Tax Issues/Clarifications/Changes In Latest COVID Relief Package

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As you are likely aware, President Trump recently signed a legislative package that included a second significant stimulus package, in total, exceeds 5,500 pages in length.

Here is my attempt to summarize the package — which I'll refer to as "the bill." The bill continues some earlier COVID tax incentives while also providing some new forms of relief.

Let's start with subtitle B of Title II of Division N of the bill – the "COVID-related Tax Relief Act of 2020."

Stimulus Payments: The bill provides another round of individual stimulus payments, although smaller than those available under the CARES Act: up to $600 for individuals and $1,200 for a married couple filing jointly, plus $600 for each dependent child under the age of 17 (no payment is available for an adult dependent). Taxpayers eligible to be claimed as a dependent on another's return are not eligible to receive a payment. As before, the payments phase out once adjusted gross income exceeds $75,000 for a single taxpayer and $150,000 for a married couple.

The checks will be cut in the coming weeks and will be based on your 2019 filing information. But as was the case with the first round of stimulus checks, the payments represent an advance against a credit taxpayers will claim on their 2020 tax return. And, if the actual credit a taxpayer is owed on his or her 2020 return exceeds the advance payment received, they will claim an additional refundable credit for the balance. To the contrary, if the advance payment exceeds the actual credit, the taxpayer is not required to "true-up" by making a payment back to the IRS.

PPP Loans: One major facet of the CARES Act was the establishing of the Paycheck Protection Program, which made loans of up to $10 million available under Section 7 of the Small Business Act to borrowers who, in general, had fewer than 500 employees. The loans could be used to pay for payroll, rent, mortgage payments, and utilities.

The most appealing part of the PPP loans, however, was that any amounts spent during the 24 week period beginning with the disbursement of the loan would be eligible to be forgiven by the SBA, and most importantly, Congress declared that the forgiveness would not create taxable income, a deviation from the general tax rules.

The subsequent rollout of the PPP, however, was riddled with problems: much of the necessary guidance was nonexistent, and what little was published was either too late to help or inconsistent with the legislative text of the CARES Act.

As VGM offered in a series of Webinars, there was a concern that soon after borrowers began obtaining the loan, the IRS issued Notice 2020-32, which concluded that expenses paid with PPP funds would not be deductible. Thus, while the forgiveness of the funds would not generate taxable income, the denial of a deduction related to the use of the funds would effectively make the loan taxable.

Many tax experts opined that this was the correct interpretation from a tax policy perspective, but it came as unexpected and unwelcome news to thousands of borrowers.

Deductibility of Expenses Paid with Forgiven PPP Funds: Ever since the IRS published the notice, borrowers, tax professionals, and other stakeholders lobbied for Congress to overrule the IRS and provide a double benefit: tax-free forgiveness of loan proceeds AND deductible expenses paid with PPP funds. Section 276 of Division N of this bill does just that, providing that "no deduction shall be denied or reduced, no tax attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income." Importantly, this rule applies to ALL borrowers; even those who have already applied for forgiveness. Thus, expenses paid with PPP funds are now completely deductible.

Other Loan Forgiveness Issues: The bill provides taxpayers to "double dip" in a number of scenarios: for example, receipt of an Economic Injury Disaster Loan advance will no longer be taxable, and any expenses paid with the advance will remain deductible. The same holds true for borrowers of traditional Section 7 SBA loans who had six months of their principal and interest paid pursuant to the CARES Act.

Employee Payroll Tax Deferral: Over the summer, President Trump used an executive order to allow certain employees to defer the 6.2% share of Social Security tax on wages paid from September 1, 2020 through the end of the year until the first four months of 2021. The bill extends the due date for that deferral to be repaid from April 30, 2021 until December 31, 2021.

FFCRA Credits: The Families First Coronavirus Response Act required certain small employers to pay up to 10 weeks of qualified family leave when an adult couldn't work because a child was without school or care, and up to 2 weeks of sick leave for a variety of COVID-related reasons. In turn, the employer would receive a fully refundable dollar-for-dollar payroll tax credit equal to the wages paid. The bill extends the credit provisions from December 31, 2020 through March 31, 2021.

