CARES Act Impact on Retirement Investors

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The CARES Act, was signed into law, making it the largest fiscal stimulus bill ever passed in U.S. history. The Act is going to provide $2 trillion of relief to small businesses, industries, and individuals who have felt the impact of COVID-19. For context, this stimulus bill is roughly 10% of total United States GDP. In addition to the stimulus, there are some important IRA rules going into place. This article intends to report, analyze, and put in context the key provisions from the CARES Act.

Individual Retirement Accounts and RMDs

To start, generally, an individual who is 72, with a traditional IRA must take a required minimum distribution, RMD, the CARES Act now allows these investors to not take this RMD. This same provision does apply to those who are beneficiaries of inherited IRAs who also have to take an RMD. This can provide a potentially significant tax break; investors can now leave tax-deferred money in retirement accounts and not pay the taxes associated with their 2020 distribution.

What if you have already taken your 2020 RMD? You may be able to roll the money back into your retirement account if it is within 60 days of the distribution. An important note, if you have already done another 60-day rollover within the past calendar year, you are no longer eligible to take advantage of the 60-day rule.

What if you took your RMD very early in 2020 and have passed the 60-day window? There is another option. You can roll your money back into your retirement account any time over the next three years (2020, 2021, 2022) if it can be shown that you were impacted by the COVID-19 crisis as stated by the CARES Act guidelines.

Roth IRA Conversions

Another potential opportunity lies in the Roth IRA conversion. In most cases, if an IRA holder is 72 or older have to take an RMD from their account then pay the taxes associated with that distribution. As discussed above, the RMD for 2020 is suspended. Now, one can look at this and leave the money in there for another year and take the RMD next year, however, there is another thought on this. Given the circumstances, now knowing you are not required to take this money out, you can use this already expected distribution for a Roth IRA conversion. So, you may now feel required to take a “Roth Distribution”, take the money out for the purposes of a Roth conversion not an RMD. Typically, you have to take RMDs out before you can do a Roth conversion. If it was an RMD, you still pay the tax, but you can’t convert the money into a Roth. Now, with the RMD holiday, the first pre-tax dollars you take out, you will pay the tax, and convert it. You can convert more before being pushed into a higher tax bracket. The CARES Act creates the planning strategy of completing a Roth conversion now that may not have made sense if it were not for these unusual times. The provision in conjunction with the lower tax rates from the TCJA of 2018 make a Roth conversion a very good opportunity for investors who would otherwise take an RMD.

Granted you will pay taxes on distribution, but with the purpose of converting it to a Roth and never paying taxes on it again (under current law). To highlight those tax benefits, the Roth IRA conversion would be occurring when the overall stock market is down sharply from its 2019 year-end value. The future potential growth would occur in your Roth IRA, so it would be tax-free also, no RMD is required from Roth IRAs. On top of that, it would further lower your future RMD amounts from your traditional IRA and the tax implications that exist with an RMD.

The practicality of a Roth Conversion

One reason a conversion might make sense for you is if you expect to be in a higher tax bracket after you retire than you are now. This may happen, for example, if your income is unusually low during a particular year or if tax rates substantially rise in the future. Considering there is no cap on how much can be converted from traditional to Roth, it would be prudent to evaluate this opportunity for future tax savings.

Another reason that a Roth conversion may appeal to an investor is that Roth IRAs, unlike traditional, do not have the RMD attached to them after you reach age 72. So, if you're fortunate enough and do not have the need to withdrawal money from your Roth IRA, you can let it continue to grow until you have to draw from it or leave it to your heirs. Speaking of advanced age, if you end up still earning eligible income at that age, you can continue to contribute to a Roth IRA and gain tax-free growth on that money.

Other Tax Savings Opportunities

Another tax savings opportunity for investors would be a charitable IRA rollover. If you’re 72 or older this year, you can donate up to $100,000 straight from your IRA to charity in a charitable IRA rollover, or a charitable qualified distribution. Under “normal” circumstances, this would need to go towards an RMD. If you give to charity and take the standard deduction, the charitable IRA rollover still leaves you with tax savings, even though you don’t have to take the required minimum distribution.

Given how uncertain our everyday lives have become as a result of COVID-19, the CARES Act aids the burden of finances for many in America. It also provides investors with an opportunity to make smart, financial and tax planning decisions that may lower or defer tax liability. Please reach out to your financial advisor or tax professional for any questions or clarifications.

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