

Stay Afloat with Tax-Favored Coronavirus-Related Distributions

The coronavirus (COVID-19) pandemic is causing economic hardship for many people and businesses in the United States. On March 27, the \$2.2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law by President Trump. A key provision of the new law allows tax-favored treatment for people who take so-called coronavirus-related distributions from tax-favored retirement accounts. Here's the story.

Tax-Favored Distributions

IRA owners who are adversely affected by the coronavirus pandemic will be eligible to take tax-favored coronavirus-related distributions (CVDs) of up to \$100,000 from their IRAs. You can recontribute (repay) a CVD back into your IRA within three years of the withdrawal date and treat the withdrawal and later recontribution as a totally tax-free rollover.

In effect, the CVD privilege allows you to borrow up to \$100,000 from your IRAs and then recontribute the amounts any time up to three years later with no federal income tax consequences.

There are no limitations on what you can use CVD funds for during that 3-year period. For example, if you're cash-strapped, you can use the money to pay your bills and recontribute later when your financial situation has improved. Or you can help your adult kids out or pay down your home equity line of credit.

Important: The CARES Act also may allow you to take tax-favored CVDs from your employer's qualified retirement plan, such as a 401(k) or profit-sharing plan, if the plan allows it. If allowed, the tax rules for CVDs taken from qualified plans are similar to those for CVDs taken from IRAs. Employers and the IRS have lots of work to do to figure out the details about how CVDs taken from qualified plans will work. Contact a tax professional or the appropriate person with your company for more information. But be patient. It may take a while for the details to fall into place.

Ground Rules

There are seven basic rules for taking CVDs from IRAs:

1. You can take one or more CVDs up to the \$100,000 limit.
2. CVDs can come from different IRAs.
3. The 3-year recontribution period for each CVD begins on the day after you receive it.
4. You can make your recontributions in a lump sum or through multiple recontributions.
5. You can recontribute to one or several IRAs, and they don't have to be the same accounts you took the CVDs from in the first place.
6. As long as you recontribute the entire CVD amount within the 3-year window, the whole transaction or series of transactions are treated as tax-free IRA rollovers.
7. If you're under 59½, the 10% penalty tax that usually applies to early IRA withdrawals is waived for CVDs.

Plus, if your spouse owns one or more IRAs in his or her own name, he or she may be eligible for the same distribution privilege.

Qualifying Distributions

CVDs must be taken between January 1, 2020, and December 30, 2020, by an eligible individual. That means an individual:

- Who's diagnosed with COVID-19 by a test approved by the Centers for Disease Control and Prevention,
- Whose spouse or dependent (generally a qualifying child or relative who receives more than half of his or her support from you) is diagnosed with COVID-19 by such a test,
- Who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off or having work hours reduced due to COVID-19,
- Who's unable to work because of lack of childcare due to COVID-19 and experiences adverse financial consequences as a result,
- Who owns or operates a business that has closed, had operating hours reduced due to COVID-19 and has experienced adverse financial consequences as a result, or
- Who has experienced adverse financial consequences due to other COVID-19-related factors.

IRS guidance on how to interpret the last two factors is needed and is presumably forthcoming. Contact your tax advisor for the latest developments.

Failure to Recontribute CVDs

Beware: You'll be taxed on the CVD amount that you don't recontribute within the 3-year window. But you won't have to worry about owing the 10% early withdrawal penalty if you're under 59½.

You can choose to spread the taxable amount equally over three years, apparently starting with 2020. But here it gets tricky, because the 3-year window won't close until sometime in 2023. Until then, it won't be clear that you failed to take advantage of the tax-free CVD rollover deal. So, you may have to amend a prior-year return to report some additional taxable income from the CVD. The IRS is expected to issue additional guidance to clarify this issue.

You also have the option of simply reporting the taxable income from the CVD on your 2020 individual income tax return Form 1040. Again, you won't owe the 10% early withdrawal penalty if you're under 59½.

Beyond CVDs

The CVD privilege can be a helpful, flexible tax-favored financial tool for eligible IRA owners and company retirement plan beneficiaries during the pandemic. But it's just one of several financial relief measures available under the CARES Act that include tax relief. We can help you take advantage of tax relief measures that will help you get through the COVID-19 crisis.

RMD Rules Suspended for 2020

Normally, you must start taking annual required minimum distribution (RMDs) from tax-favored retirement plan accounts and from traditional IRAs set up in your name, once you reach:

- 70½ if you attained age 70½ before 2020,
- or 72 if you attain age 70½ after 2019.

Fortunately, the CARES Act suspends all RMDs that would normally be required for 2020. This suspension also applies to your initial RMD if you turned 70½ last year and didn't take that initial RMD last year. (The initial RMD is actually for calendar year 2019.) Before the CARES Act, the deadline for taking that initial RMD was April 1, 2020. Now, thanks to the CARES Act, you can put off any and all RMDs that you would have otherwise had to take this year.

For 2021 and beyond, the RMD rules will be applied as if 2020 never happened. In other words, all the RMD deadlines will be pushed back by one year and any deadlines that would have otherwise applied for 2020 will simply be ignored. Contact us if you want more information about RMD relief.

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