TOPICS:

- SBA
- COVID TAX BREAKS
- $100,000 TAX - PENALTY FREE IRA GRAB
- RMD

REFERENCE:

- https://www.congress.gov/bill/116th-congress/house-bill/748/text

Tax-Saving Tips; COVID-19 Edition

May, 2019

Dear Friend, Client, Connection

Get ready for this: "I'm from the government, and I'm here to help."

Here's the deal: "I'm going to give you $20,833 today. I want you to give me $5,448 no later than two years from now. You can keep the $15,385 difference, tax-free—no strings."

It's true. The lucky recipient could be you. To obtain the full $15,385 tax-free cash result in this deal (one of many COVID-19-related assistance programs), you must

- be self-employed,
- have no employees, and
- have self-employment net profits of $100,000 or more.

If you are self-employed, you have no employees, and your net profits are

- $75,000, you pocket $11,538, tax-free.
- $50,000, you pocket $7,692, tax-free.
- $25,000, you pocket $3,846, tax-free.

The results above come from the COVID-19 Payroll Protection Program (PPP). When you are a self-employed taxpayer with no employees, the PPP treats you as the one and only employee, and treats your net profits as your payroll.

Big Picture

Under the PPP, you go to your bank or another Small Business Association (SBA) bank or lender and obtain the PPP loan based on your 2019 net profits. It's a no-doc loan—super easy. No credit report, no nothing.

Do This Now

Two steps:

1. Read this letter.
2. Get your bank (or another bank) to accept your application.

Don't Procrastinate

The SBA runs out of PPP money in a hurry. The second round of funding started a few days ago.

If you snooze, you lose. And then you'll have to wait until round 3 of funding, should it take place. (We think it will.)

If you are self-employed, with no employees, you absolutely need to qualify for this loan and its forgiveness. Think free money. Think cash help during this crisis.

Here are three questions and answers that will help you understand this program during these COVID-19 times. Read on.

Q&A 1

Question 1. I have income from self-employment, have no W-2 employees, and file a Form 1040, Schedule C. Am I eligible for a PPP loan?

Answer 1. You are eligible for a PPP loan if

- you were in operation on February 15, 2020;
- you are an individual with self-employment income (such as an independent contractor or a sole proprietor);
- your principal place of residence is in the United States; and
- you have filed or will file a Form 1040 Schedule C for 2019.

Q&A 2

Question 2. Since I have no employees, how do I calculate the maximum amount I can borrow, and what documentation is required?

Answer 2. Follow the three steps listed below:

1. Find your 2019 IRS Form 1040 Schedule C line 31 net profit. (If you have not yet filed your 2019 tax return, don't fret. Fill out the Schedule C now. You need it for the loan.) If the net profit amount is over $100,000, reduce it to $100,000.
2. Calculate the average monthly net profit amount (divide the net profit by 12).
3. Multiply the average monthly net profit amount by 2.5.

Q&A 3

Question 3. What amount of the loan qualifies for forgiveness (remember, I don't have any employees)?

Answer 3. You are going to like this. With no employees, your loan forgiveness is

- eight weeks' worth (8/52) of your 2019 net profit (yes, last year, from that Schedule C you used for the loan amount—you don't have to consider your 2020 profits);
- mortgage interest paid during the covered period (eight weeks from loan receipt) on real or personal business property (the interest you will deduct on Schedule C);
- rent payments during the covered period on lease agreements in force before February 15, 2020, to the extent they are deductible on Form 1040 Schedule C (business rent payments); and
- utility payments under service agreements dated before February 15, 2020, to the extent they are deductible on Form 1040 Schedule C (business utility payments).

The SBA will reduce your loan forgiveness by any COVID-19 qualified sick or family leave tax credit you claimed. Your loan is for two years, but you don't have to wait much longer than the eight weeks to apply for forgiveness. There are no prepayment penalties.

Example

Loan amount. Say your Schedule C shows $120,000 of net profit. Your limit is $100,000. Divide that by 12, and your monthly amount is $8,333. Multiply that by 2.5, and your loan amount is $20,833.

