The Advanced Consulting Group

White paper

What do I do now: Planning tips for individuals dealing with the financial effects of the coronavirus

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Key highlights

- The new coronavirus disaster declaration exception allows for accessing retirement accounts without a penalty.
- The CARES Act waived required minimum distributions from qualified plans and IRAs for 2020.
- By purchasing a life insurance based long-term care policy, an individual will have dedicated LTC benefits no matter when care is needed.

In this time of anxiety around so many things, there are several planning ideas advisers and clients can consider to help manage their income, retirement and estate plans effectively.

Access to retirement accounts under age 59½

Coronavirus disaster declaration exception

If an individual needs access to their retirement funds, whether qualified plan or IRA, prior to age 59½ because of the current economic situation, then they could use the new coronavirus disaster declaration exception to avoid the 10% tax on premature distributions. This waiver is part of the CARES Act, which recently became law.

The 10% tax for distributions prior to age 59½ is waived for distributions up to $100,000 from qualified plans and IRAs, but not nonqualified annuities, for coronavirus-related purposes. While the distribution is still taxable, the taxable amount attributable to such distributions would be subject to tax over three years. The taxpayer may recontribute the funds to an eligible retirement plan within three years without regard to that year's cap on contributions. A coronavirus-related distribution is a distribution made to an individual:

- Who is diagnosed with COVID-19;
- Whose spouse or dependent is diagnosed with COVID-19; or,
- Who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, having work hours reduced, being unable to work due to lack of child care due to COVID-19, closing or reducing hours of a business owned or operated by the individual due to COVID-19, or other factors as determined by the Treasury Secretary.

Age 55 exception
If an individual needs money and can't qualify for the COVID-19 exception mentioned or needs more than that exception's limit, then the individual could use the age 55 exception, but there are some limitations to be aware of with this exception.

For instance, the age 55 exception only applies to qualified plans, it does not apply to IRAs or nonqualified annuities and certain criteria must be met to qualify.

To utilize this exception the plan participant must have worked into the year they turned age 55 for the plan sponsor of the plan from which they will be taking a distribution. Then after separating from service, the former employee can take a withdrawal from their plan account and claim the exception to the 10% pre-59 ½ distribution tax (the distribution will still be taxable). Typically, the participant claims the exception on IRS Form 5329 as most qualified plans do not report this type of distribution as a known exception.

It is important to note that the participant is not able to claim the age 55 exception for distributions from plans where they separated from service prior to age 55. For public safety employees, the age to use this exception is lowered to 50.

Finally, this exception is not new. It has been available for many years and could offer relief to some in current financial distress.

Substantially Equal Periodic Payment exception
The Substantially Equal Periodic Payment (SEPP) exception could be used if an individual does not qualify for the COVID-19 exception or wants to access a nonqualified annuity while under age 59½. This exception may be used by plan participants, IRA owners and nonqualified annuity owners.

The SEPP exception permits an individual who is under age 59½ to set-up a series of payments that can avoid the 10% tax on premature distributions:

- If the payments last for the longer of either five years or attainment of age 59½; and,
- The payments are based on the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and their designated beneficiary.

This exception, like the age 55 exception, is not new. It has been available for many years but could offer relief to some in current financial distress.

Job loss rollover strategies

There are several rollover strategies that could be useful to make a rollover as tax efficient as possible now and in the future, particularly when due to a losing a job.

Net Unrealized Appreciation (NUA)
NUA is a way for qualified plan participants to enjoy long-term capital gains treatment on the gains in the employer securities they have accumulated in their qualified plan, versus having to use standard qualified account distribution taxation — generally taxed as ordinary income — when they need to liquidate assets for current use.

Upon separation from service, the plan participant may take a distribution of company stock (in-kind) from the plan. They will pay ordinary income tax on the cost basis of this stock, not its current fair market value, when it is distributed to them. Then that company stock is placed in a nonqualified brokerage account. The owner may then sell the stock, that same day if they choose, and pay long-term capital gains tax on the difference between the date of distribution value above cost basis — potentially creating cash for them to use, if needed, to deal with current economic needs at a lower effective tax rate versus taking the same withdrawal amount directly from a qualified account.

A drawback to this strategy is that if the individual is under age 59 ½ when they receive the distribution of stock, the 10% tax for premature distribution will be due on the taxable amount of the distribution - the stock's basis in the plan, unless another exception applies.

It is important to note that the entire qualified plan balance must be rolled over to another qualified plan or IRA in the same calendar year as the in-kind distribution of stock to the participant for the NUA tax benefit to be available.

Rollover after-tax amounts in qualified plans directly to Roth IRAs
An individual who has after-tax contributions in a qualified plan can rollover those contributions to a Roth IRA.

This tactic creates a Roth IRA account with no taxable income, because the rollover to the Roth IRA is only the after-tax contributions in the plan, that can then distribute tax-free income to the Roth IRA owner or their beneficiary in the future. Distributions of gain from Roth IRAs are received tax free if the owner is over age 59½ and the Roth IRA is over five years old.

The after-tax contribution amount would also be available currently, without income tax consequences, to owner if they needed funds because of current economic conditions.

It is important to note that the entire qualified plan balance must be rolled over in the same calendar year as the rollover of the after-tax amounts to the Roth IRA. Consult and work with the plan administrator before and during the rollover process to be sure that the plan allows it and that it is done correctly.

