Hess & Hess, LLP

Quarterly Tax Newsletter

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An
AICPA Personal Financial Planning Section
member benefit

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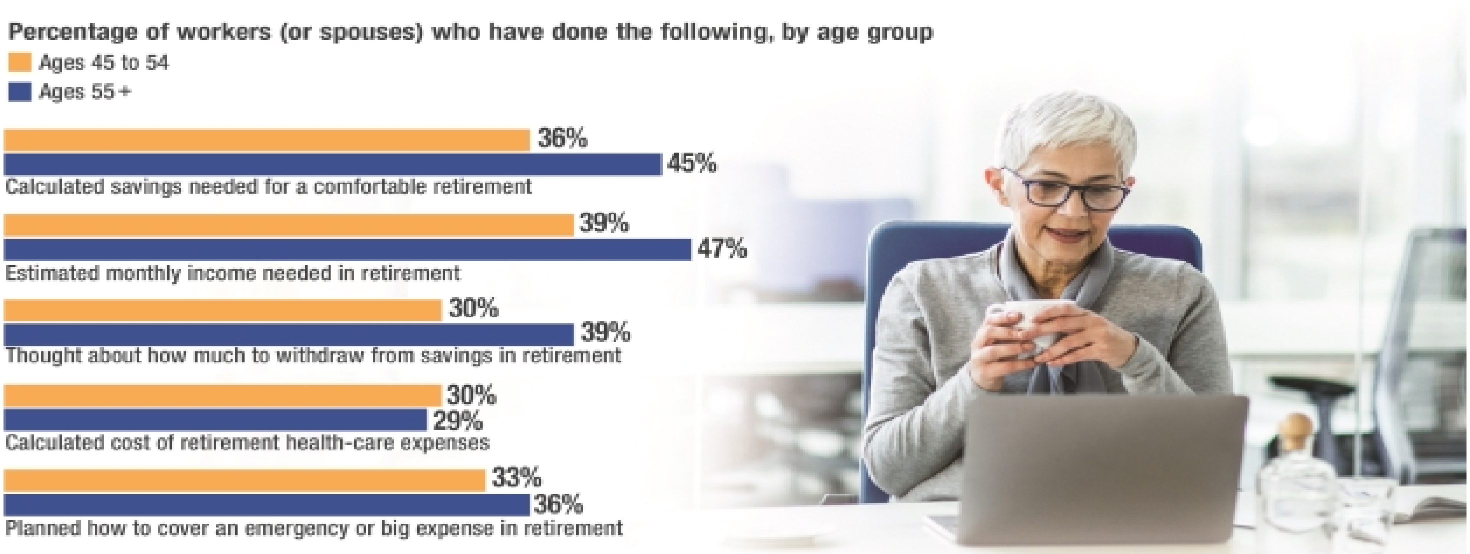
How Much Have You Thought About Retirement?

It's difficult to achieve positive results without planning, yet less than half of workers ages 55 and older have actively planned for retirement. Planning is even less common for those ages 45 to 54.



Source: Employee Benefit Research Institute, 2019

Four Questions on the Roth Five-Year Rule

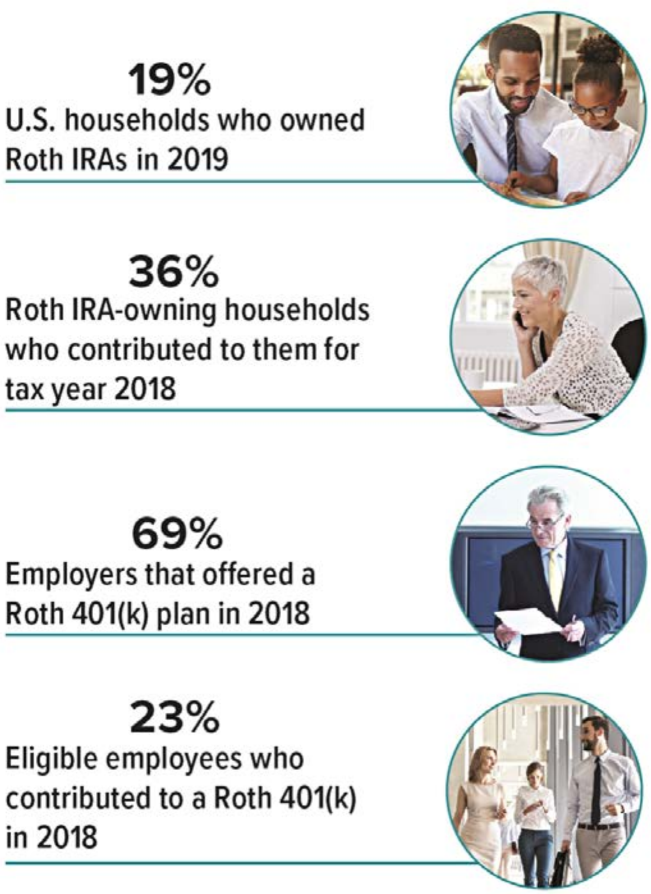
The Roth "five-year rule" typically refers to when you can take tax-free distributions of earnings from your Roth IRA, Roth 401(k), or other work-based Roth account. The rule states that you must wait five years after making your first contribution, and the distribution must take place after age 59½, when you become disabled, or when your beneficiaries inherit the assets after your death. Roth IRAs (but not workplace plans) also permit up to a $10,000 tax-free withdrawal of earnings after five years for a first-time home purchase.

