CARES ACT RESTORES THE CHARITABLE DEDUCTION & MAKES IT EASIER TO WITHDRAW 401(k) FUNDS

May 20, 2020

Enacted March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") allows Americans suffering COVID-19 related financial strain to more easily access money in their retirement savings plans (e.g., 401(k), 403(b), IRA, etc.). Although not yet issued, IRS CARES Act guidance will likely follow its policies and procedures for providing relief from natural disasters. See our note on Federal Income Tax Relief for Victims of Hurricanes Florence and Michael.

Summary of Retirement Plan Contribution and Withdrawal Relief Provisions

- You can Fully Deduct Charitable Contributions Made in 2020. If You Take the Standard Deduction (i.e., do not itemize) You Can Deduct Up to $300 of Charitable Contributions
- You Have Until July 15, 2020 to Make IRA or ROTH Contributions for the 2019 Tax Year
- You Will Not Incur the 10% Early Withdrawal Penalty on Retirement Plan Distributions
- You Can Pay the Income Tax Owed on Withdrawn Amounts Ratably over 3 years (2020 – 2022)
- You Can Recontribute Any Portion of the Withdrawn Funds Back Into Your Retirement Account. Recontributed Money Will Not be Taxed and it Will Not Affect Your Annual Contribution Limits ($19,000 for a 401(k), $6,000 for an IRA or ROTH)
- You Do Not Have to Take the Required Minimum Distribution From Your IRA in 2020

Reinstatement of the Full Deduction for Cash Contributions to Charity. The CARES Act reinstates the pre 2019 law which allowed taxpayers to deduct 100% of their charitable contributions. Such contributions made in 2020 are now fully deductible (i.e., taxpayers can claim a charitable deduction of up to 100% of AGI). Even if you do not itemize (i.e., you take the Standard Deduction), the CARES Act allows you to deduct up to $300 of charitable contributions.

Exemption From the 10% Early Withdrawal Penalty. Normally, anyone (retired or otherwise) who withdraws money from a retirement plan before they reach age 59 ½ (age 55 for 401(k)s) must pay a 10% early withdrawal penalty in addition to the ordinary income tax due. The CARES Act however removes the 10% penalty. Therefore, if you are a <u>*qualified individual*</u> *affected by the coronavirus pandemic*, you can withdraw up to $100,000 by December 30, 2020 from your retirement plan without incurring the 10% penalty.

You are a <u>Qualified Individual</u> if you meet at least 1 of the following requirements:

(1) You, your spouse, or 1 or more of your dependents have been diagnosed with COVID-19;

(2) You are experiencing adverse financial consequences as a result of being quarantined;

(3) You have been furloughed, laid off, or have had your work hours reduced due to the virus;

(4) You have been unable to work due to a lack of childcare as a result of the virus.

<u>Example 1</u>

Jill is a 57-year old retiree who receives a $50,000 per year pension and has $200,000 in her IRA. Since retiring, Jill has worked at Kidwatch Daycare earning $20,000 per year to supplement her pension income. Jill was recently laid off when the daycare center closed due to the coronavirus pandemic.

If Jill withdraws $20,000 from her IRA on May 10, 2020, she will not have to pay the $2,000 Early Withdrawal Penalty. Thus, her 2020 income tax owed will be **$15,400**.

	Taxable Income	Tax Rate	Tax Owed
Pension	50,000	22%	11,000
IRA Withdrawal	20,000	22%	4,400
Early Withdrawal Penalty		10%	2,000
TOTAL			17,400
TOTAL WITHOUT PENALTY			**15,400**

3 Year Tax Payment Period for Retirement Plan Distributions. While retirement plan withdrawals are still subject to income tax at ordinary income tax rates, taxpayers can elect to spread the income (and hence the income tax) ratably over a 3-year period beginning with the 2020 tax year.

<u>Example 2</u>

	2020	2021	2022
Income Received	$110,000	$50,000	$50,000
Pension	$50,000	$50,000	$50,000
IRA	$60,000	$0	$0
Income Taxed	$70,000	$70,000	$70,000
Pension	$50,000	$50,000	$50,000
IRA	$20,000	$20,000	$20,000
TOTAL TAX DUE	**$15,400**	**$15,400**	**$15,400**

If Jill decides to withdraw $60,000 from her IRA on May 10, 2020 to cover her for the next 3 years, she can elect to pay one third of the tax owed on this distribution on her 2020, 2021, and

2022 income tax returns. If she does, she will owe income tax of **$15,400** in each of the next 3 years.

Tax Refund for Money Redeposited Within 3 Years. If you later determine that you do not need the money you withdrew, you can repay some or all of the distribution back into your retirement plan. You will not be required to pay income tax on the redeposited amount as long as you replace the funds within 3 years of the date you received them. If you have already paid income tax on the money you later redeposit, you can obtain a refund by filing an amended return (Form 1040X). The redeposited funds will not affect your annual contribution limits (e.g., $19,000 for 401(k)s, $6,000 for IRAs).

Example 3

Jill eventually finds a new job and on May 1st of 2023, redeposits $12,000 of the $60,000 she took out on May 10, 2020. Since Jill's deposit occurs within 3 years, she is eligible for a tax refund on the redeposited amount. Jill files an amended 2020 tax return restating her taxable IRA withdrawal amount for that year as $8,000 ($12,000 less than the $20,000 she originally payed tax on). Once the return is processed, the IRS will send Jill a **$2,640** tax refund.

	ORIGINAL 2020 RETURN	AMENDED 2020 RETURN	CHANGE
Income Taxed	$70,000	$58,000	-$12,000
Pension	$50,000	$50,000	
IRA Withdrawal	$20,000	$8,000	
TOTAL TAX DUE	$15,400	$12,760	-$2,640