The CARES Act and Retirement Planning

April 2020

The super-sized Coronavirus Aid, Relief, and Economic Security (CARES) Act, written into law in late March of this year, provides $2 trillion of economic stimulus to individuals, families, and small and large businesses, all reeling from the effects of the global pandemic. Among its provisions are several designed for owners of most retirement accounts, including IRAs, 401(k)s, and other plans. We discuss a few of those features—which are temporary but significant—in this paper, highlighting the suspension of required minimum distributions (RMDs). Those distributions, based on asset size and investor age, are usually required of all plan owners who reached age 70½ on or before December 31, 2019, though the age was extended to 72 this year.[1]

Do I have to take out my RMD this year?

The quick answer for all plan owners to the above question is No. If your plan is subject to RMDs (most are, except for Roth IRAs[2]), you needn't withdraw them in 2020. For most investors, this is an important benefit: Not only does it leave their portfolios alone with some time to recover, but it lightens their tax burdens, since RMDs are subject to ordinary-income tax. This suspension of RMDs also (purposefully) comes at a time when their associated tax bills would be especially burdensome, since the taxes would be based on account balances as of December 31, 2019. Those balances may well be higher than most investors will see for the remainder of this year.

That said, investors *can*, of course, take out distributions this year if they wish, though those distributions will be taxed. Why might investors still wish to withdraw now from their plans? For one or both of two reasons: They need their distributions to live on and/or they expect their taxes to be so low in 2020 that they'd rather take out a distribution this year than potentially pay more in the future. However, we expect most participants to take advantage of the immediate windfall. In addition, investors who became subject to RMDs for the first time in 2019 and were waiting until April 1, 2020, to take the distribution will be able to forgo both their 2019 and 2020 withdrawals.

If you already took your 2020 distribution…you can't exactly undo it. But if you took your 2020 distribution no earlier than February 1 of this year, you may be able to roll it back into the account or roll it over to another IRA or 401(k) until July 15 and avoid paying the taxes. If you choose that route, you won't see 20% withheld for federal income taxes, which ordinarily applies to rollovers—again, courtesy of the CARES Act.

Meanwhile, investors 70½ or older can still send up to $100,000 from their IRAs directly to a charity of their choice,[3] a strategy that normally is used to avoid taxation on RMDs. While most of these investors will probably elect not to take RMDs in 2020, contributing philanthropically will allow them to reduce their IRA balances and hence taxes on future distributions if they expect hefty tax bills in the future.

If You've Inherited a Retirement Plan…

The distribution rules for non-spouse heirs who inherit IRAs, 401(k)s, and similar plans are complex and only recently revised. "Stretching" those plans over the lifetimes of heirs is no longer allowed. Instead, an heir must liquidate a plan in either five years after the owner's death if the owner hadn't yet begun taking RMDs, or 10 years if the owner had started withdrawing them.

[1] RMDs from 401(k) and other employer-sponsored plans may not be required if the participant is still working at the firm sponsoring the plan. This never applies to IRAs, however.
[2] Roth 401(k)s are subject to RMDs, though the distributions are not taxed for most participants.
[3] The age here did not go up to 72, a benefit for both investors and charitable organizations.

In either case, though, the CARES Act has conferred a one-year benefit on heirs in 2020, similar to the relaxation of RMD rules. For heirs who need to distribute plan assets over a five-year period, those five years will become six if the owner died after December 31, 2015. For heirs on a 10-year distribution cycle, 2020 will not count.

Easier Withdrawal and Lending Rules

The CARES stimulus extends beyond loosening the RMD requirement. The provisions for taking early withdrawals as well as loans from retirement plans have also been eased, offering investors routes to extra liquidity. Note that these provisions apply to owners (including those with inherited accounts) who meet certain criteria related to the pandemic. They or their spouses must have been diagnosed with COVID-19 or have experienced adverse financial consequence from the pandemic. The consensus reading of these requirements is that they will be very liberally interpreted—meaning that they'll be read as applicable to almost anyone. But plan owners should discuss these provisions of the new stimulus law with a tax professional before acting on them.

As to early withdrawals, the extra 10% tax penalty for investors younger than 59½, a long-standing feature in most plans,[4] will be waived on withdrawals up to $100,000 taken at any point in 2020.[5] Further, owners will have up to three years to replace a 2020 withdrawal free of taxes; normally, it's a one-year window.

Loans against plan assets (not allowed for IRAs but typical for employer-sponsored plans) have been similarly liberalized in 2020. Here, though, the start date is March 27—the date the CARES Act was passed—rather than January 1. Owners can borrow up to $100,000 or 100% of the vested assets in their plans, up from $50,000/50%, and the traditional five-year requirement for repayment without a tax penalty has been extended by one year. Similarly, for loans taken out earlier, the Act delays the deadlines on repayments due between March 27 and December 31, 2020, by one year.

While it may be tempting to take advantage of these easier withdrawal and loan terms, we'd generally advise against tapping a retirement account as a source of funds, unless there are no other alternatives. Retirement accounts are designed to grow assets tax-deferred or even tax-free (in the case of earnings on a Roth account) for as long as possible. They're often the most important contributors to income and capital growth in retirement; most investors should tread very carefully before invading these accounts.

Don't Do It Alone

We send our best to all those stricken around the world with COVID-19 and their families. We await good news, which we hope to hear very soon. And we're grateful for the stimulus that the new law is injecting into the financial system. But when it comes to tax-related matters, don't attempt to navigate the landscape alone. All plan owners should seek the advice of legal, financial, and tax experts before making any decisions based on the CARES Act.

[4] The penalty applies to withdrawals on any earnings in Roth accounts, though not contributions.

[5] The $100,000 limit on withdrawals and loans (see next paragraph) applies to the owner's eligible retirement plans in aggregate, not each plan if more than one is owned.

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