Planning in 2020: RMDs - Retirement Planning After the CARES Act

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Planning in 2020: **RMDs - Retirement Planning After the CARES Act**

The CARES Act essentially suspended required minimum distributions (RMDs) for 2020 across the board. However, there have been a lot of questions about what this means for those who already took out distributions, and the impact on taxes and inherited accounts.

It is important to remember that the CARES Act is a relief bill, and by suspending 2020 RMDs, the government is giving up short-term tax revenue to provide relief to retirees. Additionally, markets have been very volatile, and suspending RMDs gives many Americans the ability to leave their investment portfolios alone to recover over the next year.

In addition to the relief these RMD provisions provide, it also opens up some planning opportunities.

What is the 2020 RMD relief?

The bill stated that defined contribution plans, like 401(k)s, 403(b)s, 457(b) plans, and IRAs, may suspend RMDs in 2020. RMDs for 2020 were already a bit lower since 2020 is the first year in which the required beginning date switched from age 70.5 to age 72 – unless someone turned age 70.5 in 2019, in which case they owe an RMD by April 1, 2020. However, the new CARES Act allows account owners to skip both their 2019 RMD if it was their first year and had not yet made an RMD by April 1, 2020, and their 2020 RMD.

Why does skipping RMDs in 2020 matter? For most people, their IRAs and 401(k)s are funded with tax-deferred dollars. Once subject to RMDs, retirement account owners and beneficiaries have to start taking out mandatory, taxable distributions from their retirement accounts.

With many Americans struggling in 2020 because of the pandemic, having more flexibility on distributions can be beneficial. And since the markets have been extremely volatile, giving retirement portfolios another year to recover can be helpful.

It is important to note that about 20.5% of those subject to RMDs are expected to take only the minimum – most people need these distributions to live off of in retirement.[1] However, the bill now provides them the option to choose for 2020 if they want to take out money or not.

There is some confusion as to if this flexibility pertains to inherited IRAs and 401(k)s. The bill suggests that it pertains to any RMD from any individual-account retirement plan, which should include inherited IRAs or 401(k)s. This position is bolstered by the purpose of the bill itself: to provide relief to Americans during this pandemic emergency. However, what is clear is that defined benefit plans are NOT exempt from RMDs in 2020. Traditional defined benefit plans are likely to be in payout by age 70.5, but cash balance pension plans could still be sitting out there past age 70.5. A cash balance plan would need to have its RMD taken out by the end of year 2020. In essence, treat all defined benefit plans as if nothing changed.

This is not a technical tax bill looking for revenue, so expect the IRS and the government to interpret the bill under that notion.

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The bill also deals directly with specific types of inherited accounts, such as those going to an estate, charity, or certain type of trust at death. These types of beneficiaries – non-designated beneficiaries who inherit a retirement account from a decedent who died before their required beginning date – typically have to distribute the account within five years of the death of the owner. The CARES Act states that if one of the five years is 2020, beneficiaries get an extra year, turning a five-year rule into a six-year rule. This group usually gets less favorable RMD rules than other beneficiaries, so we can expect that inherited RMDs across IRAs and 401(k)s are pushed off for 2020.

What if someone already took an RMD?

If someone already took an RMD for 2020, which some people do in the first week of January, they're likely out of luck. There is no provision in the bill that allows someone to put back a distribution taken in 2020. The distribution will still be treated as such and therefore taxable.

For those who won't need their RMDs and have them set up automatically, now is a good time to call an advisor or service provider and suspend their RMDs for 2020.

However, one strategy that can be used is if someone took an RMD from an IRA or 401(k) after February 1, 2020, they can do a rollover to an IRA and not have it treated as a taxable distribution in 2020. Usually this rollover must be done within 60 days (thus the name "60-day rollover"). However, the IRS changed the 60-day rollover rule to extend to July 15 for any distributions taken between February 1 and May 15 – giving you extra time in many cases to complete your rollover.

Let's say you had an RMD of $15,000 for 2020 and you took it out on March 15, 2020. You have until July 15 to roll over $15,000 into an IRA. If you do, it will count as a 60-day rollover and the amount won't be taxable. If the deadline passes, you might not be able to get the money back into an IRA. Remember that you only get one IRA to IRA rollover per 12 months, but you have an unlimited number of 401(k) to IRA (or vise-versa) rollovers each year.

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Typically, you cannot roll over or convert a required minimum distribution, so many technologies are not set up to automatically alert you of this strategy. However, since no RMDs are owed in 2020, that changes the rollover rule.

The government waived financial companies and plan providers from giving a rollover notice. It also waived the requirement for an employer plan to withhold 20% of the distribution for federal income tax if it is an eligible rollover distribution in 2020 but would not have been eligible if the RMD requirement had still applied in 2020.

Account owners might get a payment from a 401(k) this year and not receive a notice that they could roll it to an IRA. They should be able to do a rollover in most cases if it is before the July 15 deadline.

