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Retirement

2020 Cares Act: IRA Investors Are Liberated From RMD Withdrawals For 2020

By Curt R Stauffer
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The recently passed Cares Act that was passed into law in response to the abrupt and disruptive impact of the COVID-19 pandemic on the economy and financial markets provides relief for IRA owners. Similar to the relief plan passed into law in 2009 in response to the Great Recession of 2008-09, the CARES act suspends the requirement to take RMD withdrawals from their IRA's, 401(k) and 403(b) plans, including beneficiary/inherited IRA's.

This provision of the CARES act is especially useful during this economic crisis because RMD's for the current year are based on account balance levels as of December 31, 2019. Given that most investors maintain meaningful exposure to stocks in their IRA's and equity markets were near record highs at the end of 2019, RMD requirements for 2020 are much higher as a percent of now lower-valued accounts. The suspension of RMD's for 2020 means that investors can either forgo taking distributions from their IRA's during this time of depressed values or at least reduce the amount from what otherwise would have been required.

Benefits

This will provide great help, because most 2020 RMDs are based on the retirement account value on December 31, 2019, when the Dow was 28,462 compared, to where it is today; around 22,000 as of this writing. But as we all know, this can swing wildly as we are still in an uncertain economic situation.

If the 2020 RMDs had not been waived, you likely would have had to withdraw a greater percentage of your IRA or plan balance and pay a big tax bill on value that no longer exists. So, it's good Congress gave us all a year off to sit this out and see what happens, and hopefully have more time to recover losses. Bottom line: We can take a breath on RMDs for a while.

For those investors who can decide to forgo taking their RMD's for 2020, this decision may produce an opportunity to do a Roth IRA conversion. A combination of eliminating mandated taxable income that comes along with taking RMD distributions from a qualified retirement account and lower equity market values produce a unique opportunity to do a Roth conversion. AARP published a good article covering the CARE Act and the implications for IRA investors https://www.aarp.org/money/investing/info-2020/cares-act-retiree-tax-benefit.html. This article, published on March 27, 2020, titled CARES Act Waives Required Minimum Distributions From Retirement Accounts for 2020. AARP wrote "Normally, RMDs cannot be converted to Roth IRAs, but now since there are no RMDs, you can withdraw IRA funds at low values and low tax rates and convert them to your Roth IRA. Yes, you pay taxes on the conversion, just like you would have on your RMD. But your RMD could not be converted to a Roth, so even though you paid the tax, you could not get the conversion benefit. Now, under this 2020 RMD waiver period, you can get more for the tax you pay by being able to convert the funds you withdraw to your Roth IRA at a relatively low tax cost."

"There are several additional benefits to this:

- First, any amount converted removes those funds from your IRA, lowering the balance that will be subject to future RMDs, and in turn lowers your income and tax bill for future years. Lowering your income in the future could also lower the tax on your Social Security benefits and lower your Medicare IRMAA (income-related monthly adjustment amount) surcharges.
- In addition, once the funds are in your Roth IRA, there are no more lifetime RMDs, and anything you withdraw will likely be tax-free. The Roth funds will also pass income tax-free to your beneficiaries.
- Converting now when market values have dropped will mean that any future rebound will now accumulate tax-free to you in your Roth IRA. If the market rebounded while the funds remained in your traditional IRA, then those gains would be eventually taxed.

The key factor in deciding whether to convert or not is the tax rate you are at now compared to what future tax rates might be. If you expect your future tax rate in retirement to be the same or higher, it pays tax-wise to convert."

I have been having frequent discussions with clients whose retirement is just around the corner. These discussions inevitably touch on questions about future tax rates and RMD's. Without a crystal ball making predictions about what politicians in Washington will do is a fool's game. However, after the last month where we have seen trillions of dollars in extraordinary economic support provided by the government, the need for a crystal ball is maybe lessened when it comes to predicting the direction of federal tax rates.

The aforementioned AARP article, for which there is a link provided above, covers a possible charitable giving strategy that may also become more attractive given this year's RMD waiver.

If you want to make changes to your RMD this year, consider a Roth conversion, or simply have questions about this topic, you should contact your trusted advisor.

CURT R. STAUFFER
(C) 717 877 7422
(O) 717 735 0013
cstauffer@ssummitscapital.com

Disclosure:

By Curt R Stauffer
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