Among the big-money, high-profile provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, there is a smaller tax provision. Like many of the headline items in the law, this tax provision is scheduled to expire, and so may receive some attention as a successor to the CARES Act is debated this year or next.

The objective of this provision is to allow persons adversely affected by the pandemic with respect to health or employment to meet their emergency liquidity needs by using balances in their Individual Retirement Accounts (IRAs) or other retirement vehicles at a reduced tax penalty relative to that charged for premature withdrawals under current law. There are also repayment options so that individuals who get back to work and recover from the pandemic hit can put the money back into their retirement accounts and so maintain their reserves for their retirement years without tax penalties.

There have also been limited discussions of modifying the CARES Act provision to allow individuals to transfer money at reduced tax penalties from traditional IRAs into Roth IRAs, which normally require that deposits be subject to tax (whereas people with modest incomes can make tax-deductible contributions into traditional IRAs, and postpone taxation of those dollars until they are withdrawn during retirement), and then allow withdrawals tax free upon retirement.

The bottom line is that the CARES Act provision has fairly clear advantages and disadvantages, but that policymakers may want to consider it or a modification as an aid to individuals who are suffering from the pandemic and may need to access their retirement savings to meet current needs. The repayment option under the CARES Act gives such individuals the welcome chance to rebuild their preparations for retirement if subsequent developments allow.

**CURRENT LAW**

**IRA contributions:** For 2020, an individual may contribute $6,000 ($7,000 if age 50 or over) into an IRA. The contribution is deductible for single people with incomes below $64,000, phasing out at $74,000, and for married people below $103,000, phasing out at $123,000.

**IRA withdrawals:** Withdrawals from deductible IRAs are taxable. Prior to age 59-1/2, there is an additional 10 percent penalty. (If the withdrawal is made within two years of the contribution, the penalty is 25 percent.)

**Roth IRA contributions:** Roth IRA maximum contributions are the same as for regular IRAs. For married couples, the full contribution may be made for incomes up to $196,000, phased out at $206,000.

**Roth IRA withdrawals:** Withdrawals made five years after the contributions into a Roth IRA, and after age 59-1/2 (or in case of disability or death, or for purchase of a first home) are tax free.

**IRA conversion into a Roth IRA:** The income limit for a conversion into a Roth IRA is the same as the income limit for a contribution into a Roth IRA. The taxpayer may convert up to the total balance in a traditional IRA into a Roth IRA. Previously deductible contributions into a traditional IRA are taxable at
the time of the conversion, as are earnings within the IRA; previously nondeductible contributions are not taxable at the time of the conversion. If the conversion is executed from end to end within 60 days, there is no 10 percent penalty.

CARES ACT POLICY

“Coronavirus-related distributions”: The CARES Act allows individuals who have contracted COVID-19 or have been subject to layoff (or whose spouses were so affected) to make a premature IRA distribution without penalty, and to recognize the withdrawal in income in equal installments over three years—so that the tax impact is at least postponed, and possible reduced (if the full lump sum might push the taxpayer into a higher marginal tax rate bracket). Furthermore, the taxpayer can redeposit those withdrawals over three years, and therefore in effect to take a loan from their IRAs without tax consequences. The benefit of the waiver of the penalty is obvious; the ability to restore the withdrawn funds allows the individuals to avoid the income taxation of the money they borrow (rather than withdraw). These provisions are effective for withdrawals through the end of calendar 2020.

COST

The Congressional Budget Office (CBO) and the congressional Joint Committee on Taxation (JCT) estimated that the cost of the CARES Act provision would be $3 billion over the 11 fiscal years from 2020 to 2030. Of that total, $2 billion would be realized in fiscal year 2021, when there would be reduced taxes paid on IRA withdrawals; the balance of the total would be spread in small amounts over the remainder of the 11-year measurement period. Persons who take a premature withdrawal and then repay the funds in the form of a loan will impose no tax consequences of the federal government.

ANALYSIS

On the one hand, the potential cash needs of pandemic-impacted families are clear. Some of those families, but surely not all, have sufficient cash in retirement accounts to meet those needs.

