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Certified Public Accountants

Tax Legislation Release (CAA, COVID TRA, TCDTR)

Wednesday, December 30, 2020

The Consolidated Appropriations Act, 2021 (CAA, 2021)
COVID-Related Tax Relief Act of 2020 (COVIDTRA)
Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTR)

On Sunday, December 27, 2020, President Trump signed the Consolidated Appropriations Act, 2021 (CAA, 2021) into law. This new legislation contains several business, payroll and individual related tax provisions. In addition, the new legislation contains several "tax extenders". Included in this release is a summary of the key provisions of the new legislation. If you have any questions or need further information regarding the information contained in this release, please contact our offices. We sincerely appreciate this opportunity to serve you.

BUSINESS PROVISIONS

Clarification of Tax Treatment of Covered PPP Loan Forgiveness

The CARES Act provided that a recipient of a PPP loan may use the loan proceeds to pay payroll costs, certain employee benefits relating to healthcare, interest on mortgage obligations, rent, utilities, and interest on any other existing debt obligations. If a PPP loan recipient uses their PPP loan to pay those costs, they can have their loan forgiven in an amount equal to those costs. The IRS has issued guidance that PPP loan forgiveness is akin to tax-exempt income and proposed disallowance of certain expenses paid for with funds obtained from a PPP loan. The new legislation clarifies taxpayers whose PPP loans are forgiven **are** allowed deductions for otherwise deductible expenses paid with the proceeds of a PPP loan, and that the tax basis and other attributes of the borrower's assets will not be reduced as a result of the loan forgiveness. This provision is effective as of the date of enactment of the CARES Act (March 26, 2020) and thus should apply to all PPP loans assuming the criteria for loan forgiveness are met.

Paycheck Protection Program (PPP): Round 2

The CARES Act authorized the Small Business Administration (SBA) to make loans to qualified businesses. The provision established the Paycheck Protection Program (PPP) which provides up to 24 weeks of cash-flow assistance through 100% federally guaranteed loans to eligible recipients to maintain payroll during the coronavirus (COVID-19) pandemic and to cover certain other expenses. The Paycheck Protection Program Flexibility (PPPF) Act made substantial changes to the PPP, including decreasing the percentage that loan proceeds must be used on payroll costs from 75% to 60%, thereby increasing the percentage that may be used for non-payroll costs such as rent, mortgage interest and utilities from 25% to 40%. Additionally, the PPPF Act permits borrowers to defer payments of principal, interest, and fees to 10 months after the last day of the covered period (the earlier of 24 weeks or December 31, 2020). Prior to the PPPF Act, the deferral period would end after six months. The application period closed on August 8, 2020. The SBA began approving PPP forgiveness applications and remitting forgiveness payments to PPP lenders on October 2, 2020.

The new legislation permits a second draw from the PPP of up to $2 million for certain smaller businesses, including those who previously received a PPP loan and experienced a 25% reduction in gross receipts.

Prior PPP borrowers must meet the following conditions to be eligible for the second draw loans:

- Employ no more than 300 employees per physical location;
- Have used or will use the full amount of their first PPP loan; and
- Demonstrate at least a 25% reduction in gross receipts in the first, second, or third quarter of 2020 relative to the same 2019 quarter. Applications submitted on or after January 1, 2021 are eligible to utilize the gross receipts from the fourth quarter of 2020.

Eligible entities include for-profit businesses, certain non-profit organizations, housing cooperatives, veterans' organizations, tribal businesses, self-employed individuals, sole proprietors, independent contractors, and small agricultural co-operatives.

Similar to Round 1 of the PPP, borrowers may receive a second loan of up to 2.5 times the average monthly payroll costs in the one year prior to the loan or the calendar year. However, borrowers in the hospitality or food services industries (NAICS code 72) may receive loans of up to 3.5 times average monthly payroll costs. Only a single second draw is permitted to an eligible entity.

Second draw loans of no more than $150,000 may submit a certification, on or before the date the loan forgiveness application is submitted, attesting that the eligible entity meets the applicable revenue loss requirement. Non-profits and veterans organizations may use gross receipts to calculate their revenue loss standard.

