



AN ALERT FROM THE BDO PRIVATE CLIENT SERVICES PRACTICE

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INDIVIDUALS: WHAT YOU NEED TO KNOW ABOUT THE CARES ACT

On March 6, 2020, the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020 was enacted, becoming the first of three Congressional relief and stimulus acts passed in March and setting off a firestorm of administrative relief by several federal agencies including the IRS and Department of Labor.

Since then, BDO has established a dedicated web page providing up-to-date insights and webinars on all novel coronavirus (COVID-19) issues impacting our clients. You can access that landing page by clicking [here](#). This alert attempts to provide the information of most interest to BDO's Private Clients.

BACKGROUND

This alert briefly summarizes the following relief provisions enacted in the Coronavirus Aid, Relief, and Economic Security (CARES) Act, enacted on March 27, 2020.

- ▶ Temporary waiver of required minimum distribution (RMD) rules for certain retirement plans and accounts
- ▶ Temporary waiver of early distribution penalty from tax-qualified plans and special rules related to plan loans
- ▶ Changes to charitable contribution deduction limitations
- ▶ Net operating loss (NOL) carrybacks for losses generated after December 31, 2017
- ▶ Postponement of excess business loss limitation and relief for limitations incurred in 2018 and 2019
- ▶ Recovery rebates for individuals

TEMPORARY WAIVER OF RMD RULES FOR CERTAIN RETIREMENT PLANS AND ACCOUNTS

Generally, required minimum distributions must begin at age 72 for individuals born on or after July 1, 1949, or at age 70 ½ for individuals born before July 1, 1949.

The CARES Act waives the required minimum distribution rules for certain defined contribution plans and IRAs for calendar year 2020. This applies even for taxpayers who turned 70 ½ in 2019 but deferred their first RMD to April 1, 2020.

RMDs that have already been taken in 2020 may be rolled over within 60 days of the distribution.

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Waived RMDs do not need to be taken in subsequent years. However, any forgone RMD in 2020 will affect the account balance used to calculate the RMD in 2021 and future years. It is not known whether additional relief will be offered for individuals who took their RMD early in 2020 and are already outside the 60-day rollover window. RMDs were last waived in 2009. At that time, the IRS issued a notice stating that the 60-day rollover deadline would be satisfied if completed by a given date that year. It is possible that similar guidance will be issued this year.

SPECIAL RULES FOR USE OF RETIREMENT FUNDS

Eligible individuals can withdraw up to \$100,000 for coronavirus-related purposes from tax-qualified retirement plans during 2020 without incurring the usual 10% early distribution penalty.

Taxable distributions should generally be included in gross income ratably over a three-year period.

Taxpayers may re-contribute the withdrawn amounts in one or more re-contribution payments to the qualified plan at any time within three years of the distribution. These repayments will be treated as a tax-free rollover and not subject to that year's cap on contributions.

The CARES Act also makes it easier to borrow money from 401(k) plans, raising the borrowing limit from \$50,000 to \$100,000 for the first 180 days after enactment, and by delaying the payment dates for any loans due the rest of 2020 for one year. (The CARES Act was enacted March 27, 2020; the 180-day window closes September 23, 2020.)

Coronavirus-related distributions are made to an individual (i) diagnosed with COVID-19 by a test approved by the Centers for Disease Control and Prevention; (ii) whose spouse or dependent is diagnosed with COVID-19 by such a test; or (iii) 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.

Notably, however, a "dependent" here is defined more broadly than a "qualifying child" for purposes of the recovery rebates. Here, "dependent" includes children under the age of 19 or full-time students under the age of 24 as of December 31, 2020. In addition, individuals who are permanently and totally disabled may also be considered dependents, as can certain other qualifying relatives such as parents and in-laws.

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Given that COVID-19 tests are in short supply, it's likely that most individuals will look to the last catch-all category for relief under this provision.

What's unclear in the CARES Act is the timing of these two three-year periods and whether they run concurrently, or whether the three-year gross income inclusion period is subsequent to the three-year payback period.

California has its own early distribution penalty and while California's statute generally conforms to the federal Internal Revenue Code, California likely needs to enact its own legislation to offer similar relief.

ALLOWANCE OF PARTIAL ABOVE-THE-LINE DEDUCTION FOR CHARITABLE CONTRIBUTIONS

Individuals who do not elect to itemize their deductions in 2020 may take a qualified charitable contribution deduction of up to \$300 against their adjusted gross income in 2020. A qualified charitable contribution is a charitable contribution (i) made in cash, (ii) for which a charitable contribution deduction is otherwise allowed, and (iii) which is made to certain publicly supported charities.

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This above-the-line charitable deduction may not be taken for contributions to a non-operating private foundation or a donor advised fund.

MODIFICATION OF LIMITATIONS ON CHARITABLE CONTRIBUTIONS DURING 2020

Currently, individuals who make cash contributions to publicly supported charities are permitted a charitable contribution deduction of up to 60% of their AGI. Any contributions in excess of the 60% AGI limitation may be carried forward as a charitable contribution in each of the succeeding five years.