Could the Coronavirus-related distribution exception play an RMD role?

The CARES Act also created a new exception to the 10% early withdrawal penalty tax under code section 72(t) for those who take retirement distributions prior to age 59.5.

In 2020, Americans impacted by the coronavirus crisis can take out up to $100,000 from their IRA or 401(k) without penalty tax. The distribution would be subject to normal taxation rules regarding distributions.

By default, the taxable distribution is spread out over three years, but can be treated as taxable income in 2020 if desired. This might make sense if 2020 is a low-income year.

To be eligible for the exception, the account owner or their spouse needs to be diagnosed with COVID-19, or they need to experience adverse financial consequences as a result of the pandemic due to being quarantined, laid off, furloughed, have reduced housing, childcare issues, or a number of other reasons. This exception is incredibly broad as most Americans will be impacted in some way.

This new provision is not tied directly to RMD rules, but it does allow the individual to repay the amount as a qualified rollover contribution, beginning on the day after receipt of a coronavirus-related distribution.

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While this was not designed to help people repay distributions, if someone took what they thought was an RMD early in January of 2020, they could potentially treat that distribution as a coronavirus-related distribution and repay it over the next three years, or even in 2020.

However, there must be a good faith claim that the individual satisfied the requirements for a coronavirus related distribution. Generally speaking, the individual, their spouse, or a dependent must be diagnosed with COVID-19 or "experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off or having work hours reduced due to such virus or disease." So, for some retirees, if not diagnosed with the disease, it might be challenging to qualify for a coronavirus-related distribution as they might not be adversely impacted by layoffs, being furloughed, or quarantined directly.

Again, while this was not the design of this provision, it is very likely that this provision will be interpreted broadly. If you meet the requirements, it seems like most distributions in 2020 up to $100,000 can be repaid over the next three years if the owner was impacted by COVID-19. Since, there are no RMDs owed in 2020, this would now be eligible to be rolled over, too, whereas without the RMD waiver that amount would not be eligible for a rollover.

Someone could take out a Coronavirus-related distribution in 2020 of up to $100,000 and repay it in the next three years. They can file amended returns at that time to claim refunds for the taxes paid on the distribution, because once repaid, it'll be an eligible rollover and not taxable. Without the 2020 RMD waiver, it would not be eligible for a rollover as it would have been an RMD.

It is possible the IRS tries to limit this aspect to only those under age 59.5, even though nothing in the bill suggests that is required. But, since the penalty tax typically only applies to those under age 59.5, one could argue that the exception also only applies to that group.

It seems that the payback aspect of this is to give people relief to funds and an ability to pay back. I expect this provision to be interpreted broadly and include rollovers of most distributions from retirement accounts in 2020 over the next three years if the owner decides they want to repay the account.

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How does the CARES Act impact QCDs?

Most people are familiar with qualified charitable distributions (QCDs) rules. They allow someone at age 70.5 to send up to $100,000 from an IRA to a qualified charity and have that amount offset any RMDs for the year and not be treated as a taxable distribution.

While the SECURE Act changed the required beginning date for RMDs to age 72, QCDs were still allowed at age 70.5. However, if someone uses QCDs at age 70.5, they would not offset any RMDs because none are owed yet. This circumstance would be the same in 2020.

Someone can still do a QCD from their IRA or inherited IRA if they are age 70.5 or older and send money directly to a qualified charity. However, since no RMDs are owed in 2020, their amount will not offset any future RMDs, except for the fact that their account balance is now lower.

Does the new 10-year rule from the SECURE Act get impacted?

For those who were aware of the SECURE Act, the largest change it made with regards to RMDs was replacing the lifetime stretch provisions for many beneficiaries of inherited IRAs and 401(k)s with a 10-year distribution rule. The CARES Act does not directly impact these accounts.

Instead of lifetime distributions for many beneficiaries starting in 2020, there are no RMDs or 10-year distribution rules in effect yet. The 10-year period starts in the year after the death of the retirement account owner. So, if someone died January 1, 2020, and wanted to leave their IRA to their adult kid, the 10-year rule would start in 2021. The beneficiary has until the end of the 10th year to withdraw the entire account. If the original owner's account was subject to RMDs, one would be taken the year of death as if the owner was still alive. But, because of the CARES Act the beneficiary would not have to take an RMD in 2020.

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The CARES Act was designed to provide relief to Americans who are struggling due to the economic, emotional and physical toll the coronavirus is causing. The goal of suspending RMDs is to give people more control over their funds and to reduce having to sell investments and create a taxable event during a time of emergency.

This will allow many retired Americans to ride out the storm with their retirement accounts for the next year. It is important to remember this is just one set of provisions in an otherwise gigantic relief package totaling over $2 trillion. It is not expected that the RMD relief alone will put people in a secure place, but is a step toward providing widespread relief ■

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[1] https://www.cnbc.com/2020/01/03/how-changing-required-minimum-withdrawals-affects-retirement-accounts.html

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