Like the first PPP loan, the second draw loan may be forgiven, with some exceptions, for payroll costs of up to 60% and non-payroll costs such as such as rent, mortgage interest and utilities of 40%. The new legislation extends current safe harbors on restoring full-time employees and salaries and wages. Specifically, the new legislation applies the rule of reducing loan forgiveness for the borrower reducing the number of employees retained and reducing employees' salaries in excess of 25%. The new legislation also clarifies treatment of loan forgiveness and the deductibility of expenses paid with PPP funds is the same for second draw PPP loans as mentioned in the "Clarification of Tax Treatment of Covered PPP Loan Forgiveness" above.

<u>**Depreciation of Certain Residential Rental Property Over 30-Year Period**</u>

The Tax Cuts and Jobs Act (TCJA) modified the rules regarding the current deductibility of interest expense for certain taxpayers engaged in a trade or business. The TCJA also allowed a real property trade or businesses to elect out of the business interest deduction limitations under Internal Revenue Code §163j subject to certain caveats. For tax years beginning after December 31, 2017, electing real property trade or businesses were required to depreciate nonresidential real property, qualified improvement property and residential rental property, as subject to the alternative depreciation system (the ADS). In basic terms, this requirement extended the useful life of certain real property and thus decelerated tax depreciation deductions with respect to real property. For residential real property, an election out of the interest limitation rules effectively increased the depreciable life/recover period 12.5 years from 27.5 years to 40 years for assets placed into service prior to January 1, 2018. For assets placed into service after December 31, 2017, the TCJA changed the ADS recovery period for residential real property from 40 years to 30 years.

Under the new legislation, for tax years beginning after December 31, 2017, an electing real property trade or business may depreciate residential real property using a 30-year ADS recovery period even if the property was placed in service prior to January 1, 2018 and as long as the trade or business was not required to previously determine depreciation deductions using the alternative depreciation system (the ADS).

Energy Efficient Commercial Buildings Deduction (§179D)

Under pre-Act law, for property placed into service before January 1, 2021, taxpayers could claim a deduction for energy efficiency improvements to lighting, heating, cooling, ventilation, and hot water systems of commercial buildings. This includes a $1.80 deduction per square foot for construction on qualified property. A partial $0.60 deduction per square foot is allowed if certain subsystems meet energy standards but the entire building does not, including the interior lighting systems, the heating, cooling, ventilation, and hot water systems, and the building envelope. If energy efficient commercial building property is installed on or in property owned by a governmental entity, the person primarily responsible for designing the property shall be entitled to the deduction.

50% Limitation on Certain Business Meal Deduction Suspended for 2021 and 2022

Taxpayers may generally deduct the ordinary and necessary food and beverage expenses associated with operating a trade or business, including meals consumed by employees on work travel. The deduction is generally limited to 50% of the otherwise allowable amount. Under the new legislation, the 50% deduction limitation will NOT apply to expenses for food or beverages provided by a restaurant that are paid or incurred after December 31, 2020, and before January 1, 2023. The provision is limited to "food or beverages provided by a restaurant," consistent with the policy objective behind this provision of assisting the restaurant industry. Note this change does not impact 2020 calendar year taxpayers.

Farmers' Net Operating Loss Changes

Prior to the enactment of the CARES Act, farmers were allowed to carry back net operating losses (NOLs) to each of the two preceding years. Farmers could also elect to waive the carryback and thus carry forward the net operating loss. The CARES Act provided that net operating losses arising in a tax year beginning after December 31, 2017 and before January 1, 2021 can be carried back to each of the five tax years preceding the tax year of such loss. The five-year period relating to a carryback was required absent an affirmative election to waive the net operating loss carryback period.

The new legislation allows farmers who elected a two-year net operating loss carryback prior to enactment of the CARES Act to elect to retain that two-year carryback period rather than claim the five-year carryback as provided in the CARES Act. It also allows farmers who previously waived an election to carry back a net operating loss to revoke the waiver.

PAYROLL PROVISIONS

Extension of Paid Sick and Family Leave Credits

Effective April 1, 2020 through December 31, 2020, the Families First Coronavirus Response Act (FFCRA) requires certain employers to provide paid leave to workers who are unable to work or telework due to circumstances related to COVID-19 (Qualified Paid Leave). FFCRA offsets the costs of providing Qualified Paid Leave, up to certain amounts, with refundable tax credits against employment taxes for qualified leave wages taken beginning April 1, 2020, and ending December 31, 2020.

The new legislation extends the refundable tax credits available to employers who provide paid sick and family leave related to the coronavirus (COVID-19) pandemic as enacted in the FFCRA through March 31, 2021, and extends the corresponding employer mandates through the end of March 2021.