The CARES Act suspends the AGI limitation for qualifying cash contributions and instead permits individual taxpayers to take a charitable contribution deduction for qualifying cash contributions made in 2020 to the extent such contributions do not exceed the taxpayer's AGI.

Any excess is still carried forward as a charitable contribution in each of the succeeding five years.

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This provision benefits taxpayers who elect to itemize their deductions in 2020 and make cash contributions to certain public charities. Contributions to non-operating private foundations or donor advised funds are not eligible for the 100% AGI limitation.

NET OPERATING LOSSES

Previously, NOLs generated beginning in 2018 were limited to 80% of taxable income computed without regard to any NOL deduction. Any unused NOL was not able to be carried back but could be carried forward indefinitely.

The CARES Act permits individuals with NOLs generated in taxable years beginning after December 31, 2017, and before January 1, 2021, to carry back such NOLs five taxable years. Such NOLs not carried back may continue to be carried forward indefinitely. The CARES Act also eliminates the 80% taxable income limitation imposed by the TCJA for taxable years beginning before January 1, 2021.

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Taxpayers with NOLs generated in 2018 and 2019 may find it advantageous to amend returns prior to those years to carryback NOLs to years with taxable income subject to a 39.6% tax rate.

EXCESS BUSINESS LOSS LIMITATIONS

Beginning in 2018, net business losses in excess of \$500,000 for joint filers (\$250,000 for all other taxpayers) were not allowed as a current deduction against other income. These threshold amounts were indexed for inflation and, in 2020, were scheduled to be \$518,000 for joint filers (\$259,000 for all other taxpayers). The disallowed business losses became a net operating loss applied to subsequent taxable years.

The CARES Act suspends the application of this excess business loss rule for 2020, and retroactively suspends the excess business loss limitation rule for 2018 and 2019. Thus, taxpayers will be allowed to offset their business losses against other income for 2020.

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Taxpayers will need to address with their tax advisors the impact of the retroactive removal of the excess business loss limitation rule for 2018 and 2019. Many taxpayers have not yet filed for 2019 and the removal of the loss limitation rule should be considered in the preparation of the 2019 return. If a taxpayer was subject to the excess business loss rule in his or her 2018 tax return, the taxpayer should amend his or her 2018 return to take advantage of the elimination of the rule for 2018. Taxpayers may have a refund opportunity for 2018 if their net business losses were limited and may also find their 2019 tax liabilities either increased or decreased, depending on whether their business losses were being carried forward to 2019 or were sustained in 2019 but were limited.

RECOVERY REBATES FOR INDIVIDUALS

Eligible individuals will receive a refundable tax credit against their 2020 taxable income equal to \$1,200 (\$2,400 for joint filers) plus \$500 per qualifying child. The refund is determined based on the taxpayer's 2020 income tax return but is advanced to taxpayers based on their most recent income tax filing – the 2018 or 2019 tax return, as appropriate.

The credit begins to phase out if the individual's AGI exceeds \$75,000 (\$150,000 for joint filers and \$112,500 for head of household filers), and is reduced by an amount equal to 5% of the amount in which the taxpayer's AGI exceeds these thresholds. As a result, individuals with no qualifying children completely phase out of the credit if their AGI exceeds \$99,000 (\$198,000 for joint filers). Individuals with two qualifying children completely phase out of the credit if their AGI exceeds \$119,000 (\$218,000 for joint filers).

If an eligible individual's 2020 income is higher than the 2018 or 2019 income used to determine the rebate payment, the eligible individual will not be required to pay back any excess rebate. However, if the eligible individual's 2020 income is lower than the 2018 or 2019 income used to determine the rebate payment such that the individual should have received a larger rebate, the eligible individual will be able to claim an additional credit generally equal to the difference of what was refunded and any additional eligible amount when they file their 2020 income tax return.

Individuals who have not filed a tax return in 2018 or 2019 may still receive an automatic advance based on their social security benefit statements (Form SSA-1099) or social security equivalent benefit statement (Form RRB-1099). Individuals who are otherwise not required to file and are not receiving social security benefits are still eligible for the rebate but will be required to file a tax return to claim the benefit.

The CARES Act provides that the IRS will make automatic payments to individuals who have previously electronically filed their income tax returns using direct deposit banking information provided on a return any time after January 1, 2018.

Eligible individuals do not include nonresident aliens, individuals who may be claimed as a dependent on another person's return, estates, and trusts.

A qualifying child (i) is a child, stepchild, eligible foster child, brother, sister, stepbrother, or stepsister, or a descendent of any of them, (ii) under age 17, (iii) who has not provided more than half of their own support, (iv) has lived with the taxpayer for more than half of the year and (v) who has not filed a joint return (other than only for a claim for refund) with the individual's spouse for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins.

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Individuals between the ages of 17 and 24 are ineligible to be claimed as a qualifying child and may be unable to claim their own independent rebate if they are eligible dependents on their parents' tax return. Eligible dependents include children under the age of 19 or full-time students under the age of 24 who do not provide more than half of their own support and who live with the taxpayer for more than half the year.

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