How to Tap Your Retirement Savings Penalty-Free Under the CARES Act

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Table of Contents

Introduction

The CARES Act (Coronavirus Aid, Relief, and Economic Security) changed the rules regarding retirement plan withdrawals and tax penalties for 2020.

This eBook explains how the new law—the Coronavirus Stimulus Package or H.R.748— could let you tap into your retirement savings penalty free if needed.

The types of retirement accounts covered by the new rules include:

- Individual Retirement Accounts and Annuities (IRAs)
- Qualified Pension, Profit Sharing & Stock Bonus Plans
- 401(k) & 403(b) Plans
- Thrift Savings Plans (TSP)
- Governmental Section 457 Deferred Comp Plans
- Qualified 403(a) Annuity Plans

Retirement Plan Distributions

Up to $100,000 Penalty-Free

Distributions taken prior to age 59 ½ normally trigger a 10% early withdrawal penalty

This penalty does not apply for COVID-19 Related Distributions (CRDs) under the special rules defined in Section 2202 of the CARES Act.

Qualified individuals are eligible to withdraw up to $100,000 from their IRA, 401(k), 403(b), TSP and other qualified retirement plans prior to 12/31/2020.

The $100,000 distribution limit is aggregated between all of an individual's qualified retirement plans.

Qualified individuals include:

- You, your spouse, or your dependent diagnosed with COVID-19 using a CDC-approved test
- Anyone affected financially due to quarantine, furlough, layoff, or reduced work hours due to the coronavirus
- Anyone who owns or operates a business that has closed or had operating hours reduced due to COVID-19 and experiences adverse financial consequences as a result.
- Anyone unable to work because of a lack of childcare due to the coronavirus
- Anyone who has experienced adverse financial consequences due to other COVID-19 related factors to be specified in future IRS guidance.

The CARES Act gives the Secretary of the Treasury the authority to expand this definition.

NEXT:
CARES Act Retirement Plan Withdrawals

CARES Act
Retirement Plan Withdrawals

Withdrawals differ from loans in terms of the repayment period and availability based on the type of retirement plan you have.

- Withdrawals are the only qualifying distribution method for IRA, SIMPLE IRA, SEP and SARSEP account holders
- 401(k), 403(b) and other qualified plan holders can decide between taking a wothdrwal or a loan undr the Act's tax relief provisions.

If you are under age 59 ½, qualify under the CARES ACT, and withdraw money from your IRA, 401(k), or another covered qualified retirement plan during 2020, the required 10% penalty will be waived. Federal income taxes applied to the withdrawal can be avoided by redepositing the funds within three years.

Taxes will still be due on the amount withdrawn if the funds are not repaid within three years. However, any taxes owed can be spread evenly over the same three-year period or you may elect to pay them all at once. Repayments can be made in addition to the annual contribution limits.

Let's look at an example:

If you withdraw $70,000 and your federal marginal income tax bracket is 24%, you will owe $16,800 in taxes for accessing your money (or $5,600 a year). If you do not re-deposit the funds within three years. If you redeposit some or all of the withdrawn funds you will owe taxes only on what you keep.

NEXT:
CARES Act Retirement Plan Loans

CARES Act
Retirement Plan Loans

The CARES Act doubles the amount a qualifying 401(k), 403(b), TSP, 457(b) and other retirement plans a participant can borrow to the lesser of $100,000 or 100% of the participant's vested account balance; the current limit is $50,000.

To qualify, the loan must be made by September 23, 2020 (180 day period allowed under the Act, beginning on 3/27/2020).

You will not owe income tax on the amount borrowed from your 401(k) if it is paid back within five years. This is different than the three-year payback provision for 401(k) withdrawals.

Qualified individuals under the CARES Act who already have a 401(k) loan may delay repayments due in 2020 for one year. However, interest will continue to accrue on the deferred payments

NEXT: FAQs

FAQs

QUESTION
Are there any restrictions or limitations on how COVID-19 Related Distributions (CRDs) are utilized?

