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Tax Newsletter

IRS Opens Doors to RMD Rollovers
New ruling provides more flexibility

The IRS has just enhanced the rules for tax rules for retirement plan and IRA participants who received required minimum distributions (RMDs) earlier in the year. In effect, a new ruling now allows all RMD recipients to avoid tax if they roll over the funds to a qualified plan or IRA by August 31.

Background: Normally, individuals who are older than age 72 (70½ prior to 2020) must begin taking annual RMDs from qualified employer retirement plans—such as 401(k) or 403(b) plans—and traditional IRAs. The amount of each RMD is based on the account balance at the end of the prior year and life expectancy tables. This also applies to accounts inherited by non-spouse beneficiaries.

If you fail to take an RMD on time, the IRS can impose a staggering 50% tax penalty on the amount that should have been withdrawn, on top of the regular tax liability.

But Congress relaxed the requirements in the Coronavirus Aid, Relief and Economic Security (CARES) Act it passed in March in response to the COVID-19 pandemic. Notably, the CARES Act suspends the rules for RMDs in 2020, including accounts owned by non-spouse beneficiaries. Therefore, if you have not yet arranged to take an RMD this year, you do not have to touch the money.

However, things get a little trickier if you had already received one or more RMDs before the CARES Act was passed. Initially, the IRS provided limited relief in an April ruling. Briefly stated, it allowed those who had received an RMD between February 1 and May 15 to roll over the RMD into a qualified plan or IRA by July 15 without owing any tax. The usual 60-day rule for rollovers was waived.

That solved at least one problem, but not a few others. For instance:

- This did not help taxpayers who had received RMDs in January. It appeared that they would owe tax on these RMDs.

- The relief was not available to non-spouse beneficiaries of qualified plans and IRAs. They were still liable for tax on RMDs received earlier in the year.

- The tax law limits the number of IRA rollovers to just one a year. The ruling did not address the one-per-year limit.

Fortunately, the IRS has now issued additional guidance that paves the way for RMD rollovers for virtually everyone. The latest ruling allows tax-free rollovers for RMDs received in January, permits non-spousal beneficiaries to use the rollover technique and waives the one-a-year limit for IRAs for rollovers completed by **August 31**.

In other words, if you received an RMD anytime in 2020, you can roll it over to a qualified plan or IRA tax-free before September 1—no questions asked by the IRS!

Should you do it? It depends on your personal situation. For someone who expects to be in a high tax bracket in 2020 and does not need the cash right now, this is probably a good deal. However, if you are struggling to make ends meet and/or have already spent the money, you might skip it. Rely on your professional tax advisor for guidance.

Big Tax Payoff for Bonus Depreciation
Enhanced tax break for businesses

If your business is starting to emerge from this year's slumber, you may be inclined to acquire new equipment or other assets to help generate more income. In addition to the Section 179 allowance, which allows your business to expense up to $1.04 million of the cost of assets placed in service in 2020 (subject to certain limitations), your operation may benefit from "bonus depreciation."

The Tax Cuts and Jobs Act (TCJA) recently enhanced this tax break. However, the benefits are being gradually phased out in the near future.

Background: Prior to the TCJA, a business could claim a first-year bonus depreciation deduction equal to 50% of the cost of new qualified property placed in service. The deduction was added onto the amount expensed under Section 179.

Bonus depreciation was available for assets like computers, vehicles, off-the-shelf software, machinery and equipment, office furniture and other depreciable property with a cost recovery period of 20 years or less under the Modified Accelerated Cost Recovery System (MACRS). But "used" property did not qualify for the deduction

Furthermore, a business was able to claim 50% bonus depreciation for "qualified improvement property" (QIP) of a building. The definition of QIP excludes costs for the enlargement of a building, elevators and escalators and a building's internal structural framework.

Tax update: The TCJA doubled first-year bonus depreciation to 100% for qualified property placed in service after September 27, 2017 and before January 1, 2023. This deduction is scheduled to be phased out as follows:

- 80% in 2023;
- 60% in 2024;
- 40% in 2025; and
- 20% in 2026.

After 2026, no bonus depreciation is allowed after 2026, absent further action by Congress.

Significantly, the TCJA also expanded the definition of qualified property eligible for bonus depreciation to include used property. Previously, only new property qualified.

Finally, note that a change in the new Coronavirus Aid, Relief and Economic Security (CARES) Act fixes a glitch in the TCJA. The CARES Act establishes that QIP has a cost recovery period of 15 years, so it now qualifies for bonus depreciation. This change, which has been called for since the enactment of the TCJA and is retroactive to 2018, reflects the original intent of Congress to allow bonus depreciation for QIP.