Loan forgiveness. Your loan forgiveness is $15,385 (8/52 of $100,000) plus qualifying interest, rent, and utilities, not to exceed total loan forgiveness of more than $20,513.

In the SBA loan application, the amounts from this example show as follows:

- Average monthly payroll: $8,333
- x 2.5 = $20,833
- Number of employees: self

Paperwork

The paperwork is easy:

- Your 2019 1040 Schedule C (if you have not filed yet, complete Schedule C now)
- Proof that you were self-employed during 2019, such as a 2019 Form 1099-MISC, invoice, bank statement, or other book of record
- Proof that you were operating as a Schedule C business on or around February 15, 2020 (a 2020 invoice, bank statement, or book of record)
- Completed application with an SBA lender

Other Facts to Know

How can I request loan forgiveness?

You submit your forgiveness request to the lender that is servicing the loan. The lender must make a decision on the forgiveness within 60 days.

What is my interest rate?

1.00 percent fixed rate.

When do I need to start paying interest on my loan?

All payments are deferred for six months; however, interest will continue to accrue over this period.

When is my loan due?

In two years.

Can I pay my loan earlier than two years?

Yes. There are no prepayment penalties or fees.

Do I need to pledge any collateral for these loans?

No. No collateral is required.

Do I need to personally guarantee this loan?

No. There is no personal guarantee requirement.

Takeaways

It's true: the government is here to help your self-employed business during these difficult times, even when the only worker is you. The funds you receive and the minimum amount forgiven are automatic—based solely on your 2019 Schedule C net profit.

You need to move quickly. The government's newest (round 4) PPP funding will be used up in a matter of weeks.

COVID-19-Related Distributions from IRAs Get Tax-Favored Treatment

If you are an IRA owner who has been adversely affected by the COVID-19 pandemic, you are probably eligible to take tax-favored distributions from your IRA(s).

For brevity, let's call these allowable COVID-19 distributions "CVDs." They can add up to as much as $100,000. Eligible individuals can recontribute (repay) CVD amounts back into an IRA within three years of the withdrawal date and can treat the withdrawals and later recontributions as federal-income-tax-free IRA rollover transactions.

In effect, the CVD privilege allows you to borrow up to $100,000 from your IRA(s) and recontribute the amount(s) at any time up to three years later with no federal income tax consequences.

There are no income limits on the CVD privilege, and there are no restrictions on how you can use CVD money during the three-year recontribution period.

If you're cash-strapped, use the money to pay bills and recontribute later when your financial situation has improved. Help your adult kids out. Pay down your HELOC. Do whatever you want with the money.

CVD Basics

Eligible individuals can take one or more CVDs, up to the $100,000 aggregate limit, and these can come from one or several IRAs. The three-year recontribution period for each CVD begins on the day after you receive it.

You can make recontributions in a lump sum or make multiple recontributions. You can recontribute to one or several IRAs, and they don't have to be the same account(s) you took the CVD(s) from in the first place.

As long as you recontribute the entire CVD amount within the three-year window, the transactions are treated as tax-free IRA rollovers. If you're under age 59 1/2, the dreaded 10 percent penalty tax that usually applies to early IRA withdrawals does not apply to CVDs.

If your spouse owns one or more IRAs in his or her own name, your spouse is apparently eligible for the same CVD privilege if he or she qualifies (see below).

Do I Qualify for the CVD Privilege?

That's a good question. Some IRA owners will clearly qualify, while others may have to wait for IRS guidance. For now, here's what the CARES Act says.