RESPONSE
There are no limitations on what you can use the withdrawn funds for during the three-year period. You can use the funds to pay bills, pay down your debts, or simply help get you through these uncertain times.

QUESTION
How does the three-year payback provision work if I make multiple withdrawals by December 31, 2020?

RESPONSE
The three-year re-contribution period for each withdrawal begins on the day after you receive it. This means you will need to keep track of each withdrawal separately if you plan on repaying some or all of the amount within three years to avoid paying the taxes due on amounts not re-contributed.

QUESTION
Do I have to redeposit any IRA withdrawals I make to the same account the funds came from?

RESPONSE
You can re-contribute to one or several of your IRA's, and they don't have to be the same account(s) you took the withdrawal from.

QUESTION
What if I have several retirement accounts? Can I withdraw from each of them, and at different times, up to the $100,000 limit?

RESPONSE
You can take one or more withdrawals from any number of retirement accounts you may have, subject to each plan's provisions, up to the $100,000 limit.

QUESTION
Does the Employer Need to Verify whether an individual qualifies for a COVID-19 Distribution or Loan

RESPONSE
No. The employer may rely on the individual's certification of eligibility

FAQs

QUESTION

Will these new temporary penalty-free withdrawal and loan options be automatically available in my 401(k) plan?

RESPONSE

Not necessarily. These new temporary early withdrawal provisions under the CARES Act are optional, meaning your plan doesn't have to permit them even if they already offer hardship withdrawals or loans. Check with your plan provider as to the availability of these options.

QUESTION

If I took a $50,000 distribution from my retirement account back in January, is that withdrawal eligible for the CARES Act 10% Penalty waiver if I meet the qualification requirements?

RESPONSE

Coronavirus-related distributions include those made from qualifying retirement plans and individual retirement accounts on or after January 1, 2020.

QUESTION

What if I already have two loans out on my 401(k) or 403(b), which is my plan limit, will I be able to take an additional loan out under the CARES act?

RESPONSE

Whether you can take out another loan from your 401(k) or 403(b) when you already have an existing loan will depend on your company's plan's rules. These rules can be found in the Summary Plan Description (SPD).

Most retirement plans limit the number of loans that you are allowed to have outstanding at any time, and the CARES Act doesn't automatically change such limitations.

If a plan allows for only one loan outstanding at a time, and you currently have one $25,000 loan outstanding, you would be unable to get another loan for the additional $75,000 that is available under the CARES Act unless your companies plan sponsor decides to amend the plan to allow for more than one loan. In light of the financial hardships the coronavirus crisis is creating for many individuals and families, some companies are beginning to look at making such amendments.

FAQs

QUESTION

Are there any other hardship withdrawal provisions available for my company-sponsored retirement plan if I am NOT a COVID-19 qualified individual?

RESPONSE

Although not required, a retirement plan may allow participants to receive hardship distributions. A hardship distribution can generally only be made if the distribution is both:

- Due to an immediate and heavy financial need
- Limited to the amount necessary to satisfy that financial need

An employee is automatically considered to have an **immediate and heavy financial need** if the distribution is for:

- Medical care expenses for the employee, the employee's spouse, dependents or beneficiary;
- Costs directly related to the purchase of an employee's principal residence (excluding mortgage payments);
- Tuition, related educational fees and room and board expenses for the next 12 months of postsecondary education for the employee or the employee's spouse, children, dependents or beneficiary;
- Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence;
- Funeral expenses for the employee, the employee's spouse, children, dependents, or beneficiary;
- Certain expenses to repair damage to the employee's principal residence;
- Expenses and losses (including loss of income) on account of federally declared disaster area disaster designated by the Federal Emergency Management Agency (FEMA) if your principal residence or place of employment at the time of a disaster was in an area FEMA designates as qualifying for individual assistance in connection with a federally declared disaster.

If a participant is under the age of 59 ½, distributions under the hardship provisions are subject to a 10% early withdrawal penalty but are not subject to a 20% withholding.

FAQs

QUESTION

Are there any hardship withdrawal provisions available to IRA holders who are NOT COVID-19 qualified individuals?