Employee Retention Credit Expansion and Extension
Under the CARES Act, the Employee Retention Credit (ERC) provides a refundable payroll tax credit for 50% of qualified wages of up to $10,000 per employee for a maximum credit of $5,000 per employee. The ERC may be claimed for wages paid after March 12, 2020, and before January 1, 2021. "Eligible Employers" include private-sector businesses and tax-exempt organizations whose operations have been fully or partially suspended as a result of a government order limiting commerce, travel, or group meetings. The credit is also provided to employers who have experienced a greater than 50% reduction in quarterly receipts (sometimes referred to as a "significant decline in gross receipts"), measured on a year-over-year basis.

Beginning on January 1, 2021 and through June 30, 2021, the new legislation extends and expands the following
CARES Act provisions related to the Employee Retention Credit:

- Increases the ERC rate from 50% to 70% of qualified wages
- Expands eligibility for the credit by reducing the required year-over-year gross receipts decline from 50% to 20% and provides a safe harbor allowing employers to use prior quarter gross receipts to determine eligibility
- Increases the limit on per-employee creditable wages from $10,000 for the year to $10,000 for each quarter
- Increases the 100-employee delineation for determining the relevant qualified wage base to employers with 500 or fewer employees
- Allows certain public instrumentalities to claim the credit
- Removes the 30-day wage limitation, allowing employers to, for example, claim the credit for bonus pay to essential workers;
- Allows businesses with 500 or fewer employees to advance the credit at any point during the quarter based on wages paid in the same quarter in a previous year
- Provides rules to allow new employers who were not in existence for all or part of 2019 to be able to claim the credit
- Provides for a small business public awareness campaign regarding availability of the credit to be conducted by the Secretary of the Treasury in coordination with the Administrator of the Small Business Administration

The new legislation also makes the following provisions retroactively to March 12, 2020:

- Provides clarification for the determination of gross receipts for certain tax exempt organization
- Reaffirms prior IRS guidance that group health plan expenses can be considered qualified wages even when no wages are paid to an employee
- Provides that employers who receive a Paycheck Protection Program (PPP) loan may still qualify for the ERC for wages that are not paid for with forgiven PPP proceeds

Finally, the new legislation also provides a tax credit for 40% of wages (up to $6,000 per employee) paid by a disaster-affected employer to a qualified employee. The credit applies to wages paid without regard to whether services associated with those wages were performed. Certain tax-exempt entities are provided the option to claim the credit against payroll taxes.

INDIVIDUAL PROVISIONS

Additional 2020 Recovery Rebates

In March of 2020, The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) added a new refundable credit for the 2020 tax year, the "initial" 2020 Recovery Rebate. Eligible individuals should have received an "advanced refund" of $1,200 ($2,400 for a married couple) and $500 for each qualifying child, generally dependent children under age 17. The initial recover rebate was subject to phase outs at a rate of $5 for each $100 of adjusted gross income in excess of $75,000 for single taxpayers ($150,000 for married couples).

The COVID-Related Tax Relief Act of 2020 provides an "additional" 2020 Recovery Rebate for individuals. The amount of "additional" Recovery Rebate is $600 per taxpayer ($1,200 for married filing jointly), in addition to $600 per qualifying child. Similar to the "initial" 2020 Recovery Rebate, the "additional" Recovery Rebate phases out starting at $75,000 of modified adjusted gross income ($150,000 for married filing jointly) at a rate of $5 per $100 of additional income.

Comment: On December 28, 2020, the House of Representatives, with bi-partisan support, passed the Caring for Americans with Supplemental Help Act (CASH Act). The CASH Act would effectively increase the amount of the "additional" 2020 Recovery Rebate from $600 to $2,000 and would substitute "dependent" child for "qualifying" child, thus allowing an advance credit for children over the age of 17. As of the date of this release, the CASH Act has not been voted on by the Senate with Senate Majority Leader Mitch McConnell objecting to bringing such bill to a vote on the Senate floor.

Certain Charitable Contributions Deductible by Non-Itemizers

The CARES Act previously enhanced tax incentives for making charitable contributions for those individuals who do not itemize their deductions. The CARES Act provided an above-the-line deduction of $300 for cash charitable contributions made by individuals. The additional $300 could be claimed in addition to the standard deduction for the 2020 tax year.

The Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTR) extends the above rule through December 31, 2021. Individuals who normally do not itemize deductions may take up to a $300 above-the-line deduction for cash contributions to qualified charitable organizations. The new legislation also clarifies the above-the-line deduction is $600 for married taxpayers filing a joint return.

Modification of Limitations on Charitable Contributions

The limitation on charitable deductions for individuals that is generally 60% of modified adjusted gross income (the contribution base). The CARES Act previously suspended the 60% limitation for cash contributions made, generally, to public charities in 2020 (qualifying contributions). Effectively, an individual's qualifying contributions, reduced by other contributions, can be as much as 100% of the contribution base. No connection between the contributions and COVID-19 activities is required.

The Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTR) extends the above rule through December 31, 2021, effectively a 1 year extension of the provision contained in the CARES Act.

Note: The CARES Act also provided that the limitation on charitable deductions for corporations, generally 10% of (modified) taxable income, does not apply to qualifying contributions made in 2020. Instead, a corporation's qualifying contributions, reduced by other contributions, can be as much as 25% of (modified) taxable income. No connection between the contributions and COVID-19 activities is required. Furthermore, for contributions of food inventory made in 2020, the deduction limitation increases from 15% to 25% of taxable income for C corporations and, for other taxpayers, from 15% to 25% of the net aggregate income from all businesses from which the contributions were made.

Temporary Rules for Health and Dependent Care Flexible Spending Arrangements

Health and dependent care Flex Spending Arrangements (FSA) are generally subject to a "use it or lose it" rule pursuant to which employees must use their account balances for eligible expenses incurred during the plan year. The normal rule for health care FSAs is that year-end balances are forfeited, unless the employer's plan contains provisions known as the "carryover rule" or the "grace period rule". Under the "carryover rule", up to $550 may be carried over into the next year to pay claims incurred at any point during the year. The "grace period rule" permits an unlimited amount to be used to pay for claims incurred during the first 2½ months of the year following election. Dependent care FSAs are generally eligible for the "grace period rule" but not the "carryover rule".

Under the new law, **both** health care and dependent care FSAs may apply either the carryover rule or the grace period rule for unused amounts as of the end of 2020 with two important changes. First, $550 cap on the carryover amount no longer applies for the 2020 or 2021 calendar years. Second, for the 2020 and 2021 tax years, the grace period rule can be applied for a full 12 month period, not just 2½ months. As a practical matter, the effect is the same – the full amount of unused balances at the end of the 2020 plan year can be used to pay claims incurred in the next plan year. Again, these rules apply to both the 2020 and 2021 calendar years.

The normal rule for dependent care FSAs is that in order for expenses to be eligible for reimbursement, a child must be under the age of 13 when the expenses are incurred. The new law provides that if a participant enrolled in a dependent care FSA had a child that turned age 13 in the 2020 plan year (more specifically, in the plan year for which the open enrollment period ended on or before January 31, 2020), then the participant may be reimbursed for expenses incurred after the child's 13th birthday for the remainder of that plan year, or if there is an unused balance at plan year end, in the following year until the child turns age 14.

Reduction in Medical Expense Deduction Floor

Generally, for tax years beginning before January 1, 2021, individuals could claim an itemized deduction for unreimbursed medical expenses to the extent that such expenses exceeded 7.5% of adjusted gross income. For tax years beginning on or after January 1, 2021, the 7.5% of adjusted gross income limitation was set to increase to 10%. The new legislation makes the 7.5% threshold permanent, applicable for tax years beginning after December 31, 2020, in essence eliminating the 10% limitation previously enacted.

Individuals May Base 2020 Refundable Child Tax Credit & Earned Income Credit on Preceding Year

Generally, to the extent the child tax credit (CTC) exceeds an individual taxpayer's federal tax liability, the taxpayer is eligible for a refundable portion of the credit. Essentially all individual taxpayers with qualifying children are eligible for the refundable additional credit if their tax liability does not fully absorb the otherwise allowable credit and they have earned income in excess of $2,500. The earned income credit (EIC) is calculated based on a percentage of the taxpayer's earned income for a given tax year, most often the calendar year. Earned income means wages, salaries, tips, and other employee compensation, if includible in gross income for the tax year. Earned income also includes self-employment income, computed without the deduction for one-half of self-employment tax. For the 2020 tax year, the refundable portion of the child tax credit and the earned income credit would thus typically be based on a taxpayer's 2020 earned income.

