Q/A: Update on RMD Rules and IRA Planning in 2020

On March 26, 2020, in the wake of the COVID-19 pandemic, Congress overwhelmingly passed the CARES Act that included several favorable rules affecting IRAs in 2020. These rules were passed to grant relief to taxpayers struggling with sudden unemployment and economic upheaval.

On June 23, 2020, the IRS issued guidance (Notice 2020-51) clarifying that all RMDs taken in 2020 can be returned to the IRA they were taken from by August 31, 2020. The relief applies to all types of IRAs, including inherited IRAs, and other defined contribution retirement accounts. The relief applies even if the RMD was taken in monthly installments and if the rollover would normally violate the one-rollover-per-year rule. This relief also provides an opportunity to consider Roth conversions, unwind a concentrated position or realize capital gains in a year with potentially lower tax rates and brackets.

With the rapid and sweeping changes passed by the government, we collected questions that are top-of-mind for our clients as we plan for 2020.

How has the CARES Act affected Required Minimum Distributions in 2020?

Under normal rules, IRA owners who turned 70 ½ by December 31, 2019 must take a Required Minimum Distribution (RMD) from their IRAs in 2020.[1] However, the CARES Act suspended RMDs for 2020 to allow owners who do not need the money to leave the funds invested. Anyone who would normally be required to take an RMD this year is not required to do so. This rule applies to all types of IRAs including inherited IRAs, and other defined contribution plans:

- Traditional IRAs, Roth IRAs, and Inherited IRAs
- SIMPLE and SEP IRAs
- 401(k) and 403(b) plans
- Governmental 457 plans

What if I already took my RMD? Can I put it back?

Yes. The CARES Act and subsequent IRS guidance states that IRA owners who withdrew RMDs in 2020 may return all of the withdrawn funds back into the same IRA by August 31, 2020. In that case, none of the withdrawn RMDs will count as taxable income in 2020. This is true even if the withdrawal occurred more than 60 days ago or if you took more than one installment of your RMD this year. See IRS Notice 2020-51 (6/23/2020).

What if income taxes were withheld?

Tax withholdings that cannot be reversed will count as a taxable withdrawal from the IRA for 2020, but you will be given credit for the taxes withheld. However, you may wish to use other funds to complete the full rollover. If so, any taxes withheld will still be credited as a tax payment for this year.

[1] For anyone turning 70 ½ after December 31, 2019, the age for RMDs has been moved to 72 by the SECURE Act of 2019.

What if I made a Qualified Charitable Distribution (QCD) from my IRA in 2020?

The special rules for rolling over RMDs in 2020 do not apply to QCDs. Moreover, a QCD cannot be reversed. A QCD will show up as a regular distribution on a 1099-R but is excluded from gross income on your tax return. You can still make a QCD this year. However, since RMDs are not required in 2020, you might wish to consider whether a QCD still makes sense or whether using other assets (such as appreciated stocks) is a better vehicle for charitable giving in 2020. Note also that the CARES Act increased the deduction limitations on cash contributions to charity in 2020.

Do the special rules for 2020 also apply to inherited IRAs?

Yes. Although normal rules prohibit rollovers to inherited IRAs, recent IRS guidance states that for 2020, RMDs taken from an inherited IRA in 2020 may be returned to the same IRA before August 31, 2020. See IRS Notice 2020-51.

How does this impact beneficiaries taking distributions under the 5-year rule?

For non-designated IRA beneficiaries (non-individuals including charities, estates, and certain trusts) subject to a 5-year distribution period starting the year after year of death, the CARES Act allows the 2020 distribution to be skipped. This impacts beneficiaries inheriting in 2015 and later. For example, a non-designated beneficiary who inherited in 2018 would have started the 5-year clock in 2019, completing in 2023. In skipping 2020, the new year of final distribution year is 2024.

Is it a good idea to return my RMD to my IRA or retirement plan?

The answer depends on your situation. The waiving of RMDs in 2020 creates an opportunity for planning in a year where you may be in a lower tax bracket, if you do not need the RMD to meet living expenses. The planning opportunities include considering a Roth conversion (see next question), unwinding highly appreciated stocks or a concentrated position in a taxable account, or taking more capital gains under a long-term portfolio management strategy.

If you have the other resources to fund living expenses such as a taxable account or savings, you can take funds from those accounts instead of your IRA. Raising cash from a taxable account means you may owe capital gains taxes if you sell appreciated stocks or other assets to raise cash, but long-term capital gains rates are generally more favorable and result in a lower net tax cost compared to the taxes on ordinary income.

We recommend consulting with your tax advisor and your portfolio management team before making a decision.

