CARES ACT changes retirement plan and charitable contribution rules

As we all try to keep ourselves, our loved ones, and our communities safe from the coronavirus (COVID-19) pandemic, you may be wondering about some of the recent tax changes that were part of a tax law passed on March 27.

The Coronavirus Aid, Relief, and Economic Security (CARES) Act contains a variety of relief, notably the "economic impact payments" that will be made to people under a certain income threshold. But the law also makes some changes to retirement plan rules and provides a new tax break for some people who contribute to charity.

Waiver of 10% early distribution penalty

IRAs and employer sponsored retirement plans are established to be long-term retirement planning accounts. As such, the IRS imposes a penalty tax of an additional 10% if funds are distributed before reaching age 59½. (However, there are some exceptions to this rule.)

Under the CARES Act, the additional 10% tax on early distributions from IRAs and defined contribution plans (such as 401(k) plans) is waived for distributions made between January 1 and December 31, 2020 by a person who (or whose family) is infected with COVID-19 or is economically harmed by it. Penalty-free distributions are limited to $100,000, and may, subject to guidelines, be re-contributed to the plan or IRA. Income arising from the distributions is spread out over three years unless the employee elects to turn down the spread-out.

Employers may amend defined contribution plans to provide for these distributions. Additionally, defined contribution plans are permitted additional flexibility in the amount and repayment terms of loans to employees who are qualified individuals.

Waiver of required distribution rules

Depending on when you were born, you generally must begin taking annual required minimum distributions (RMDs) from tax-favored retirement accounts — including traditional IRAs, SEP accounts and 401(k)s — when you reach age 70½ or 72. These distributions also are subject to federal and state income taxes. (However, you don't need to take RMDs from Roth IRAs.)

Under the CARES Act, RMDs that otherwise would have to be made in 2020 from defined contribution plans and IRAs are waived. This includes distributions that would have been required by April 1, 2020, due to the account owner's having turned age 70½ in 2019.

New charitable deduction tax breaks

The CARES Act makes significant liberalizations to the rules governing charitable deductions including:

- Individuals can claim a $300 "above-the-line" deduction for cash contributions made, generally, to public charities in 2020. This rule means that taxpayers claiming the standard deduction and not itemizing deductions can claim a limited charitable deduction.
- The limit on charitable deductions for individuals that is generally 60% of modified adjusted gross income (the contribution base) doesn't apply to cash contributions made, generally, to public charities in 2020. Instead, an individual's eligible contributions, reduced by other contributions, can be as much as 100% of the contribution base. No connection between the contributions and COVID-19 is required.

Far beyond

The CARES Act goes far beyond what is described here. The new law contains many different types of tax and financial relief meant to help individuals and businesses cope with the fallout.