Let's continue with "Division EE, the Taxpayer Certainty and Disaster Tax Relief Act of 2020."

Extension of the Employee Retention Tax Credit: The CARES Act created the Employee Retention Credit (ERC), a mutually exclusive option to a PPP loan. The credit was only available for 2020, and offset a taxpayer's payroll tax liability. The credit was equal to 50% of the first $10,000 of qualified wages paid to an employee during an "eligible quarter;" generally, either a quarter in which 1) the business had its operations fully or partially suspended by an appropriate government order, or 2) the business had a precipitous drop in gross receipts quarter-over-quarter when comparing 2020 to 2019. The credit was computed differently if the business had more than 100 employees – above that threshold, the employer could only claim the credit on wages paid to employees NOT to work.

The bill extends the ERC through July 1, 2021, and greatly expends several aspects of the credit for amounts paid in the first two quarters of 2021. First, the credit percentage is increased from 50% to 70% of qualified wages. Qualified wages, in turn, are increased from $10,000 in TOTAL per employee to $10,000 per quarter per employee, while the change in treatment of qualified wages that once occurred above 100 employees now does not kick in until employees exceed 500. In addition, a mere 20% drop in quarter-over-quarter receipts are now required to make a quarter an "eligible quarter," rather than the 50% initially required by the CARES Act.

Perhaps most importantly, it appears that a taxpayer may now claim the ERC AND take out a PPP loan; they are no longer mutually exclusive. Any wages upon which an ERC is computed, however, would not be forgivable costs under the PPP program.

Full Business Meals Deduction Permitted in 2021 and 2022: Section 274(n)(2) has been modified to allow for full expensing of "restaurant" meals purchased in 2021 and 2022 provided the other requirements for deductibility under Reg. Section 1.274-12 are met; i.e., not lavish, the taxpayer is present, as is an employee or business associate, etc…

Changes to Charitable Contributions: The CARES Act permitted taxpayer who do NOT itemize their deductions to claim up to a $300 charitable deduction in arriving at adjusted gross income for 2020 only, provided the contribution were paid in cash to a public charity. The bill extends the provision to 2021, but increases the deduction to $600 for a married couple filing jointly. The CARES Act also temporarily increased the limitation for deductible cash contributions to a public charity from 60% to 100%. The bill extends this treatment into 2021.

Special "Lookback" for EITC and CTC: The bill includes a special temporary rule allowing lower-income individuals to use their earned income from tax year 2019 to determine the Earned Income Tax Credit and the refundable portion of the Child Tax Credit (i.e., the Additional Child Tax Credit) in the 2020 tax year. This will help workers who experienced lower wages this year, due to the pandemic, to get a larger refund that is consistent with their earnings from prior filing seasons.

Extension of Certain Expiring Provisions: The bill revives several provisions that were set to expire at the end of 2020, some permanently, some for shorter durations. Here are a few of the provisions that are now permanent fixtures of the Code:

- Unreimbursed medical expenses are deductible to the extent they exceed 7.5% of adjusted taxable income. This floor was slated to increase to 10% in 2021, but the bill makes permanent the 7.5% floor.
- Section 179D, which allows for a limited deduction upon making energy efficient improvements to nonresidential rental, was set to expire at the end of 2020. It is now permanent.
- The deduction in arriving at adjusted gross income for qualified tuition expenses – which was set to expire at the end of 2020 – WILL be allowed to expire, though it will be replaced with increased income phaseout thresholds on the Lifetime Learning Credit under Section 25A.

New provisions extended for five years (until December 31, 2025). They include:

- Section 108(a)(1)(E), which allows for up to $2 million of mortgage principle secured by a taxpayer's principal residence to be forgiven tax-free. The new limit, however is $750,000 for a married couple, $375,000 for a single taxpayer;
- Section 127, which had historically allowed an employer to pay up to $5,250 of an employee's qualified tuition each year tax-free before being amended by the CARES Act to include within that limit – for 2020 only — payments of an employee's student loan principal and interest, has been amended to allow for student loan payments through the end of 2025.
- The bill also extended through the end of 2021 a host of soon-to-expire energy credits, including the credits for nonbusiness energy property, energy efficient homes, and fuel cell motor vehicles.

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