Should I do a Roth conversion in 2020?

A Roth conversion should be considered in 2020 because (1) there are no RMDs this year (which means you might be able to better absorb the tax on the conversion) and (2) market volatility could offer a reduced tax bite on a lower conversion amount, as well as a provide an opportune window to invest the Roth dollars.

You may convert your traditional IRA to a Roth IRA but, in so doing, you will realize taxable income on the amount converted. Generally, we advise paying this tax with funds outside the IRA to maximize long-term tax deferral. The benefits of a Roth IRA include tax-free growth and withdrawals, and no RMDs if you (or your spouse) are the owner.[2] While we cannot predict future tax rates, current tax rates are low compared to historical tax rates. Further, the current tax brackets under the Tax Cuts and Jobs Act are set to expire in 2025, after which point income tax rates may increase substantially. Choosing to convert some traditional IRA dollars at current tax rates, may be a good option in preparation for higher tax rates in the future.

[2] However, after your death, your non-spouse beneficiary is required to take an RMD (or, if the owner died after Dec. 31, 2019, to withdraw the entire IRA by the end of the 10 year after death unless certain exceptions apply).

Finally, if your children or other non-spouse beneficiaries will be inheriting significant IRA assets, a traditional IRA under current rules will subject them to a 10-year distribution period. For beneficiaries in high-tax states or in high income tax years, inheriting a traditional IRA can significantly increase their tax burden. While an inherited Roth IRA is also subject to a 10-year drawdown period, the beneficiary is inheriting an asset that can grow tax-deferred for 10 years without owing federal or state income taxes on distributions.

Any conversion to a Roth IRA requires a careful analysis of the numbers and consideration of the long-term impact, including the current and anticipated tax brackets of the current owner, surviving spouse, and beneficiaries. Note that a Roth conversion should be done by a trustee-to-trustee transfer and not a rollover. If you wish to return an RMD taken earlier this year and do a Roth conversion, consult your portfolio management team or tax advisor.

What relief is available if I need to take an early withdrawal from my IRA?

The CARES Act allows IRA owners who have been affected by COVID-19 to withdraw up to $100,000 from an IRA in 2020 without any tax withholding and to spread the tax liability over three years. The Act also allows you to recontribute those funds back into the IRA within the three-year period and avoid the tax altogether. Furthermore, if you are under age 59 ½, the Act waives the 10% penalty tax on early withdrawals as long as you meet the CARES Act requirements. See IRS Notice 2020-50 (6/20/2020).

The 2020 tax changes are complex and continue to change. In addition, federal tax laws enacted in 2017 and 2019 create additional complexity for tax planning this year, especially for IRA owners. We invite you to contact your Portfolio Manager or Client Advisor at 1919 Investment Counsel about these developments and planning opportunities.

WARWICK M. CARTER, JR
Principal, Senior Wealth Advisor

Warwick M. Carter, Jr. is a Principal at 1919 Investment Counsel based in New York. As a Senior Wealth Advisor, his primary focus is generational wealth planning for high net worth individuals and families. He also advises on philanthropic planning. When giving advice, Warwick takes a comprehensive approach to assessing all aspects of a client's tax, financial and family situation. Warwick works closely with Portfolio Managers and Client Advisors in all of our offices to integrate wealth strategies with a client's investments. He regularly meets with outside advisors to devise appropriate solutions that will help grow wealth in a tax-aware way over the long term.

Warwick is a graduate of Denison University and the Columbus School of Law at The Catholic University of America. He also holds a master's in taxation from Georgetown University. He is admitted to the bar in New York and the District of Columbia. Warwick is also a member of the New York State Bar Association and the Society of Trust and Estate Practitioners (STEP).

Email address: wcarter@1919ic.com

LU HAN, CFA, CFP®
Principal, Senior Client Advisor

Lu Han is a Principal and Senior Client Advisor at 1919 Investment Counsel. Her primary focus is financial planning for individuals and families. Lu takes a comprehensive approach to assessing all aspects of a client's financial situation, including retirement planning, goal funding, cash flow analysis, insurance reviews, college savings, and estate planning. She partners with Portfolio Managers to identify and integrate meaningful solutions with investment management, and to interface with clients on a regular basis to provide ongoing financial planning services as a part of the firm's wealth management services.

Lu joined the firm from UBS Financial Services Inc., where she was a Financial Planning Specialist working with financial advisors to deliver planning and advice to clients. Lu is a Certified Financial Planner®, a CFA Charterholder, and holds a B.A. in English and Psychology from Barnard College. She enjoys rock climbing, hiking, running, and traveling.

Email address: lhan@1919ic.com