Under the new legislation, for purposes of determining the refundable portion of the child tax credit and the earned income credit for the 2020 tax year, taxpayers may elect to substitute the earned income for the preceding tax year so long as the preceding tax year's earned income is greater than the taxpayer's earned income for 2020.

$250 Educator Expense Deduction Applies to PPE

Eligible educators, generally, kindergarten through grade 12 teachers, instructors, counselors, principals or aides, are allowed a $250 above-the-line deduction for certain out of pocket expenses. Eligible expenses include books, supplies, other than nonathletic supplies for courses of instruction in health or physical education, computer equipment, including related software and services, and other equipment and supplementary materials used by the educator in the classroom, and certain professional development expenses.

The new legislation provides that, not later than February 28, 2021, the IRS must, by regulation or other guidance, clarify that personal protective equipment (PPE), disinfectant, and other supplies used for the prevention of the spread of COVID-19 are treated as eligible expenses for purposes of the educator deduction. Such regulations or other guidance will apply to expenses paid or incurred after March 12, 2020.

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Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTR)

General Description	Status	Code Section / Citation
Above the line deduction for qualified tuition and related expenses	Not extended, expires after 2020	222 (repealed)
Accelerated depreciation for business property on an Indian reservation	Extended through 2021	168(j)(9)
American Samoa economic development credit	Extended through 2021	Tax Relief and Health Care Act
Black lung liability trust fund excise tax	Extended through 2021	4121(e)(2)(A)
Classification of certain race horses as 3-year property	Extended through 2021	168(e)(3)(A)(i)
Credit for 2-wheeled plug-in electric vehicles	Extended through 2021	30D(g)(3)(E)(ii)
Credit for alternative fuel vehicle refueling property	Extended through 2021	30C(g)
Credit for electricity produced from certain renewable sources	Extended through 2021	45(d) and 48(a)(5)(C)(ii)
Credit for energy-efficient new homes	Extended through 2021	45L(g)
Credit for health insurance costs of eligible individuals	Extended through 2021	35(b)(1)(B)
Credit for new qualified fuel cell motor vehicles	Extended through 2021	30B(k)(1)
Credit for nonbusiness energy property	Extended through 2021	25C(g)(2)
Excise tax credits relating to alternative fuels	Extended through 2021	6426(d)(5); 6426(e)(3); 6427(e)(6)(C)
Indian employment tax credit	Extended through 2021	45A(f)
Mine rescue team training credit	Extended through 2021	45N(e)
Mortgage insurance premiums treated as qualified residence interest	Extended through 2021	163(h)(3)(E)(iv)(I)
Production credit for Indian coal facilities	Extended through 2021	45(e)(10)(A)
Residential Energy Efficient Property Credit	Extended through 2022	25D(h)
Second generation biofuel producer credit	Extended through 2021	40(b)(6)(J)(i)
Empowerment zone tax incentives	Extended through 2025 (w/ modifications)	1391(d)(1)(A)(i)
Exclusion from gross income of discharge of qualified principal residence debt	Extended through 2025 (w/ modifications)	108(a)(1)(E)
7-year recovery period for motorsports entertainment complexes	Extended through 2025	168(i)(15)(D)
Carbon oxide sequestration credit (scheduled expiration after 2024)	Extended through 2025	45Q(d)(1)
Credit for paid family and medical leave	Extended through 2025	45S(i)
Exclusion from gross income of certain employer payments of student loans	Extended through 2025	127(c)(1)(B)
Look-thru rule for related controlled foreign corporations	Extended through 2025	954(c)(6)(C)
New markets tax credit	Extended through 2025	45D(f)(1)
Oil spill liability trust fund financing rate	Extended through 2025	4611(f)(2)
Special expensing rules for certain productions	Extended through 2025	181(g)
Work opportunity credit	Extended through 2025	51(c)(4)
Energy efficient commercial buildings deduction	Permanent extension (w/ modifications)	179D
Miscellaneous provisions related to beer, wine and distilled spirits	Permanent extension (w/ modifications)	263A(f); 5001(c);5041; 5051(a); 5212; 5414(b)
Railroad track maintenance credit	Permanent extension (w/ modifications)	45G
7.5% of AGI floor for medical and dental expense deduction	Permanent extension	213(a)
Exclusion from gross income of benefits provided to volunteer 1st responders	Permanent extension	139B