But a further consideration is the feared shortage of long-term saving for retirement on the part of many families. Some families may choose to meet perceived current needs by drawing down their retirement savings if facilitated by some reduction of the cost of premature IRA withdrawals, but this will leave them less prepared for retirement later. If the people for whom we are concerned truly are down on their luck—presumably because of unemployment—it surely would be more constructive to provide them with increased unemployment benefits, perhaps through some improved form of the now-expired benefit increases from the CARES Act, rather than inducing them to weaken their already questionable preparation for retirement. There already is a bipartisan political consensus to augment unemployment benefits and to extend them to longer durations until the economy recovers. Either increased unemployment benefits or reduced taxation of IRA or other retirement plan conversions would require an Act of Congress, so neither is easier to obtain than the other. But if for some reason it is deemed necessary to provide support through liberalization of IRAs, the CARES Act provision to permit loans that can be repaid might induce the beneficiaries of such relief to save more in the future to restore their retirement savings.
ALTERNATIVE PROPOSAL FOR ROTH IRA CONVERSIONS

An alternative proposal is to liberalize conversions of traditional IRAs into Roth IRAs to provide liquidity to persons adversely affected by the economic downturn. Given that conversions are permitted without limit for taxpayers with incomes of up to $196,000, raising the income eligibility limit would not seem appropriate (for reference, the cash pandemic stimulus payments were permitted only for families with incomes of up to $75,000; and state unemployment benefits typically provide quite limited income replacement for high-wage workers), and there is no conversion limit to raise (except perhaps to the extent that the amount of a conversion would raise the income of the individual to beyond the eligibility limit; but again, the amounts of income and wealth involved in that consideration would probably be regarded as unseemly and unfair).

Under current law, conversions are not subject to any penalty (if completed from end to end within 60 days), but the amounts converted are subject to income tax. Thus, one possibility would be to reduce the income tax on the amount converted.

Policy Considerations

What concessionary tax rate. Current statutory income tax rates range from zero at the low end to 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent, and 37 percent. Therefore, a fixed conversion tax rate such as 10 percent would not benefit lower-income taxpayers at all, and would provide outsized tax savings for those in higher tax brackets. Therefore, presumably, a better concession would be to reduce the tax rate (and therefore the tax due) by some fraction, perhaps half.

Cost

Estimating the cost of a Roth IRA conversion option with publicly available data is subject to enormous error. And while the data are limited, there is a further virtually imponderable question of how many people would take advantage of a Roth conversion option.

Who has an IRA: Annual IRS tax return data show how many people make contributions to or take taxable withdrawals from IRAs. Those data do not show how many people have IRAs. The best source of data on that question is the Federal Reserve Board’s “Survey of the Financial Characteristics of Consumers,” which is conducted every three years. The latest survey covered 2019. It showed that overall, 50.6 percent of all families had a “retirement account,” which surely includes households that had accounts other than IRAs. (According to the survey, persons aged 65 and over are somewhat less likely to have a “retirement account” than those who are younger.) The identification by family income is limited; the survey reports that of families with incomes of less than $20,000, 10.7 percent have a retirement account; of families with incomes between $20,000 and $40,000, 32.8 percent do; between $40,000 and $60,000, 53.7 percent do; between $60,000 and $80,000, 69.9 percent; between $80,000 and $90,000, 80.8 percent do; and between $90,000 and $100,000, 90.5 percent have retirement accounts. (No higher income levels are reported.)

Who contributes to an IRA: Income tax return statistics provide information on tax deductible contributions to IRAs (but not on who has an IRA, or on nondeductible contributions). The latest available tax return data cover income year 2018. In that year, 1.6 percent of all returns reported an income adjustment for deductible contributions. Of returns with no adjusted gross income (AGI) at all,
0.9 percent made deductible contributions, of an average of more than $5,300 per return. Returns with AGI of between $1 and $30,000 had less than 1 percent making deductible contributions. From $30,000 to $50,000, it was between 1 and 2 percent; between $50,000 and $100,000, it was between 2 and 3 percent; from $100,000 to $200,000, it was 3.3 percent; and above $200,000, it ranged from 1.4 to 2.7 percent. (It is not clear how deductible contributions were permitted at such high income levels; there may be fine points of the law that make it permissible under limited circumstances, including potentially rollovers of pre-existing accounts.)

