The CARES Act: A Simple Summary for Investors

Sweeping legislation to respond to COVID-19 pandemic was cleared by Congress and signed into law on March 27, 2020. The Coronavirus Aid, Relief, and Economic Security Act ("the CARES Act") authorizes more than $2 trillion to battle COVID-19 and its economic effects. The law is wide-ranging from support to the health care system's fight against the coronavirus, as well as direct payments to individuals, expanded unemployment insurance, loans to small and large businesses, and support for state and local governments.

This document provides an overview on retirement investor's relief in the government's stimulus bill to help alleviate the financial strains from the coronavirus. The complete CARES Act is available for reading online.

WAIVER OF EARLY WITHDRAWAL PENALTY

Retirement savers will have more options for coping with the economic impact of the coronavirus. The act waives the 10% early withdrawal penalty for distributions up to $100,000 from qualified retirement accounts for those affected by the virus. Further, the income tax due on those distributions can be spread over three years, and investors have three years to return the funds to their accounts. The limits on loans from qualified plans also have been increased, to the lesser of $100,000 or the full vested balance of the account.

Things to consider: Individuals should check with their plan sponsors regarding the CARES Act relief and think carefully about withdrawing funds set aside for retirement. The economic impacts of the coronavirus pandemic are forcing many families to make tough financial decisions, yet, selling investments at a market low means you are locking in that loss rather than waiting for markets to improve. When you withdraw money from a retirement account, even without a 10 percent penalty, this can have significant impacts on your retirement savings because you lose out on the compound growth from any funds you withdraw. Absent an urgent need, investors may want to rely on emergency savings to the extent available, and, remain focused on long term-financial goals.

Eligibility: You are eligible for a coronavirus-related distributions (CRDs) if you certify that you, your spouse or dependent is diagnosed with COVID-19 (or SARS-CoV-2) or you experience certain adverse financial consequences as a result of (i) being quarantined, furloughed or laid off or having to work reduced hours because of the virus (or disease), (ii) being unable to work due to lack of child care because of the virus (or disease), (iii) closing or reducing hours of a business owned or operated by you due to the virus (or disease), or (iv) other factors as determined by the U.S. Department of Treasury.

Resources Used: FINRA | Vanguard | Kiplinger | Merrill Edge

TEMPORARY WAIVER FOR REQUIRED MINIMUM DISTRIBUTIONS

The CARES Act also will help retirees keep their savings in their retirement accounts. It includes a temporary waiver for required minimum distributions (RMDs), which applies to both 2020 RMDs and RMDs due by April 1 for individuals who turned 70½ last year.

Things to consider: The temporary RMD waiver applies to all individuals who were subject to an RMD requirement in 2020, not just those who may have been impacted by the coronavirus pandemic. If this waiver applies to you, be sure to monitor any updates to this legislation and make plans for taking required distributions in 2021.

INCENTIVES FOR CHARITABLE GIVING

$300 Above-the-Line Deduction (Must Take Standard Deduction)

Taxpayers will be able to deduct up to $300 of cash contributions regardless of whether they itemize deductions, and the limits on charitable deductions for those who do itemize will be increased.

If you take the standard deduction on your 2020 tax return (the one that you'll file in 2021), you can claim a brand new "above-the-line" deduction of up to $300 for cash donations to charity you make this year. Donations to donor advised funds and certain organizations that support charities are not deductible. Normally, you must itemize on Schedule A to get a tax break for charitable donations. In this case, though, it is the other way around—if you itemize, you cannot take this new deduction.

60% of AGI Limit Waived (Must Itemize)

If you itemize on Schedule A of your tax return, you can claim a deduction for your charitable donations. However, the amount you can deduct for cash contributions is generally limited to 60% of your adjusted gross income (AGI). Any cash donations over that amount can be carried over for up to five years and deducted later.

The CARES Act lifts the 60% of AGI limit for cash donations made in 2020 (although there is still a 100% of AGI limit on all charitable contributions). That means itemizers can deduct more of their charitable cash contributions this year, which will hopefully boost charitable giving. As with the new above-the-line deduction, donations to Donor Advised Funds and supporting organizations do not count.

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TEMPORARY INCREASE IN AMOUNT FOR RETIREMENT ACCOUNT LOANS

In general, loans taken from a qualified retirement plan account (401(a), 401(k), 403(b) and government plans) are limited to the lesser of $50,000 or 50 percent of the participant's vested balance and must be paid back within five years. The CARES Act doubles these retirement plan loan limits for qualified individuals eligible for a CRD to the lesser of $100,000 or 100 percent of the participant's vested account balance. To qualify, the loan must be made within 180 days after the enactment of the CARES Act. The participant will not owe income tax on the amount borrowed from the 401(k) if it is paid back within five years.

In addition, qualified individuals with an outstanding loan from their plan (i.e., one taken before the CARES Act was enacted) with a repayment due between March 27, 2020, and Dec. 31, 2020, can delay their loan repayments for up to one year, although interest will continue to accrue on these delayed payments.

Things to consider: Before you determine whether to borrow from your retirement account, consider some of the advantages and drawbacks to this decision. On the plus side, you usually don't have to explain why you need the money or how you intend to spend it, the loan fees and interest rate might be lower than those available on a personal loan or a credit advance, and the interest you repay is paid back into your account. On the negative side, the money you withdraw will not grow if it isn't invested, and repayments are made with after-tax dollars that will be taxed again when you eventually withdraw them from your account. Also, if you lose your job, the loan generally will be considered a withdrawal on which you must pay income tax.

Importantly, employers may, but are not required to, offer COVID-19-related distributions and loan relief under their plans.

Resources Used: FINRA | Vanguard | Kiplinger | Merrill Edge