North American Management

Your True North

SPRING 2020
PLANNING NOTE

The CARES Act Will Help Americans Weather This Storm

2020 has been an extraordinary year so far. COVID-19 has upended daily life and the economy, and we are all coping with the fallout: increased health risk, social distancing, workplace shutdowns, potential job losses, and school closings. During this turmoil, we offer our heartfelt thanks to the health care workers, grocery and pharmacy clerks, truck drivers, and all others who continue to put their health at risk to provide essential, invaluable services to us.

The U.S. government has also taken an active role in providing assistance to individuals and businesses affected by the fallout from COVID-19. The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") is a stimulus package recently signed into law that provides liquidity, grants, loans to critical businesses, tax incentives, and other provisions to help Americans weather the social and economic storm caused by the shutdown.

Relief for Individuals and Families

The CARES Act provides stimulus payments to households of up to $1,200 per individual and $500 per child under age 17. These payments are subject to 2020 income limits, but since total current year income is not known, checks will be issued based upon income reported on your most recent federal return. For most taxpayers, that will be their 2018 or 2019 return. Individual filers reporting less than $75,000 ($150,000 for joint filers) will receive the full amount, with the benefit completely phased out if reported income exceeds $99,000 ($198,000 for joint filers). When 2020 returns have been filed, if taxpayers qualified for more than the payment received, a reimbursement payment will be issued. Taxpayers who qualified for less than the payment they received will not be required to return excess funds. If you have not filed a 2018 or 2019 federal tax return, or were not otherwise required to file a 2019 federal return, you can claim your stimulus payment by providing the necessary information to the IRS here.

The deadline for almost all required tax actions typically due on April 15 of this year has been extended to July 15. These include the filing of all federal and most state income tax returns and any final payments due for tax year 2019.[1] Also extended to July 15 are the April 15 and June 15 estimated federal tax payments and deadline to make any contributions to your Traditional and Roth IRAs for the 2019 tax year. No extra filing is required for these extensions — they are automatically granted to all taxpayers. If you will receive a refund this year, it's advisable to file sooner than July 15 while taxpayers subject to payments should take advantage of the extra three-month grace period.

The CARES Act also relaxes the rules on defined contribution plans, i.e., traditional IRAs, SEP-IRAs, 401(k) plans, etc. Required minimum distribution (RMD) rules for 2020 have been suspended. If you haven't taken your RMD yet this year, and do not rely on the funds for

[1]As of April 22, 2020, Hawaii, Idaho, Iowa, Mississippi and Virginia have elected non-July 15 filing dates. Please reference https://www.taxadmin.org/state-tax-agencies for more information.

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living expenses, you can elect to skip your RMD, allowing the funds to remain in your account until December 31, 2021. Suspending your RMD will limit the amount of taxable income you recognize in 2020 as well as give your account the opportunity to recover from the recent drop in market value. If you have taken a large RMD within the past 60 days, it is possible to return the funds, following the 60-day rollover rule. It is important to note this rule does not apply to inherited IRAs; any funds withdrawn from an inherited IRA this year will remain taxable.

Hardships and Loans

Withdrawals from certain retirement plans such as 401(k)s and traditional IRAs have been temporarily made easier via the CARES Act. Early distribution and loan provisions are available to qualified participants who have been impacted by COVID-19, including a diagnosis for you, your spouse, or dependent, or those who have experienced financial distress due to a layoff, furlough or inability to work, including loss of childcare. Eligible participants can withdraw up to $100,000 in total from retirement plans in 2020 without having to pay the 10% penalty tax (prior to age 59½). The mandatory 20% withholding tax requirement is also suspended and the IRS allows you to spread the income taxes due on the distribution over a three-year period. If your economic situation improves following the withdrawal, and you return the funds to your qualified plan within three years, you will not owe any taxes until you start taking normal distributions during retirement.

The maximum loan amount a participant can now take from an employer-sponsored plan has increased from 50% of your vested balance up to 100%, or $100,000, whichever is less. The increased limit is available to any loans taken out during the six-month period from March 27 to September 23, 2020. You have five years in which to repay the loan back to the plan, but you can forgo repayment in 2020 and start the five-year clock in 2021.

While it may be tempting to take an early retirement plan distribution or loan to help provide some monetary relief to yourself or family members, this is only recommended for a true emergency situation. Any early withdrawal, even if repaid, will impact long-term financial goals. While we cannot predict future valuations, selling equities following the market drop is not a recommended investment strategy. Withdrawn funds will not grow if not invested and any repayments will be made with after-tax dollars. This could result in individuals having to save more aggressively, or work a few years longer, before being able to comfortably retire.

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Charitable Deductions and Cash Gifts

If you are in the fortunate situation to be able to donate to charities, the CARES Act provides a universal deduction for 2020. Taxpayers who do not itemize their deductions can now take a deduction of up to $300 for gifts made to qualified charitable organizations (gifts to donor-advised fund or private foundations are not covered). This special deduction is only for gifts of cash; gifts of securities or tangible property will not qualify.

The adjusted gross income limitation for cash gifts has been increased from 60% to 100%, so for 2020, there is no limit on the amount of cash gifts you can deduct. While high standard deductions and the $10,000 limit on deducting state and local taxes usually preclude many from itemizing, 2020 could provide some individuals with the ability to fund a donor-advised fund with enough cash to pre-fund projected gifting goals for future years while also providing the tax benefit of itemized deductions.

Roth IRA Conversions Still Attractive

Amid all of the uncertainty and change this year, there is one planning strategy that could be very promising for preserving and growing family wealth: a Roth IRA conversion. With no RMD requirements, taxpayers may find themselves in a lower tax bracket than anticipated. This makes converting all or part of your Traditional IRA balance more attractive. Paying taxes on converted assets whose values may be down from their peak, and positioning those assets to grow tax-free over your lifetime, could help you pursue long-term financial goals for your family.

Roth IRAs are also a great defense to one of the provisions of the Setting Every Community Up for Retirement Enhancement legislation ("SECURE Act") enacted in January of this year — the loss of the "stretch" IRA. Pre-SECURE Act, non-spousal IRA beneficiaries could elect to spread RMDs over their own life expectancy. Now, most non-spousal beneficiaries are required to fully distribute inherited IRA assets within 10 years of the original owner's death. For some beneficiaries, especially low-wage earners, the tax liability of recognizing RMD income from Traditional IRAs could be difficult to manage. Making the decision now to do a Roth conversion could alleviate the tax burden your children may unknowingly inherit. More details on the SECURE Act.

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Protections for Small Businesses

The CARES Act also provides assistance to small businesses in the form of the Paycheck Protection Program ("PPP"). Initially funded with $349 billion, the PPP was established to provide low-interest loans to small businesses, administered by the Small Business Administration ("SBA"), to help keep their employees on the payroll. The SBA will forgive loans if payroll is continued for eight weeks and funds are used for payroll, rent, utilities, and other qualifying expenses. While cancellation of debt typically creates taxable income to the borrower, the CARES Act provides that forgiveness of any loans extended via the PPP will be completely tax-free.

Due to overwhelming demand, PPP funds were exhausted within the first 14 days and the SBA has stopped taking new applications from lenders. On April 21, the U.S. government reached a deal on an additional relief package that includes $310 billion in funds to aid small businesses. Small business owners who missed out on the first round of aid now have a second chance to help keep their business afloat.

If you would like more information about how provisions of the CARES Act may apply to your financial situation, or help with retirement distributions or other planning needs, please contact your Wealth Advisor or me at any time. We are always here to help.

Disclosure