While this seems straightforward, several nuances may affect your distribution's tax status. Here are four questions that examine some of them.

1. When does the clock start ticking?

"Five-year rule" is a bit misleading; in some cases, the waiting period may be shorter. The countdown begins on January 1 of the tax year for which you make your first contribution.

Roth by the Numbers



Sources: Investment Company Institute and Plan Sponsor Council of America, 2019

For example, if you open a Roth IRA on December 31, 2020, the clock starts on January 1, 2020, and ends on January 1, 2025 — four years and one day after making your first contribution. Even if you wait until April 15, 2021, to make your contribution for tax year 2020, the clock starts on January 1, 2020.

2. Does the five-year rule apply to every account?

For Roth IRAs, the five-year clock starts ticking when you make your first contribution to any Roth IRA.

With employer plans, each account you own is subject to a separate five-year rule. However, if you roll assets from a former employer's 401(k) plan into your current Roth 401(k), the clock depends on when you made the first contribution to your former account. For instance, if you first contributed to your former Roth 401(k) in 2014, and in 2020 you rolled those assets into your new plan, the new account meets the five-year requirement.

3. What if you roll over from a Roth 401(k) to a Roth IRA?

Proceed with caution here. If you have never previously contributed to a Roth IRA, the clock resets when you roll money into the Roth IRA, regardless of how long the money has been in your Roth 401(k). Therefore, if you think you might enact a Roth 401(k) rollover sometime in the future, consider opening a Roth IRA as soon as possible. The five-year clock starts ticking as soon as you make your first contribution, even if it's just the minimum amount and you don't contribute again until you roll over the assets.[1]

4. What if you convert from a traditional IRA to a Roth IRA?

In this case, a different five-year rule applies. When you convert funds in a traditional IRA to a Roth IRA, you'll have to pay income taxes on deductible contributions and tax-deferred earnings in the year of the conversion. If you withdraw any of the converted assets within five years, a 10% early-distribution penalty may apply, unless you have reached age 59½ or qualify for another exception. This rule also applies to conversions from employer plans.[2]

[1] You may also leave the money in your former employer's plan, roll the money into another employer's Roth account, or receive a lump-sum distribution. Income taxes and a 10% penalty tax may apply to the taxable portion of the distribution if it is not qualified.

[2] Withdrawals that meet the definition of a "coronavirus-related distribution" during 2020 are exempt from the 10% penalty.

Five Key Benefits of the CARES Act for Individuals and Businesses

By now you know that Congress has passed a $2 trillion relief bill to help keep individuals and businesses afloat during these difficult times. The Coronavirus Aid, Relief, and Economic Security (CARES) Act contains many provisions. Here are five that may benefit you or your business.

1. Recovery Rebates

Many Americans will receive a one-time cash payment of $1,200. Each U.S. resident or citizen with an adjusted gross income (AGI) under $75,000 ($112,500 for heads of household and $150,000 for married couples filing a joint return) who is not the dependent of another taxpayer and has a work-eligible Social Security number, may receive the full rebate. Parents may also receive an additional $500 per dependent child under the age of 17.

The $1,200 rebate amount will decrease by $5 for every $100 in excess of the AGI thresholds until it completely phases out. For example, the $1,200 rebate completely phases out at an AGI of $99,000 for an individual taxpayer and the $2,400 rebate phases out at $198,000 for a married couple filing a joint return.

