The CARES Act Impact on Your Personal Finances and Retirement Accounts

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You have probably been hearing in the news that the government is going to mail each taxpayer a check in the next few weeks. Those checks are actually being called "rebates" and not every taxpayer is eligible. However, the CARES Act does give benefits to almost every taxpayer through some important changes to withdrawals from retirement accounts, charitable deductions, and student loan payments. All of these changes are intended to help taxpayers weather this crisis.

Rebates:

Lawmakers have been on the news a lot in recent days talking about getting money in American's pockets as quickly as possible. The CARES Act does provide for such payments and they are being titled as rebates.

Under Section 2201 of the CARES Act, eligible individuals are entitled to a rebate of $1,200 ($2,400) for married couples, plus an additional $500 for each child. Eligible individuals are taxpayers with an adjusted gross income up to $75,000 ($150,000 for a married couple) who are not dependent upon another taxpayer. Eligible individuals include those who have no income, as well as those individuals whose sole source of income is means-tested benefit programs, like SSI.

For most Americans, no action needs to be taken in order to receive a rebate check. The IRS will use the taxpayer's 2019 tax return if filed, or if the 2019 tax return has not been filed, the IRS will determine eligibility based on the taxpayer's 2018 return.

For individuals who earn more than $75,000 (or $150,000 for a married couple), the rebate is reduced by $5 for each $100 that the taxpayer's income exceeds the threshold, and is gradually phased out. The amount is completely phased out for taxpayers with income exceeding $99,000, $146,500 for head of household filers with one child, and $198,000 for joint filers with no children.

Retirement Accounts:

The CARES Act contains a series of changes that relax rules on retirement savings and contains three key provisions:

First, Section 2202 of the Act would allow affected savers to take coronavirus-related distributions of up to $100,000 from retirement plans and individual retirement accounts in 2020. Those individuals are defined as people who are diagnosed with COVID-19, spouses or dependents who have the disease or those experiencing financial consequences from quarantine, furlough, layoffs or having their hours cut due to coronavirus. If the taxpayers are under age 59½, these withdrawals would be exempt from the 10% penalty that would normally apply. Taxpayers will still be liable for income tax on the amounts withdrawn, but the bill allows the taxpayer to pay these taxes over three years. In addition, taxpayers have three years from the date the distribution is made to make contributions back into the retirement account equal to the amount that was withdrawn (so the normal limitations on contributions would not apply to a repayment).

Second, Section 2202 of the Act allows taxpayers to take larger loans against the money the taxpayer has saved in their workplace retirement plan. Normally, a taxpayer can borrow only up to $50,000 or 50% of their vested account balance, whichever is less. The bill would double that: up to $100,000 against the amount the taxpayer saved in their plan. Generally speaking, a taxpayer can borrow against their retirement account tax-free if certain requirements are met. If the taxpayer fails to repay the loan, it is treated as a distribution and subject to income taxes. You will need to check with your plan administrator regarding the rules regarding loans vs. withdrawals.

Third, Section 2203 of the Act suspends required minimum distribution (RMD) rules for 2020. In 2020, individuals who turn 72 are required to take annual mandatory distributions from their workplace retirement plans and their IRAs. The bill would suspend those RMD payments for 2020, a move that will keep taxpayers from drawing down on savings at a time when the market is in flux over COVID-19 worries.

Charitable Deductions:

Section 2204 of the Act gives a partial above the line deduction for charitable contributions, up to a $300 deduction for charitable giving, even if you do not itemize your deductions on your 2020 return. This means that for individuals who take the standard deduction – which is $12,400 for singles and $24,800 for married filing jointly – you can still write off up to $300 in deductions. The law would take effect on 2020 income tax filings.

The value of the deduction for each individual tax payer depends upon the tax bracket the taxpayer is in, so the higher your bracket, the greater the deduction. Remember that a deduction, even an above the line deduction, is not as good as a tax credit. A tax credit is more valuable than a tax deduction. For example, a $10 credit reduces tax by $10. But the value of a $300 deduction depends on the taxpayer's tax rate. If that is 37%, the value of the deduction is worth about $111.

Section 2205 of the Act increases the limitations on deductions for charitable contributions for individuals who itemize their deductions, as well as for corporations. For individuals, the cap on deductions to 50% of adjusted gross limitation is suspended. For corporations, the limitation on qualifying charitable contributions increases from 10% of taxable income to 25% of taxable income. Contributions must be paid in cash during 2020 to qualifying organizations. Section 2205 also increases the limitation on deductions of food inventory from 15% to 25%.

Student Loan Relief:

Section 2206 of the Act allows employers to provide a student loan repayment benefit to employees. An employer may contribute up to $5,250 annually toward an employee's student loans, and the payment would be excluded from the employee's income tax. The $5,250 applies to student loan repayments and educational assistance provided by the employer under current loan. This provision applies to any payments made after the enactment of the act through January 1, 2021.

Section 3513 of the Act provides that the student loan borrowers who have their loans through the Department of Education will not be required to make a payment for 6 months (through September 30th). In the Act, the Department of Education is required to defer student loan payments, principal, and interest for 6 months, without penalty to the borrower for all federally owned loans. This provision does not apply to private loans. Loan borrowers should call their lender or student loan administrator to verify eligibility.