COVID-19 IRS Response

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COVID-19 IRS Response

- On Friday, March 27th, President Trump signed the Coronavirus Aid, Relief and Economic Security Act (CARES Act) stimulus package designed to spur the economy and combat the ongoing pandemic.
- The CARES act provides over $2 trillion to boost the economy in addition to providing much needed funding for hospitals and other health professionals in the fight against the novel coronavirus.

Small Business Loans

- *What is it?* The CARES Act makes available $350 billion in loans under Section 7(a) of the Small Business Administration during the period between February 15, 2020 through June 30, 2020. Also known as the Paycheck Protection Loan Program (PPP).

- *Who's eligible?* Businesses with fewer than 500 employees.

- *Details and Benefits:*
  - Fully guaranteed by the U.S. government
  - No personal guarantee required
  - Interest rate not to exceed four percent
  - No prepayment penalty
  - Sole proprietors and independent contractors are eligible loan recipients.
  - Subject to restrictions, loan amounts are forgivable
  - Any loan forgiveness is tax-free

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Small Business Loans

- Amount of loan available limited to the lesser of:
  - The sum of 1) average monthly payroll costs (payroll costs as defined under the Act) for the one year period ending on the date the loan was made multiplied by 2.5 AND 2) any disaster loan taken out after January 31, 2020 that has been refinanced in the paycheck protection loan, and
  - $10 million

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Borrower Requirements:

A good faith certification that:

- The loan is needed to continue operations during the COVID-19 emergency:
- Funds will be used to retain workers and maintain payroll or make mortgage, lease, and utility payments:
- The applicant does not have any other application pending under this program for the same purposes; and
- From February 15, 2020 until December 31,2020, the applicant has not received duplicative amounts under this program.

Small Business Loans

USE OF AVAILABLE FUNDS

- Payroll costs:
  - Includes: compensation to employees, such as salary, wage, commissions, cash, etc.; paid leave; severance payments; payment for group health benefits, including insurance premiums; retirement benefits; state and local payroll taxes; and any compensation to or income of a sole proprietor~~s~~ or independent contractor~~s~~ (including commission-based compensation) up to $100,000 in 1 year, prorated for the covered period;
  - Excludes: individual employee compensation above $100,000 per year, prorated for the covered period; certain federal taxes; compensation to employees whose principal place of residence is outside of the US; and sick and family leave wages for which credit is allowed under the Families First Act;
- Group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums;
- Salaries, commissions, or similar compensations;
- Payments of interest on mortgage obligations;
- Rent/lease agreement payments;
- Utilities; and
- Interest on any other debt obligations incurred before the covered period

Small Business Loans

LOAN FORGIVENESS AND PAYMENT DEFERRAL RELIEF

- Businesses that were operating on February 15, 2020 and that have a pending or approved loan application under this program are presumed to qualify for complete payment deferment relief for six months to one year.
- Indebtedness is forgiven (and excluded from gross income) in an amount equal to the following costs incurred and payments made during the covered period (not to exceed principal amount of the loan)
  - Payroll costs;
  - Interest payments on mortgages;
  - rent; and
  - Utility payments

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FORGIVENESS REDUCTION FACTORS

- Forgiveness amounts will be reduced for any employee cuts or reductions in wages. **The reduction formula for fewer employees is:**
  - The maximum available forgiveness under the rules described above **multiplied by**:
  - Average number of full-time equivalent employees (FTEEs) per month – calculated by the average number of FTEEs for each pay period falling within a month – during the covered period **divided by**:
  - Either (at election of the borrower) –
    - Average number of FTEEs per month employed from February 15, 2019 to June 30, 2019; or
    - Average number of FTEEs per month employed from January 1, 2020 until February 29, 2020;
- There is a separate computation available for seasonal employers.

Small Business Loans

FORGIVENESS REDUCTION FACTORS

- **The reduction formula for reduction in wages is:**
  - A straight reduction by the amount of any reduction in total salary or wages of any employee during the covered period that is in excess of 25% of the employee's salary/wages during the employee's most recent full quarter of employment before the covered period.
  - "Employee" is limited, for purposes of this subparagraph only, to any employee who did not receive during any single pay period during 2019 a salary or wages at an annualized rate of pay over $100,000.
  - There is relief from these forgiveness reduction penalties for employers who rehire employees or make up for wage reductions by June 30, 2020. Specifically, in the following circumstances, the forgiveness reduction rules above will not apply to an employer between February 15, 2020 and 30 days following enactment of the CARES Act –
    - The employer reduces the number of FTEEs in this period and, not later than June 30, 2020, the employer has eliminated the reduction in FTEEs; or
    - There is a salary reduction, as compared to February 15, 2020, during this period for one or more employees and that reduction is eliminated by June 30, 2020 (it is unclear whether this is also intended to be limited to employees who made under $100,000 in 2019).

