STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

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SUBJECT

Coronavirus Aid, Relief, and Economic Security Act (CARES) Act-Qualified Employer Plan Loans

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), conform to Section 2202(b) of the CARES Act (Public Law 116-136) relating to loans from qualified retirement plans.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

The July 2, 2020 amendments removed provisions of the bill related to the Education Code and replaced them with the provisions discussed in this analysis.

This is the department's first analysis of the bill.

REASON FOR THE BILL

The reason for this bill is to provide relief to individuals currently suffering from unexpected economic difficulties caused by the COVID-19 pandemic.

ANALYSIS

Under the Personal Income Tax Law (PITL), this bill would amend Revenue and Taxation Code (R&TC) section 17085 to conform to Section 2202(b) of the federal CARES Act, relating to qualified retirement plan loans.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2020.

Federal/State Law

Federal Law

Loans from qualified plans

Section 2202(b) of the CARES Act modified the rules applicable to loans from qualified retirement plans by increasing the monetary limit on loans not treated as distributions to the lesser of either $100,000 reduced by the excess (if any) of the loans highest outstanding balance from the plan during the one year period ending on the day before the date on which the loan was made over the outstanding balance of loans from the plan on the date the loan was made, or the greater of the present value of the nonforfeitable accrued benefit of the employee under the plan or $10,000. These modifications apply to loans made to qualified individuals during the 180-day period beginning March 27, 2020.

This provision also delays by one year the due date for any repayment for an outstanding loan from a qualified employer plan if the due date falls during the period beginning on March 27, 2020, and ending on December 31, 2020. This same period is also not taken into account in determining the five-year repayment period and term of the loan. Section 2202(b) of the CARES Act also clarifies that amendments to any plan or annuity contract would be treated as complying with the terms of the plan during this period.

Under this section, a qualified individual is defined as an individual who:

- Who is diagnosed with the virus SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention.
- Whose spouse or dependent is diagnosed with the virus or disease by a test.
- Who experiences adverse financial consequences as a result of being quarantined, furloughed or laid off, or having a reduction in work hours reduced, being unable to work due to lack of child care, closing or reducing hours of a business owned or operated due to the virus, or other factors as determined by the Secretary of the Treasury.

The administrator of an eligible retirement plan may rely on an employee's certification that the employee satisfies the above conditions.

State Law

R&TC section 17081 conforms to federal law regarding loans from qualified plans as of January 1, 2015, and generally allows a qualified employer plan, to provide specified loans to a participant or a beneficiary that are not treated as taxable distributions from the plan if specified conditions are met, including that the maximum amount that a plan may permit as a loan does not exceed (1) the greater of $10,000 or 50 percent of the participant's vested account balance, or (2) $50,000, whichever is less, and that generally the loan be repaid within 5 years. Section 17085 of the R&TC includes specific provisions regarding Section 72 of the Internal Revenue Code, including a penalty of 2.5 percent that would apply to distributions resulting from loans from qualified plans.

Under current law, the portion of a loan from a qualified plan in excess of these amounts would be treated as a distribution, which would be required to be included in income and subject to the 2.5 percent penalty.

Implementation Considerations

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

Technical Considerations

For consistency of terminology, the following changes are recommended:

- On page 4, line 14, add "For taxable years beginning on or after January 1, 2020 before "For"
- On page 4, line 14, the term "part" should be replaced with "section."

Policy Considerations

Conforming the state's rules to the federal law would decrease the differences between federal and state tax return preparation for those years to which the provisions apply.

LEGISLATIVE HISTORY

Research of California legislative history found no legislation similar to the provisions of this bill.

PROGRAM BACKGROUND

The Joint Committee on Taxation (JCT) report for Public Law 116-136 states:

> Loan from tax-favored retirement plans
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> Qualified employer-sponsored retirement plans are permitted to provide loans to a participant or beneficiary. Employer-sponsored retirement plans are permitted, but not required, to provide loans to participants. Unless the loan satisfies certain requirements in both form and operation, the amount of a retirement plan loan is a deemed distribution from the retirement plan. Among the requirements that the loan must satisfy are that (1) the loan amount must not exceed the lesser of 50 percent of the participant's account balance or $50,000 (generally taking into account outstanding balances of previous loans), and (2) the loan's terms must provide for a repayment period of not more than five years (except for a loan specifically to purchase a home) and for level amortization of loan payments to be made not less frequently than quarterly.[1] Thus, if an employee stops making payments on a loan before the loan is repaid, a deemed distribution of the outstanding loan balance generally occurs. A deemed distribution of an unpaid loan balance is generally taxed as though an actual distribution occurred, including being subject to a 10 percent early withdrawal tax, if applicable. A deemed distribution is not eligible for rollover to another eligible retirement plan. The rules generally do not limit the number of loans an employee may obtain from a plan except to the extent that any additional loan would cause the aggregate loan balance to exceed limitations.

FISCAL IMPACT

This bill would not significantly impact the department’s costs.

[1] IRC section 72(p).

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 276 as Amended July 2, 2020
Assumed Enactment after June 30, 2020

($ in Millions)

Fiscal Year	Revenue
2020-2021	-$2.4
2021-2022	-$1.4
2022-2023	-$0.2

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

This bill would conform to Section 2202(b) of the CARES Act which would increase the amount of loans that taxpayers could take from employer retirement plans that would not be treated as a distribution.

Using available data from the JCT, it is estimated that the revenue impact to California related to Section 2202(b) of the CARES Act for taxable years 2020 and 2021 would be a loss of $845,000 and $3 million respectively.

The tax year estimates are converted to fiscal year estimates, and then rounded to arrive at the amounts reflected in the above table.

LEGAL IMPACT

None noted

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

None noted.

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