Rebate payments will be based on 2019 income tax returns (2018 if no 2019 return was filed) and will be sent by the IRS via direct deposit or mail. Eligible individuals who receive Social Security benefits but don't file tax returns will also receive these payments, based on information provided by the Social Security Administration.

The rebate is not taxable. Because the rebate is actually an advance on a refundable tax credit against 2020 taxes, someone who didn't qualify for the rebate based on 2018 or 2019 income might still receive a full or partial rebate when filing a 2020 tax return.

2. Extra Unemployment Benefits

The federal government will provide $600 per week to those who are eligible for unemployment benefits as a result of COVID-19, on top of any state unemployment benefits an individual receives. Unemployed individuals may qualify for this additional benefit for up to four months (through July 31.) The federal government will also fund up to an additional 13 weeks of unemployment benefits for those who have exhausted their state benefits (up to 39 weeks of benefits) through the end of 2020.

The CARES Act also provides assistance to workers who have been affected by the COVID-19 pandemic but who normally wouldn't be eligible for unemployment benefits, including self-employed individuals, part-time workers, freelancers, independent contractors, and gig workers. Individuals who have to leave work for coronavirus-related reasons are also potentially eligible for benefits.

3. Federal Student Loan Deferrals

For all borrowers of federal student loans, payments of principal and interest will be automatically suspended for six months, through September 30, without penalty to the borrower. Federal student loans include Direct Loans (which includes PLUS Loans), as well as Federal Perkins Loans and Federal Family Education Loan (FFEL) Program loans held by the Department of Education. Private student loans are not eligible.

4. IRA and Retirement Plan Distributions

Required minimum distributions from IRAs and employer-sponsored retirement plans will not apply for the 2020 calendar year. In addition, the 10% premature distribution penalty tax that would normally apply for distributions made prior to age 59½ (unless an exception applied) is waived for coronavirus-related retirement plan distributions of up to $100,000. The tax obligation may be spread over three years, with up to three years to reinvest the money.

5. Help for Businesses

The CARES Act includes several provisions designed to help self-employed individuals and small businesses weather the financial impact of the COVID-19 crisis.

Self-employed individuals and small businesses with fewer than 500 employees may apply for a Paycheck Protection Loan through a Small Business Association (SBA) lender. Businesses may borrow up to 2.5 times their average monthly payroll costs, up to $10 million. This loan may be forgiven if an employer continues paying employees during the eight weeks following the origination of the loan and uses the money for payroll costs (including health benefits), rent or mortgage interest, and utility costs.

Also available are emergency grants of up to $10,000 (that do not need to be repaid if certain conditions are met), SBA disaster loans, and relief for business owners with existing SBA loans.

Businesses of all sizes may qualify for a refundable payroll tax credit of 50% of wages paid to employees during the crisis, up to $10,000 per employee. The credit is applied against the employer's share of Social Security payroll taxes.

The CARES Act Suspends Federal Student Loan Payments

On March 27, 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Included in the legislation are new rules for student loan relief.

The legislation provides a six-month automatic payment suspension for any student loan held by the federal government. This six-month period ends on September 30, 2020.

If you have a federal student loan, you don't need to contact your loan servicer to request a suspension; the six-month freeze will be applied automatically to any eligible federal student loan. However, you can choose to keep making your monthly student loan payments during the six-month suspension period if you wish.

Interest will not accrue during the six-month suspension period. In effect, the interest rate is set to 0%.

Only Federal Loans Qualify

Only student loans held by the federal government are eligible for payment suspension. This includes Direct Loans (which includes PLUS Loans), as well as Federal Perkins Loans and Federal Family Education Loan (FFEL) Program loans held by the Department of Education. Private student loans are not eligible.

Impact on Public Service Loan Forgiveness Program

Under the Public Service Loan Forgiveness (PSLF) Program, borrowers who work in an eligible public service job and make 120 on-time student loan payments are eligible to have the remaining balance on their federal Direct Loans forgiven.

Under the CARES Act, the six-month freeze on student loan payments will not affect the 120-month running period for purposes of the PSLF program. In other words, each month of the suspension period will still count toward a borrower's 120 payment tally, even if the borrower does not make any payments during the six-month period.

How to Contact Your Loan Servicer

Your federal loan servicer is the company that handles your loan's billing and provides related services. If you want to contact your loan servicer for any reason you should try to do so online or by phone. If you don't know the name of your loan servicer or how to contact the company, you can visit studentaid.gov/login or call 1-800-4-FED-AID for assistance.