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COVID-19: CARES Act Allows $100,000 Tax-Free IRA Grab and Repay

More Relief: Retirement Account Required Minimum Distribution Rules Suspended for 2020

The $2 trillion COVID-19 economic recovery bill finally made it through Congress and was signed into law by President Donald Trump on March 27.

The legislation is titled the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). It's a daunting 880 pages long, but it contains good news for individuals and businesses, including meaningful tax relief.

This article explains two tax relief measures that can potentially benefit IRA and retirement account owners. Here goes.

COVID-19-Related Distributions from IRAs Get Tax-Favored Treatment

If you are an IRA owner who has been adversely affected by the COVID-19 pandemic, you are probably eligible to take tax-favored distributions from your IRA(s).

For brevity, let's call these allowable COVID-19 distributions "CVDs." They can add up to as much as $100,000. Eligible individuals can recontribute (repay) CVD amounts back into an IRA within three years of the withdrawal date and can treat the withdrawals and later recontributions as federal-income-tax-free IRA rollover transactions.[1]

In effect, the CVD privilege allows you to borrow up to $100,000 from your IRA(s) and recontribute the amount(s) at any time up to three years later with no federal income tax consequences.

There are no income limits on the CVD privilege, and there are no restrictions on how you can use CVD money during the three-year recontribution period.

If you're cash-strapped, use the money to pay bills and recontribute later when your financial situation has improved. Help your adult kids out. Pay down your HELOC. Do whatever you want with the money.

CVD Basics

Eligible individuals can take one or more CVDs up to the $100,000 aggregate limit, and these can come from one or several IRAs. The three-year recontribution period for each CVD begins on the day after you receive it.

You can make recontributions in a lump sum or make multiple recontributions. You can recontribute to one or several IRAs, and they don't have to be the same account(s) you took the CVD(s) from in the first place.

As long as you recontribute the entire CVD amount within the three-year window, the transactions are treated as tax-free IRA rollovers. If you're under age 59 1/2, the dreaded 10 percent penalty tax that usually applies to early IRA withdrawals does not apply to CVDs.[2]

If your spouse owns one or more IRAs in his or her own name, your spouse is apparently eligible for the same CVD privilege if he or she qualifies (see below).

Do I Qualify for the CVD Privilege?

That's a good question. Some IRA owners will clearly qualify, while others may have to wait for IRS guidance. For now, here's what the CARES Act says.[3]

A COVID-19-related distribution is a distribution of up to $100,000 from an eligible retirement plan, including an IRA, that is made *on or after January 2, 2020, and before December 31, 2020,* to an individual

- who is diagnosed with COVID-19 by a test approved by the Centers for Disease Control and Prevention; or

- 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; or

- who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, or forced to reduce work hours due to COVID-19; or

- who is unable to work because of a lack of child care due to COVID-19 and experiences adverse financial consequences as a result; or

- who owns or operates a business that has closed or had operating hours reduced due to COVID-19, and who has experienced adverse financial consequences as a result; or

- who has experienced adverse financial consequences due to other COVID-19-related factors to be specified in future IRS guidance.

We await IRS guidance on how to interpret the last two factors. We hope and trust that the guidance will be liberally skewed in favor of IRA owners. We shall see.

What If I Don't Recontribute a CVD within the Three-Year Window?

Another good question. You will owe income tax on the CVD amount that you don't recontribute within the threeyear window, but you don't have to worry about owing the 10 percent early withdrawal penalty tax if you are under age 59 1/2.

If you don't repay, you can choose to spread the taxable amount equally over three years, apparently starting with 2020.[4]

Example. Tomorrow you withdraw $90,000 from your IRA, and you don't recontribute it and don't elect out of the three-year spread; you have $30,000 of taxable income in years 1, 2, and 3.

Here it gets tricky, because the three-year recontribution 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 tax return to report some additional taxable income from the three-year spread. The language in the CARES Act does not address this issue, so the IRS will have to weigh in. Of course, the IRS may not be in a big hurry to issue guidance right now, because it has three years to mull it over.

You also have the option of simply electing to report the taxable income from the CVD on your 2020 Form 1040. You won't owe the 10 percent early withdrawal penalty tax if you are under age 59 1/2.[5]

Can the One-IRA-Rollover-Per-Year Limitation Prevent Me from Taking Advantage of the CVD Deal?

Gee, you ask a lot of good questions. The answer is no, because when you recontribute CVD money within the three-year window, it is deemed to be done via a direct trustee-to-trustee transfer that is exempt from the oneIRA-rollover-per-year rule. So, no worries there.[6]

Can I Take a CVD from My Company's Tax-Favored Retirement Plan?

Yes, if your company allows it. The tax rules are similar to those that apply to CVDs taken from IRAs.[7]

That said, employers and the IRS have lots of work to do to figure out the details for CVDs taken from employersponsored qualified retirement plans. Stay tuned for more information.

More Good News: Retirement Account Required Minimum Distribution Rules Are Suspended for 2020

In normal times, after reaching the magic age, you must start taking annual required minimum distributions (RMDs) from traditional IRAs set up in your name (including SEP-IRA and SIMPLE-IRA accounts) and from taxfavored company retirement plan accounts. The magic age is 70 1/2 if you attained that age *before 2020* or 72 if you attain age 70 1/2 *after 2019*.[8]

And you must pay income tax on the taxable portion of your RMDs. Ugh![9]
Thankfully, the CARES Act suspends all RMDs that you would otherwise have to take in 2020.

The suspension applies equally to your initial RMD if you turned 70 1/2 last year and did not 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 otherwise would have had to take this year. Good!

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 otherwise would have applied for 2020 will simply be ignored.[10]

Takeaways

- The CVD privilege can be a very helpful and very flexible tax-favored financial arrangement for eligible IRA owners.
- You can get needed cash into your hands right now without incurring the early withdrawal penalties.
- You can get needed cash into your hands right now without incurring the early withdrawal penalties.
- You can then recontribute the CVD amount anytime within the three-year window that will close sometime in 2023—depending on the date you take the CVD—to avoid any federal income tax hit.

The suspension of RMDs for this year helps your 2020 tax situation, because you avoid the tax hit on RMDs that you otherwise would have had to withdraw this year.

1 CARES Act, Sections 2202(a)(2) through 2202(a)(5).

2 Basically, the CVD withdrawal and recontribution rules are the same as for IRA withdrawals and subsequent rollovers, under IRC Section 408(d)(3), except you get three years to put CVD money back into your IRA to avoid triggering a tax bill—instead of the 60-day recontribution window that applies under the regular IRA rollover rules. See Sections 2204(a)(3)(A) and 2204(a)(3)(C) of the CARES Act. The 10 percent early withdrawal penalty tax is imposed by IRC Section 72(t), but Section 2202(a)(1) of the CARES Act exempts CVDs from the 10 percent penalty tax.

3 CARES Act, Section 2202(a)(4)(A).

4 CARES Act, Section 2202(a)(5)(A).

5 CARES Act, Sections 2202(a)(1); 2202(a)(5)(A).

6 CARES Act, Section 2202(a)(3)(C); IRS Announcements 2014-15; 2014-32.

7 CARES Act, Sections 2202(a(3)(A); 2202(a)(3)(B).

8 IRC Section 401(a)(9).

9 If you don’t take at least the RMD amount for the year, you can get slammed with a 50 percent penalty tax on the shortfall, under IRC Section 4973.

10 CARES Act, Section 2203.