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SBA Disaster Loan Program

- The CARES Act expands the SBA's Disaster Loan Program. The covered period for this section is January 31, 2020-December 31, 2020. In addition to current eligible entities, the following may receive SBA disaster loans:
  - A business with 500 or fewer employees;
  - Sole proprietorships, with or without employees, and independent contractors;
  - Cooperatives with 500 or fewer employees;
  - ESOPs with 500 or fewer employees; and
  - Tribal small business concerns.
- The CARES Act makes the following additional changes to the SBA Disaster Loan program during the covered period for loans made in response to COVID-19:
  - Waives rules related to personal guarantees on advances and loans of $200,000 or less for all applicants;
  - Waives the "1 year in business prior to the disaster" requirement (except the business must have been in operation on January 31, 2020);
  - Waives the requirement that an applicant be unable to find credit elsewhere; and
  - Allows lenders to approve applicants based solely on credit scores (no tax return submission required) or “alternative appropriate methods to determine an applicant’s ability to repay.”

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SBA Disaster Loan Program

- Entities applying for loans under the Disaster Loan Program in response to COVID-19 may request an emergency advance from the Administrator of up to $10,000, which does not have to be repaid, even if the loan application is later denied.
- Advances are to be awarded within three days of an application.
- Advances may be used for purposes already authorized under the SBA Disaster Loan Program, including:
  - Providing sick leave to employees unable to work due to direct effect of COVID-19;
  - Maintaining payroll during business disruptions during slow-downs;
  - Meeting increased supply chain costs;
  - Making rent or mortgage payments; and
  - Repaying debts that cannot be paid due to lost revenue.
- If an entity that receives an emergency advance transfers into, or is approved for, a loan under the SBA Business Loan Program (described in the section above), the advance amount will be reduced from any payroll cost forgiveness amounts.

Employee Retention Credit

- Refundable credit against payroll tax liability equal to 50% of the first $10,000 in wages per employee.
- Eligible employers must have carried on a trade or business during 2020 and satisfy one of two tests:
  - Have business operations fully or partially suspended operations due to orders from a governmental entity limiting commerce, travel, or group meetings; or
  - Experience a year-over-year (comparing calendar quarters) reduction in gross receipts of at least 50% – until gross receipts exceed 80% year-over-year.
- For employers with more than 100 full-time employees, only employees who are currently not providing services for the employer due to COVID-19 causes are eligible for the credit.
- Effective for wages paid after March 12, 2020, and before January 1, 2021

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Deferment of Payroll Taxes

- Employers and self-employed taxpayers can delay payment of the employer portion of payroll taxes beginning on the day of enactment through the end of 2020.
- Fifty percent of any payroll taxes deferred under this provision must be paid by December 31, 2021, with the remaining fifty percent paid by December 31, 2022.

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Business Losses

NET OPERATING LOSSES (NOLs)

- The CARES Act amends IRC §172(b) to allow for the carryback of losses arising in taxable years ending after December 31, 2017 and before January 1, 2021 to each of the **five taxable years** preceding the taxable year of such loss.
- Does not alter the indefinite carryforward of NOLs arising in those years.
- Removes the limitation that NOLs could be used to offset no more than 80% of taxable income. Applies to tax years beginning before January 1,2021 (previously, tax years beginning after December 31, 2017, were subject to the 80% limitation).

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Excess Business Losses

PRIOR LAW:

- Applicable to noncorporate taxpayers
- Beginning in 2018, through the 2025 tax year, taxpayers can only deduct up to **$500,000** (for married filing joint taxpayers) of business losses against nonbusiness income.

- **The CARES Act removes the limitation on excess business losses for taxpayers other than corporations for tax years beginning after December 31, 2017, and before January 1, 2021.**

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Business Interest Limitations

- For tax years beginning in 2019 and 2020, the deduction for business interest expense is limited to the sum of:
  - business interest income,
  - **50% of adjusted taxable income (ATI)** (increased from 30% of ATI), and
  - floorplan financing interest expense.
  - Taxpayers may elect not to use the increased limitation. Given that many taxpayers may have significantly reduced income in 2020, taxpayers may elect to substitute 2019 ATI for 2020 ATI.

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Business Interest Limitations

SPECIAL RULE FOR PARTNERSHIPS

- In the case of a partnership, the increase to the ATI portion of the limitation applies only to tax years beginning in 2020.
- Any election not to use the increased limitation must be made at the partnership level.
- Like other taxpayers, partnerships may elect to substitute 2019 ATI for 2020 ATI.
- A special rule provides that partners treat 50% of any excess business interest expense allocated to the partner in a tax year beginning in 2019 as paid or accrued in the partner's first tax year beginning in 2020, with the remaining 50% subject to the default limitation based on allocated excess taxable income (or excess interest income pursuant to Prop. Reg. §1.163(j)- 6(g)(2)(i)). A partner may elect out of this special rule.