Tax planning ideas because of the down market

Tax loss selling
The owners of nonqualified capital assets like stocks, real estate, and mutual funds, whose value is less than their cost basis, could sell those capital assets to reduce or eliminate the taxation of the sale of other highly appreciated capital assets.

If losses exceed gains, then $3,000 per year can be used against ordinary income and then carried forward until the loss is fully recaptured. Avoid repurchasing the assets sold for a loss for 30 days before or after the sale to be able to utilize the loss as a deduction against gain.

Roth conversions
Due to recent market losses, now may be a time to consider converting some pre-tax qualified dollars to Roth dollars either in a plan (if permitted) or from a pre-tax IRA to a Roth IRA so that any future appreciation would occur in the Roth account.

Roth accounts, as mentioned earlier, can be attractive as future retirement income or inheritance vehicles because of the potential tax-free nature of distributions.

Required Minimum Distribution effectiveness

Required Minimum Distributions (RMD) are waived for 2020
The CARES Act waived RMDs from qualified plans and IRAs for 2020. This waiver also includes 2019 RMDs that were required to be taken before April 1, 2020.

This waiver applies to both owners and beneficiaries of qualified plans and IRAs. It does not apply to the annual life expectancy-based payments beneficiaries must take from inherited nonqualified annuities.

RMD start age increased to 72
Once RMDs must resume in 2021 another important planning rule change to be aware of is the change in the starting age for required minimum distributions (RMD) for IRA owners and most qualified plan participants from age 70½ to age 72. This change was part of the SECURE Act passed in late 2019.

The age 72 starting point for RMDs applies to those individuals who turn age 70½ in 2020 or thereafter. For owners who turned age 70½ prior to 2020 RMDs must continue as before, mindful of the 2020 RMD suspension mentioned above.

Qualified Charitable Distributions (QCD)
Qualified Charitable Distributions (QCDs) allow a traditional IRA or Roth IRA owner, but not a SIMPLE IRA, SEP IRA or qualified plan owner, who is currently over age 70½, to have their IRA custodian send up to $100,000 per year directly to a charity.

This QCD distribution will not be taxable to the IRA owner and the distribution can also satisfy the owner's RMD requirement — essentially tax-free RMDs if done correctly. The owner does not get a charitable contribution income tax deduction for the gift to the charity but does not have to include the distribution sent directly to the charity as taxable income. This increases the income tax efficiency of IRA withdrawals.

QCDs are available only for distributions to public charities not to private foundations and donor advised funds.

Estate planning

Starting to plan how assets are allocated to heirs and how to approach end of life issues has come into sharper focus for many because of concerns from the virus. Advisers and clients can take certain steps to review or start those plans so those concerns can be reduced.

Beneficiary designation
The first step is to review the beneficiary designations on qualified plans, IRAs, nonqualified annuities and life insurance policies (including any employer-provided group term insurance) and make sure that primary and contingent beneficiaries are named.

Not having a beneficiary designated can lead to the proceeds being transferred via the probate process, which can last longer, be more expensive, and is not private. In the case of qualified accounts and nonqualified annuities, this can lead to more income taxation than passing directly to an individual beneficiary.

Spouses, adult children, trusts or charities are typically the preferred named beneficiaries on these types of accounts for tax efficiency, control or privacy reasons versus transferring them via an estate.

It is important to note that the inheritance rules for qualified accounts (includes qualified plans and IRAs) recently changed with the passage of the SECURE Act in December 2019. For most qualified account owner's death in 2020 or thereafter, nonspouse individual beneficiaries will have 10 years to liquidate the qualified account they have inherited. Previously, these beneficiaries could use their life expectancy to take out required distributions from these inherited qualified accounts. This change from life expectancy to 10 years will likely reduce the amount of wealth that beneficiaries would have inherited from these accounts.

However, the SECURE Act did not change the spousal inheritance rules for qualified accounts, so surviving spouses will still be able to re-register the account they have inherited into their own name or leave it in the name of the deceased spouse.

The inheritance rules for nonqualified annuities and life insurance were not changed by the SECURE Act.

Documents
Another part of estate planning is having the correct documents in place to manage affairs and assets when someone dies or becomes incapacitated.

An attorney can help put together a **will** to direct how non-designated beneficiary assets get allocated and who will serve as guardian of minor children, among other things. **Power of attorney** documents will direct who can conduct financial and other affairs for an individual when they cannot. There can be different power of attorney documents for financial affairs and health care. An **advanced health care directive** allows an individual to state their wishes relative to continuing medical treatment in the event of a terminal illness. **Trusts** can be set-up and used to manage assets and their distribution over long periods of time.

Long-term care planning

The concerns over the virus have also brought more focus on the need for long-term care (LTC) planning. By purchasing a life insurance based LTC policy, an individual will have dedicated LTC benefits no matter when care is needed. The policy can potentially be underwritten from the client's home with no personal contact, and if LTC is not needed, then a tax-free life insurance death benefit will be paid to the policy beneficiaries.

Tax filing deadline extension for 2020

The 2019 income tax filing and payment deadlines for all taxpayers who file and pay their Federal income taxes on April 15, 2020, are automatically extended until July 15, 2020. This relief also includes estimated tax payments for tax year 2020 that are due on April 15, 2020. Many states have extended their tax filing deadlines until July 15, 2020, as well.

IRA contribution deadlines for 2019 contributions are extended to July 15, 2020.

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