Caveat: Despite the benefits, the decision to elect first-year bonus depreciation requires a thorough analysis. For instance, if your business is organized as a pass-through entity—such as an S corporation, partnership or limited liability company (LLC)— the bonus depreciation deduction reduces qualified business income (QBI). In turn, this lowers the QBI deduction. Therefore, if you are entitled to a QBI deduction, consider the potential tax impact of bonus depreciation.

Also, it may be advantageous for a business to "elect out" of bonus depreciation in a year when it has expiring net operating loss (NOL) carryovers or expiring credit carryovers that it cannot use if taxable income is reduced by the bonus depreciation deduction.

Practical advice: Do not make any hasty decisions. Before you commit to acquiring expensive equipment for your business, discuss all the ramifications with your professional tax advisor.

FAQs on Retirement Plan Loans
Key provisions in CARES Act

During these trying times, employees may be forced to take out loans from their 401(k) plans to meet certain financial obligations. Fortunately, the Coronavirus Aid, Relief and Economic Security (CARES) Act provides some relief for borrowers. Following are the answers to several frequently asked questions (FAQs) about retirement plan loans.

Q. What are the limits for 401(k) loans?

A. Previously, the maximum loan allowed was the lesser of $50,000 or 50% of a plan participant's vested balance in the account. The CARES Act increases the limit to the lesser of $100,000 or 100% of the vested balance for loans made between March 27, 2020 and September 22, 2020. For example, if an employee has a vested balance of $500,000 in a 401(k) account, he or she can borrow up to $100,000, if the plan permits it.

Q. How long can an employee take to repay the loan?

A. If an employee has a loan payment due between March 27, 2020 and December 31, 2020, the CARES Act says he or she can delay the repayment for up to one year. Thus, the usual five-year repayment maximum is stretched out to six years. This applies to qualified employees who are still working as well as qualified furloughed employees and those on a temporary leave of absence. Interest on the outstanding loan balance will continue to accrue.

Q. How does an employee qualify for a loan repayment extension?

A. The employee must be able to show one of the following:

- The employee (or his or her spouse or dependent) has been diagnosed with COVID-19.
- The employee is financially affected by quarantine, job loss or reduced hours due to COVID-19.
- The employee is unable to work because of childcare needs caused by COVID-19.
- The employee experiences other extenuating factors determined by the Secretary of the Treasury.

Note: The employer does not need to verify this information and may rely on the participant's certification for eligibility.

Q. Which employers can adopt the CARES Act changes?

A. In some cases, firms that offer plan loans will have their provisions updated automatically. For others, the employer can choose to implement the changes, even if it previously did not permit loans. As with other 401(k) plan management decisions, employers must weigh the pros and cons of these provisions benefitting plan participants. Remember that plans are meant to be saving vehicles for retirement and that should remain the main objective of this employee benefit.

Q. What is the deadline for adopting the CARES Act changes?

A. An employer has until the end of the 2022 plan year to incorporate the CARES Act provisions into plan documents. Conversely, a firm may amend its plan immediately to allow participants to benefit from them.

Q. Should a plan participant arrange a 401(k) loan?

A. This is strictly a personal decision based on the circumstances for each individual. Traditionally, however, a plan loan is viewed as a last resort and other options are usually preferable. Plan participants are encouraged to gather all the necessary information and seek professional guidance.

Tax Angles on Unemployment

Many CPA firms have been asked this question: If I lost my job due to COVID-19, do I have to pay federal income tax on unemployment benefits?

The answer, at least for now, is "yes." The Coronavirus Aid, Relief and Economic Security (CARES) Act authorizes extra unemployment benefits of $600 a week from April 5, 2020 until July 31, 2020 on top of regular unemployment benefits from the state. (An extension is being contemplated.) But the CARES Act does not include any special tax exemption for unemployment benefits.

Unemployment benefits are taxable at your regular tax rate. Do not forget to factor this into the equation.

Facts and Figures
Timely points of particular interest

IRA Reminder—Time is running out—again—for making an IRA contribution for the 2019 tax year. The original deadline of April 15 was extended to July 15 due to the COVID-19 pandemic Contributions are wholly or partially deductible depending on income and if you (or your spouse) participate in an employer-sponsored retirement plan. For 2019 returns, the contribution limit is $6,000 ($7,000 for those age 50 or older).

Friendly Hires—Sometimes the easiest way to fill a job opening is to hire a friend. But that is where the real difficulties may begin. This can create a ripple effect with negative ramifications in the workplace while possibly compromising a friendship. Do not consider it an outright prohibition, but tread carefully in this area. Usually, the best solution is to hire the best person for the job.