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Qualified Improvement Property (QIP)

- The CARES act contains a technical correction to the TCJA with respect to qualified improvement property (QIP).
  - 15-year recovery period for purposes of the general depreciation system
  - QIP is any improvement made by the taxpayer to the interior of a non-residential building that is placed in service after the building's initial placed in service date other than improvements attributable to elevators, escalators, building enlargements or the building's internal structural framework.
- Because it has a recovery period of 15 years, QIP is eligible for the additional first-year depreciation deduction ("bonus depreciation") under section 168(k).
- Electing real property trade or business—i.e., a real property trade or business that has elected out of the interest limitation provisions of section 163(j)—is required to use the alternative depreciation system ("ADS") for QIP and thus cannot claim bonus depreciation on QIP.
- The provision is retroactive to January 1, 2018. Accordingly, taxpayers are required to change the depreciation methods of QIP placed in service after 2017 that has been depreciated as 39-year building property. Taxpayers should generally be able to change QIP depreciation methods by filing an automatic accounting method change. If a QIP asset was only depreciated on a single tax return, the asset's depreciation method may also be corrected with an amended return.

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Individual Recovery Rebates

- Eligible individuals are allowed a credit of $1,200 ($2,400 for joint filers), plus $500 for each qualifying child, for the first taxable year beginning in 2020. An eligible individual is any individual who has a Social Security number and who is not a nonresident alien, an individual who can be claimed as a dependent on another taxpayer's return, or an estate or trust.
- The allowable credit is reduced by 5% of the eligible individual's adjusted gross income in excess of $75,000 (all filers other than joint and head of household), $112,500 (head of household), or $150,000 (joint filers). The credit phases out entirely at $99,000 ($198,000 for joint filers).
- The Internal Revenue Service (IRS) will work to deliver rebates quickly in the form of advance payments. For people who filed a federal income tax return in 2018 or 2019, payment processing will be based on payment or address information already on file with the IRS. Electronic distributions will be automatic to an account the payee authorized January 1, 2018 or later.

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Unemployment Insurance

UNEMPLOYMENT INSURANCE PROVISIONS

- The CARES act provides states the opportunity to enter agreements with the federal government to provide enhanced unemployment compensation (UC) benefits under existing state UC benefit programs.
- The Act provides for immediate UC payments (i.e., no one-week waiting period), an additional **$600/week for up to four months** (even if the employee is currently making less), and an additional 13 weeks of UC benefits for participating states.

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Retirement Provisions

RETIREMENT PLAN DISTRIBUTIONS

- The CARES Act waives the 10% additional tax on early distributions related to the coronavirus from retirement plans and IRAs for amounts not to exceed $100,000 subject to the following rules:
  - Amounts distributed may be repaid at any time over the three-year period commencing on the date the distribution was received.
  - To the extent that the amounts are not repaid, the income inclusion with respect to any coronavirus distribution can be included ratably over the three taxable years beginning with the taxable year in which the distribution was received;
  - The distribution provision applies to individuals who have been diagnosed with SARS-CoV-2 or COVID-19 by a test approved by the Centers for Disease Control (CDC), their spouse or dependent who has been diagnosed by such a test, or a person who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, or suffered reduced working hours, or who is unable to work due to lack of child care.

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Retirement Provisions

LOANS FROM RETIREMENT PLANS

- Loans from qualified employer plans up to $100,000 (increased from $50,000) are permitted in the 180 days beginning on the date of enactment.
- For outstanding loans, repayment dates between the date of enactment of the CARES Act and December31, 2020 are delayed for one year, and subsequent payments as well as interest accrual are adjusted accordingly. A plan will not be disqualified as a result of plan amendments in accordance with the CARES Act provisions.

Retirement Provisions

REQUIRED MINIMUM DISTRIBUTIONS

- Minimum distribution rules are **waived for calendar year 2020** for IRAs and certain defined contribution plans.
- Waiver does not apply to required beginning dates in calendars year after 2020, and amounts which would otherwise be required to be distributed are not eligible rollover distributions.
- For distributions to be made over a 5-year period that includes calendar year 2020, calculations of the distribution period may disregard calendar year 2020.

Charitable Contributions

CHARITABLE CONTRIBUTION CHANGES

- Individuals:
  - For the 2020 tax year, the deduction percentage limitation for charitable contributions of cash has been removed for individual taxpayers. The TCJA had provided for an increased limitation of 60% for cash contributions; however, the CARES Act suspends the percentage limitations entirely.
  - For tax years beginning in 2020, eligible taxpayers are entitled to an above-the-line **deduction of up to $300** for qualified charitable contributions. An eligible taxpayer is an individual that did not elect to itemize deductions.
  - The suspension is applicable only for cash contributions
- Corporations:
  - The CARES Act also increases the limitation on the corporate charitable contribution deduction from 10% of taxable income to 25% of taxable income.
  - The limitation on contributions of food inventory is increased from 15% to 25%.