A COVID-19-related distribution is a distribution of up to $100,000 from an eligible retirement plan, including an IRA, that is made *on or after January 2, 2020, and before December 31, 2020,* to an individual

- who is diagnosed with COVID-19 by a test approved by the Centers for Disease Control and Prevention; or
- whose spouse or dependent (generally a qualifying child or relative who receives more than half of his or her support from you) is diagnosed with COVID-19 by such a test; or
- who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, or forced to reduce work hours due to COVID-19; or
- who is unable to work because of a lack of child care due to COVID-19 and experiences adverse financial consequences as a result; or
- who owns or operates a business that has closed or had operating hours reduced due to COVID-19, and who has experienced adverse financial consequences as a result; or
- who has experienced adverse financial consequences due to other COVID-19-

related factors to be specified in future IRS guidance.

We await IRS guidance on how to interpret the last two factors. We hope and trust that the guidance will be liberally skewed in favor of IRA owners. We shall see.

What If I Don't Recontribute a CVD within the Three-Year Window?

Another good question. You will owe income tax on the CVD amount that you don't recontribute within the three-year window, but you don't have to worry about owing the 10 percent early withdrawal penalty tax if you are under age 59 1/2.

If you don't repay, you can choose to spread the taxable amount equally over three years, apparently starting with 2020.

Example. Tomorrow you withdraw $90,000 from your IRA, and you don't recontribute it and don't elect out of the three-year spread; you have $30,000 of taxable income in years 1, 2, and 3.

Here it gets tricky, because the three-year recontribution window won't close until sometime in 2023. Until then, it won't be clear that you failed to take advantage of the tax-free CVD rollover deal.

So, you may have to amend a prior-year tax return to report some additional taxable income from the three-year spread. The language in the CARES Act does not address this issue, so the IRS will have to weigh in. Of course, the IRS may not be in a big hurry to issue guidance right now, because it has three years to mull it over.

You also have the option of simply electing to report the taxable income from the CVD on your 2020 Form 1040. You won't owe the 10 percent early withdrawal penalty tax if you are under age 59 1/2.

Can the One-IRA-Rollover-Per-Year Limitation Prevent Me from Taking Advantage of the CVD Deal?

Gee, you ask a lot of good questions. The answer is no, because when you recontribute CVD money within the three-year window, it is deemed to be done via a direct trustee-to-trustee transfer that is exempt from the one-IRA-rollover-per-year rule. So, no worries there.

Can I Take a CVD from My Company's Tax-Favored Retirement Plan?

Yes, if your company allows it. The tax rules are similar to those that apply to CVDs taken from IRAs.

That said, employers and the IRS have lots of work to do to figure out the details for CVDs taken from employer-sponsored qualified retirement plans. Stay tuned for more information.

More Good News: Retirement Account Required Minimum Distribution Rules Are Suspended for 2020

In normal times, after reaching the magic age, you must start taking annual required minimum distributions (RMDs) from traditional IRAs set up in your name (including SEP-IRA and SIMPLE-IRA accounts) and from tax-favored company retirement plan accounts. The magic age is 70 1/2 if you attained that age *before 2020* or 72 if you attain age 70 1/2 *after 2019*.

And you must pay income tax on the taxable portion of your RMDs. Ugh!

Thankfully, the CARES Act suspends all RMDs that you would otherwise have to take in 2020.

The suspension applies equally to your initial RMD if you turned 70 1/2 last year and did not take that initial RMD last year (the initial RMD is actually for calendar year 2019). Before the CARES Act, the deadline for taking that initial RMD was April 1, 2020. Now, thanks to the CARES Act, you can put off any and all RMDs that you otherwise would have had to take this year. Good!

For 2021 and beyond, the RMD rules will be applied as if 2020 never happened. In other words, all the RMD deadlines will be pushed back by one year, and any deadlines that otherwise would have applied for 2020 will simply be ignored.

Takeaways

The CVD privilege can be a very helpful and very flexible tax-favored financial arrangement for eligible IRA owners.

- You can get needed cash into your hands right now without incurring the early withdrawal penalties.
- You can then recontribute the CVD amount anytime within the three-year window that will close sometime in 2023—depending on the date you take the CVD—to avoid any federal income tax hit.

The suspension of RMDs for this year helps your 2020 tax situation, because you avoid the tax hit on RMDs that you otherwise would have had to withdraw this year.