

Congress could adjust any of the loan requirements, such as increasing the maximum loan amount or extending the repayment period.

Internal Revenue Service (IRS) Could Deem COVID-19 Related Expenses as Hardship

In the absence of Congressional action, the IRS could issue regulations that specifically deem COVID-19 related expenses as qualifying for a hardship distribution. Should this occur, retirement plans that seek to (1) start offering hardship distributions or (2) include COVID-19 related expenses as a qualifying hardship situation would need to amend their plan documents.

Legislative Proposals in the 116th Congress

Section 2202 of Division A of H.R. 748, the "Coronavirus Aid, Relief, and Economic Security Act," or "CARES Act," as passed by the Senate on March 26, 2020, and by the House on March 27, 2020, as well as Section 401 of Division T of H.R. 6379, the "Take Responsibility for Workers and Families Act," as introduced on March 23, 2020, contain nearly identical provisions that would modify rules for early withdrawals and loans from employer-sponsored retirement plans for qualified individuals. Qualified individuals are defined as (1) any individual or individual with a spouse or dependent who tested positive for COVID-19, (2) any individual facing financial difficulties due to being quarantined, furloughed, laid off, or unable to work due to lack of child care or due to reduced work hours, and (3) any individual whose business closed or reduced hours as a result of COVID-19. For qualified individuals, the provisions would

- allow for penalty-free distributions of up to $100,000 from January 1, 2020, through December 31, 2020,
- increase the maximum loan limit from $50,000 to $100,000 for 180 days after the bill's enactment, and
- extend the due date by one year for DC plan loans that are in repayment from the date of the bill's enactment through December 31, 2020.

Under the proposal, individuals who take a COVID-19 distribution would include the amount in taxable income and could report it as income either in the year received or spread equally over three years. Alternatively, part or all of the distribution could be repaid to the retirement plan within three years of receiving the distribution.

Policy Considerations

Allowing individuals early access to their retirement funds might help people facing financial difficulties. Some temporary relief might be justified, particularly given current economic concerns. Allowing early access to retirement accounts also may have drawbacks. First, funds that individuals take from their retirement accounts to pay for current expenditures will not be available when the individuals retire and would not accrue investment returns in a potential market recovery. This is a concern for some because many households rely on a combination of Social Security and withdrawals from their retirement accounts as income sources in retirement. Second, suspending the penalty on withdrawals would not help individuals who are not permitted hardship or early withdrawals from their retirement accounts.

For More Information

- CRS In Focus IF11369, *Early Withdrawals from Individual Retirement Accounts (IRAs) and 401(k) Plans*
- CRS Report R40828, *An Analysis of Borrowing From Defined Contribution Retirement Plans*
- CRS Report R46279, *The Coronavirus Aid, Relief, and Economic Security (CARES) Act—Tax Relief for Individuals and Businesses*

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