Advisory Commentary

A Rare Confluence of Tax-Planning Opportunities

October 23, 2020

This year provides taxpayers with rare tax-planning opportunities related to recent and pre-existing laws, as well as possible legislation that may change depending on the election outcome.

CARES Act

Earlier this spring, Congress passed the Coronavirus Aid, Relief and Economic Security Act ("CARES Act"), Pub. L. No. 116-36, based on H.R. 748 and S. 3548, 116th Congress (2019-2020), which was offered to help all taxpayers affected by our pandemic. The CARES Act provides the following planning opportunities for taxpayers.

Retirement Account Distributions

The CARES Act provides relief for retired and working Americans alike.

- For retired Americans, all required minimum distributions (RMDs) are waived for 2020. This includes the first RMD someone would have had to take after turning 70.5 last year. This also extends to beneficiaries of inherited IRAs (including Roth), who also are not required to take distributions this year.
    - If someone already took a distribution from their own IRA earlier this year, there are two possible ways to return those funds. For distributions taken within the past 60 days, they can be returned within the 60 day-rollover window. Distributions taken more than 60 days ago (and after 1/1/2020) can be returned within three years if treated as a qualified coronavirus-related distribution as described below.
    - Inherited IRA beneficiaries generally cannot return distributions made earlier this year since they are not treated as account owners. Notwithstanding, a surviving spouse could work around this limitation by completing a spousal rollover of the inherited IRA distribution to the spouse's own IRA account.

- For working Americans, the 10% early withdrawal penalty is waived (up to $100,000) for qualified, coronavirus-related distributions ("CRDs"). For this purpose, qualified CRDs include diagnosis, care, and distributions that benefit individuals experiencing adverse financial consequences (such as quarantine, layoff, or reduced hours).
    - Although the 10% early withdrawal penalty is waived for qualified CRDs, income tax on them is still due and will be spread over the next three years.
    - Alternatively, taxpayers may recontribute withdrawn amounts to their IRAs within the next three years and avoid the income tax (regardless of annual IRA contribution limits).

Finally, loan limits for 401(k) accounts were raised from $50,000 to $100,000 for this year, and related loan payments due this year are now extended for another year.

Charitable Contributions

Charitable contributions are more advantageous this year.

- The CARES Act allows taxpayers to deduct $300 (above the line) for charitable contributions made in 2020 regardless of whether the taxpayers are otherwise able to itemize deductions.

- The CARES Act also removes charitable deduction limitations based on adjusted gross income, so taxpayers can deduct charitable cash contributions up to 100% of adjusted gross income ("AGI") this year.

The CARES Act made these adjustments solely for cash contributions to qualified public charities; taxpayers cannot apply these benefits when making gifts to supporting organizations, private foundations, or donor-advised funds. Further, the text of the CARES Act states these rules apply beginning this year, but whether they will extend beyond 2020 remains uncertain.

Qualified Charitable Contributions (QCDs)

The QCD rules allow individuals over age 70.5 to distribute up to $100,000 of IRA assets to charity each year. These distributions do not qualify for a charitable deduction, but they are not recognized as taxable income. This provides a greater income tax benefit since the distribution is excluded from income "above the line."

The QCD rules remain unchanged by the CARES Act this year; however, the CARES Act provides taxpayers between the ages 59.5 and 70.5 with a similar opportunity. Since taxpayers can deduct charitable cash contributions up to 100% of AGI, they can take IRA distributions and then contribute the full amount to a qualified public charity to offset the IRA distribution income. This tax savings could be significantly higher than offered by the QCD, which limits its benefit to a maximum $100,000 distribution.

Pre-Existing Tax Laws

Taxpayers continue to benefit from the following planning opportunities that remain unchanged by the CARES Act.

- Calculating withholding and adjusting levels of tax payments by year-end, especially if income has gone down this year.
- Continuing to make retirement plan contributions to reduce earned income for tax purposes.
- Tracking investment income and harvesting capital gains or losses as needed to balance them out.
- Considering Roth Conversions if income has gone down this year while tax rates remain lower under current law.

President Trump and former Vice President Biden have different views on tax policy. *(For more information about the candidates' proposals, see our commentary "Tax-Related Proposals of Presidential Candidates.")* However, regardless of the election outcome, taxpayers can make gifts or loans to family members before year-end and benefit by taking advantage of our current economy and tax laws.

- Parents can loan cash to children without making a gift provided that parents charge a minimum interest rate set by the IRS each month, depending on the loan term. This fall, rates have fallen near or well below one percent for these family loans. Family loans are attractive while interest rates remain this low, and parents should consider refinancing older family loans at these low rates, too.
- Estate and gift tax exemptions remain historically high, and these aren't scheduled to change until January 1, 2025. Exemptions could be reduced by one-half or more depending on the outcome of our general election this fall. For this reason, parents are considering major family gifts this year to preserve their use of exemptions while they are so high.

Potential Legislation

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The upcoming election also raises concerns for parents who are considering major family gifts though a variety of advanced gift and estate planning techniques. These techniques have come under challenge by Congress before, and Congress has proposed curbing the use of these techniques through a variety of proposals designed to:

- Force recognition of gifts involving trust transfers—including those that zero out current gifts—by only passing appreciation to family;
- Eliminate the benefit of gifts through family business structures that are designed to discount their value; and
- Eliminate perpetual trusts that protect property from all future estate taxes by ending them sooner and taxing their assets again.

Whether current tax policy will reverse will depend on election outcomes. Further changes to advanced planning opportunities will depend on these outcomes and more. Prior Congresses have sought some of the changes noted above for years without success. They bear mentioning again because we can’t always rely on tax laws remaining safe until their next scheduled sunset years ahead.

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