RESPONSE

Generally speaking, you can take an IRA hardship withdrawal to cover the following expenses:

- Unreimbursed medical expenses that exceed more than 7.5% of adjusted gross income (AGI) or 10% if younger than 65
- Qualified higher-education expenses
- Purchasing your first-home that doesn't exceed $10,000
- Certain expenses if you're a qualified military reservist called to active duty

But keep in mind that you would still owe income tax on any withdrawals you make. An IRA hardship withdrawal just spares you the 10% early withdrawal penalty.

IRA Hardship Withdrawals for Medical Expenses

- The IRS allows you to take a hardship withdrawal to pay for unreimbursed qualified medical expenses that do not exceed 10% of your adjusted gross income (AGI). Qualified medical expenses include most medical, dental and vision treatments that diagnose, prevent or treat disease.
- You have to take the IRA hardship withdrawal during the same calendar year that you incurred your medical bills.

IRA Hardship Withdrawals for Disability

You can take a penalty-free hardship withdrawal if you have experienced "total and permanent disability."

IRA Hardship Withdrawals to pay Health Insurance Premiums While Unemployed

If you have been unemployed for at least 12 weeks, you can take an IRA hardship withdrawal to pay for health insurance premiums.

FAQs

QUESTION

What are the main differences between the CARES Act penalty-free withdrawal provisions and the existing penalty-free hardship withdrawal and loan provisions already available for my IRA, 401(k) or other qualified retirement plan?

RESPONSE

The main differences between the CARES Act coronavirus related hardship withdrawal and loan provision versus the existing provisions already available include:

For IRAs under the existing hardship withdrawal provisions, early withdrawal penalties are waived only for withdrawals prompted by a medically related hardship. If you don't have medical insurance or your medical expenses are higher than what your plan will cover for the year. However, the amount available to withdraw penalty-free is the cost difference between the expense and 7.5% of your adjusted gross income.

For 401(k)s or 403(b)s the availability and qualifications for a hardship withdrawal are up to your employer who sponsors your plan. Although permitted by the IRS, employers are not required to offer them. If your employer permits hardship withdrawals, however, the IRS rules govern whether or not the 10% early withdrawal penalty prior to age 59 ½ will be waived, as well as how much you're allowed to withdraw.

The amount withdrawn under the existing hardship withdrawal provisions for IRAs, 401(k)s, 403(b)s, or another qualified plan, cannot be paid back, and any taxes due are levied in the year of the withdrawal and cannot be spread out.

NEXT:
Other Ways you Can Access Retirement Funds Penalty-Free

Other Ways you Can Access Retirement Funds Penalty-Free

The Rule of 55

Under what is known as "The Rule of 55", 401(k) or 403(b) participants who leave their employer for any reason after turning 55 years old are always free to pull money from their plans without paying the 10% penalty. This Rule of 55 could apply to you.

If you currently own a ROTH IRA, even if you are under age 59 ½, you can withdraw contributions any time, tax-free and penalty-free. However, under the traditional rules, you are be subject to taxes and penalties on any withdrawals before the account is five years old and if you are under age 59 ½.

You may be able to avoid penalties (but not taxes) on any earnings withdrawn prematurely if you qualify for one of many traditional exemptions offered.

NEXT: Summary

Summary

The relief provided by the CARES Act for retirement plan distributions can be a critical lifeline if you need access to funds to get you through this challenging period. However, your ability to repay the amount withdrawn, the impact on your overall tax situation, and other factors should be reviewed before making a COVID-19 related withdrawal or loan.

Speak with a fee-based financial planner first who can help guide you as to all your available options and help you better understand the nuances of the CARES Act provisions.

Have Questions? We Can Help.

Call us today at (800)530-6635 to schedule your free, no-obligation telephone or virtual consultation

Or Schedule Now

IN THIS FREE, NO-OBLIGATION CONSULTATION, WE WILL:

- Discuss your current situation
- Answer questions you may have
- Identify opportunities where we may be able to assist you
- Provide proactive next steps to get you on the right track

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