

## CARES Act changes that affect Form 1099-R Early Distribution – Box 7 Code 1

The CARES Act made several changes to retirement plans. **The most significant change for our clients is the waiver of the 10% penalty for early withdrawal in certain cases. If Form 1099-R Box 7 has a “1” in it, we should ask the taxpayer some follow-up questions.**

**Use the screening sheet on the following page** to determine whether this was a coronavirus-related retirement distribution. Proceed to the sections below only if this was considered a qualified distribution.

### **First, how does the taxpayer want to handle the retirement distribution?**

1. Report the entire distribution on their **2020** tax return.
  - a. The only action needed is to **follow the steps in the following section to complete Form 5329 to waive the early withdrawal penalty.**
2. Default option: Elect to report one-third of the taxable amount of the distribution as income on each return for tax years **2020, 2021, and 2022. You do not need to complete Form 5329 in this case.**
  - a. On the 1099-R entry form in TaxSlayer, you would then select Retirement Plan from the types of plans and then “Yes” to the question, “Did you make an early withdrawal from a retirement account due to a qualified disaster?”
  - b. The taxpayer is responsible for keeping records of this election so they know how much to report on the following three tax returns.
  - c. The data entry form in TaxSlayer for Form 1099-R will now show a zero taxable amount. **The tax return will show the original gross distribution and the correct one-third taxable amount.**
3. The taxpayer can elect to recontribute (i.e. repay to the payer) part or all of the distribution within that same three-year period (tax years 2020, 2021, and 2022).
  - a. This is only available if the payer is willing to accept this and is usually elected at the time of withdrawal. **No election is needed in the software;** the taxpayer will report this information when filing each future tax return to reduce the amount included in taxable income that year.
  - b. You can change your mind about recontributing your distribution (that is, you aren’t required to repay it). But the #2 election above to include the distribution in income ratably over three years cannot be changed once your 2020 tax return is filed.
  - c. **You will still need to complete Form 5329 to waive the early withdrawal penalty.**

### **Second, claim a waiver from the early withdrawal penalty (if applicable):**

1. On the second page of the 1099-R entry form in TaxSlayer, select Retirement Plan from the types of plans, then select the checkbox for “There are certain circumstances in which the IRS will allow you to make an early withdrawal and not have to pay the appropriate penalty. Not sure if your withdrawal qualifies to be exempt from the penalty?” Select Continue.
2. The software will then display Form 8915-E. Select “No” to the question, “Did you make an early withdrawal from a retirement account due to a qualified disaster?” Select Continue.
3. Next, type “5329” in the Form Finder field in the upper-left corner of the TaxSlayer menu and click “Go to Form 5329.”
4. In Form 5329, enter the taxable distribution amount from Form 1099-R and select “Other” from the dropdown as the reason for the exemption. Select Continue. This completes the waiver of the 10% penalty for early withdrawal.

# Screening Sheet for CARES Act Coronavirus-Related Retirement Plan Distributions

Instructions: Use this screening sheet to assist taxpayers with retirement plan distributions received on or after January 1, 2020, and before December 31, 2020, that may be eligible for special treatment.

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1. Were **you** or your **spouse** or **dependent** diagnosed with the virus SARS-CoV-2 or the coronavirus disease 2019 (collectively, "COVID-19") by a test approved by the Centers for Disease Control and Prevention (including a test authorized under the Federal Food, Drug, and Cosmetic Act);

\_\_\_\_\_ YES \_\_\_\_\_ NO

or

Did you or your spouse experience adverse financial consequences as a result of **you**, your **spouse**, or a **member of your household** (that is, someone who shares your principal residence):

- being quarantined, furloughed, or laid off or having work hours reduced due to COVID-19,
- being unable to work due to lack of childcare due to COVID-19,
- closing or reducing hours of a business that they own or operate due to COVID-19,
- having pay or self-employment income reduced due to COVID-19, or
- having a job offer rescinded or start date for a job delayed due to COVID-19.

\_\_\_\_\_ YES \_\_\_\_\_ NO

**If you answered yes to either of the above**, you may be able to designate your retirement plan distribution as a coronavirus-related distribution. Continue to the next question.

**If you checked no to both**, stop here. Your distribution is not a coronavirus-related distribution.

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2. Is your distribution any of the following:

- corrective distributions of elective deferrals and employee contributions that are returned to the employee (together with the income allocable thereto) (Form 1099-R, Box 7, code 8)
- certain excess elective deferrals or contributions (Form 1099-R, Box 7, code 8)
- loans that are treated as deemed distributions (Form 1099-R, Box 7, code L)
- dividends paid on applicable employer securities (Form 1099-R, Box 7, code U)
- the costs of current life insurance protection (Form 1099-R, Box 7, code 9)
- prohibited allocations that are treated as deemed distributions (Form 1099-R, Box 7, code 5)
- distributions that are permissible withdrawals from an eligible automatic contribution arrangement
- distributions of premiums for accident or health insurance

\_\_\_\_\_ YES \_\_\_\_\_ NO

**If you answered yes**, stop here. Your distribution is not a coronavirus-related distribution.

**Note:** The maximum amount of distributions for these special provisions is \$100,000. You and your spouse are each limited to \$100,000 for either option for your respective distributions.

**First choice:** You can include your eligible distribution in income ratably over 3 years. If you select this option:

- 1/3 of your eligible distributions will be included in income in 2020, 1/3 in 2021, and 1/3 in 2022.
- all coronavirus-related retirement distributions must be treated the same (either spread all over 3 years or include the entire amount in income in 2020).
- this election cannot be changed after the timely filing of your 2020 tax return.

3. Would you like to spread the income from your distribution over the 3 years? \_\_\_\_\_ YES \_\_\_\_\_ NO
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# Screening Sheet for CARES Act Coronavirus-Related Retirement Plan Distributions

**Second choice:** You also may retribute all or part of a coronavirus-related distribution that is eligible for tax-free rollover treatment. You cannot retribute the following:

- Any coronavirus-related distribution (whether from an employer retirement plan or an IRA) paid to a qualified individual as a beneficiary of an employee or IRA owner (other than the surviving spouse of the employee or IRA owner).
- Any distribution (other than from an IRA) that is one of a series of substantially equal periodic payments made (at least annually) for:
  - A period of 10 years or more,
  - The individual's life or life expectancy, or
  - The joint lives or joint life expectancies of the individual and the individual's beneficiary.
- Required minimum distributions.

Additionally:

- Recontributions can be to the same account, if allowed by the administrator or trustee, or to a different account, such as an IRA.
- You have 3 years from the day after you received the distribution to retribute. A retribution up to the day you timely file your federal income tax return will reduce the ratable portion of the coronavirus-related distribution that is includible in gross income for that tax year. For example: a repayment on Feb. 1, 2021, (before you file your 2020 return) will reduce the amount included in income in 2020.

**No election is needed – just let us know how much you repay and when.**

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**You can choose both:**

- Include 1/3 of the distribution in income for 2020, 2021, and 2022, and
- Reserve the right to retribute any or all of your distribution.

You can change your mind about recontributing your distribution (that is, you aren't required to retribute it). But the election to include the distribution in income ratably over three years cannot be changed once your 2020 return is filed.