**Traditional-IRA-to-Roth conversions:** Only aggregate data are available on conversions undertaken. In 2018 (latest available), there were 77,993 tax returns that reported a Roth conversion, with an average of $23,008 per conversion. The is no available breakdown of this figure according to income or any other taxpayer characteristic.

**Revenue consequences.** There is no doubt that such a change would reduce tax revenue (over the long term, appropriately discounted), because (other than desperation) there is no reason for a taxpayer to undertake a conversion if it does not reduce his or her tax liability. One estimate of accumulated balances in traditional IRAs is reported to be approximately $7.4 trillion (not all of which is taxable; some percentage, surely less than half, is nondeductible contributions). The short-term Treasury revenue gain and long-term revenue loss from reducing income tax upon conversion would of course be a function of the share of that accumulation that would be converted. There is no publicly available estimate what share of IRA balances would be eligible for conversion, and would be converted if a concessionary tax rate were made available.

However, as a rough rule of thumb for whatever amount of aggregate conversions should occur, assuming that the tax upon conversion is cut in half, that the average tax rate facing taxpayers executing conversions is 22 percent (income limits for conversions under current law would prohibit high-income persons from executing conversions), that the proceeds are spent after five years (which is the current-law minimum holding period for tax-free withdrawals), and that an appropriate discount rate for the deferred revenues is 2 percent per year, then the federal government would lose revenue equal to almost $0.09 on every dollar converted over the long run. This would be the net of higher revenues at the time of the conversion, and lower revenues when the money from the traditional IRA would have been withdrawn and taxed. Changing any of these assumptions would change the ultimate estimate.

Some might argue that a dollar of revenue today is needed more urgently because deficits are large. Others would counter that the economic slowdown and the continuing drag of pandemic restrictions means that large deficits today are more tolerable, and that the projected growing deficits in the long run, when interest rates could rise if the economy shows any signs of life, would make future revenue losses more problematic than current ones.

**Target efficiency.** The first motivation ascribed to this idea was providing liquidity to persons harmed by the economic downturn. The mechanism to achieve that would be to unlock savings in traditional IRAs, which can be withdrawn only with income taxation plus a penalty, and move that money into Roth IRAs, which can be withdrawn without penalty. However, Roth IRA withdrawals are tax free only after five years, and only for individuals who are at least 59-1/2 years old. People who are at least 59-1/2 years old can withdraw their traditional IRA balances without penalty under current law, and so waiving the penalty would make no difference for them. Of course, the five-year delay and the minimum age could be waived for purposes of response to the pandemic.
However, this raises another question. If the purpose is truly to allow people who are down on their luck to have cheaper access to the money in their traditional IRAs, why is there any need to have them move the money into Roth IRAs, and then withdraw it to meet their pressing needs? Why not take the much simpler step of merely extending the liberalization of the traditional IRA premature withdrawal penalty, such as the CARES Act provisions do? If there is felt to be a need to be more generous than the CARES Act, why not also give a concessionary tax rate on the withdrawal, and leave out the additional complexity of the Roth IRA creation? Either approach would require a change of law, so neither would be any easier to implement. The only distinction between the two, it would seem, would be that involving the Roth IRA would allow persons who actually are not down on their luck and not liquidity constrained to exercise a cheaper conversion to a Roth IRA than is allowed under current law, and to enjoy a tax benefit and save the money rather than accessing it to meet current needs. Note that use of the concessionary provisions in the CARES Act requires that either the taxpayer or spouse have an adverse health or employment event because of the pandemic; that tougher standard could be applied to any Roth IRA liberalization to avoid the risk of windfalls to people who are not in need, but surely there would be some people who suffered brief unemployment or an inconsequential case of the virus to justify a reduced-cost tax break by engaging in a Roth IRA conversion.