MAHER & CO.
CERTIFIED PUBLIC ACCOUNTANTS

Dear Clients and Friends:

The Consolidated Appropriations Act, 2021 (the CCA, 2021), signed into law on December 27, 2020, is a further legislative response to the coronavirus (COVID-19) pandemic. The CCA, 2021 include along with spending and other non-tax provisions primarily tax provisions affecting individuals and businesses.

Business provisions

Paycheck Protection Program Second Draw Loans

The CARES Act authorizes the Small Business Administration (SBA) to make loans to qualified businesses under certain circumstances. The provision established the 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 nonpayroll 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.

Paycheck Protection Program Second Draw Loans. The Additional Coronavirus Response and Relief (ACRR) which is part of CCA, 2021permits certain smaller businesses who experienced a 25% reduction in gross receipts may take a second draw from the PPP of up to $2 million.

Eligible entities. 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 (for businesses that previously received a PPP loan); **and**
- Demonstrate at least a 25% reduction in gross receipts in any quarter of 2020 relative to the same 2019 quarter.

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.

Loan terms. 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.

Gross receipts and simplified certification of revenue test. 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.

Loan forgiveness. Like the first PPP loan, the second draw loan may be forgiven for payroll costs of up to 60% (with some exceptions) and nonpayroll costs such as such as rent, mortgage interest and utilities of 40%.

Application of exemption based on employee availability. ACRR extends current safe harbors on restoring full-time employees and salaries and wages. Specifically, applies the rule of reducing loan forgiveness for the borrower reducing the number of employees retained and reducing employees' salaries in excess of 25%.

Clarification of tax treatment of Paycheck Protection Program loans. Sec. 276 clarifies that gross income does not include any amount that would otherwise arise from the forgiveness of a PPP loan. This provision also clarifies that deductions are allowed for otherwise deductible expenses paid with the proceeds of a PPP loan that is forgiven, and that the tax basis and other attributes of the borrower's assets will not be reduced as a result of the loan forgiveness. The provision is effective as of the date of enactment of the CARES Act. The provision provides similar treatment for Second Draw PPP loans, effective for tax years ending after the date of enactment of the provision

<u>Clarification of tax treatment of covered loan forgiveness</u>

CARES Act Sec. 1102 provides 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. PPP loan forgiveness does not give rise to taxable income and the Code generally does not allow a taxpayer to deduct expenses that are paid with tax exempt income.

New law. COVIDTRA 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.

Effective date. This provision is effective as of the date of enactment of the CARES Act.

<u>Clarification of tax treatment of certain loan forgiveness and other business financial assistance under the CARES Act</u>

The CARES Act expanded access to Economic Injury Disaster Loans (EIDL) and established an emergency grant to allow an EIDL applicant to request a $10,000 advance on that loan. The CARES Act also provided loan repayment assistance for certain recipients of CARES Act loans.

New law. COVIDTRA clarifies that gross income does not include forgiveness of EIDL loans, emergency EIDL grants, and certain loan repayment assistance. The provision also clarifies that deductions are allowed for otherwise deductible expenses paid with the amounts not included in income, and that tax basis and other attributes will not be reduced as a result of those amounts being excluded from gross income.

Effective date. The provision is effective for tax years ending after March 26, 2020, date of enactment of the CARES Act.

<u>50% limit on business meal deduction is suspended for meals provided by restaurants in 2021 and 2022</u>

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. Code Sec. 274(n)(2) provides certain exceptions to this 50% limit. However, under pre-Act law, there was no exception for meals provided by a restaurant.

New law. Under the Act, the 50% limit will not apply to expenses for food or beverages provided by a restaurant that are paid or incurred after Dec. 31, 2020, and before Jan. 1, 2023.

Paid Sick and Family Leave Extension.

Effective April 1, 2020 through Dec. 31, 2020, the Families First Coronavirus Response Act (FFCRA, P.L. 116-127) 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.

New law. Section 286 of the ACRR 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.

Section 287 of the ACRR similarly extends the credits available to self-employed individuals and allows them to use their reported wages from tax year 2019 instead of tax year 2020 to compute the credit.

Section 288 aligns the definitions of qualified wages for paid sick and family leave with the IRC and excludes leave payments from employer Social Security employment taxes.

Effective date. All the above listed provisions are effective as if they were included in the original FFCRA legislation.

Extension of certain deferred payroll taxes.

On August 8, 2020, President Trump signed a Presidential Memorandum directing Treasury Secretary Mnuchin to permit the postponement of the withholding, deposit, and payment of the employee's share of Social Security tax (6.2%), as well as the employee's share of Railroad Retirement Tax Act (RRTA) Tier 1 taxes on wages and compensation paid from September 1, 2020 through December 31, 2020 for employees whose amount of wages or compensation, payable during any biweekly pay period generally is less than $4,000, or the equivalent amount with respect to other pay periods. Amounts were to be deferred without any penalties, interest, or additional amount to the tax. The IRS issued Notice 2020-65 to provide further guidance to employers on the withholding and remittance of the taxes involved in that order, postponing the withholding and remittance of the taxes ratably from wages and compensation paid between January 1, 2021 and April 30, 2021. Penalties, interest, and additional amounts would begin to incur on May 1, 2021

New law. Section 274 of ACCR extends the repayment period of the deferred employee taxes through December 31, 2021. It also provides that penalties and interest will not begin to accrue on the deferred amounts until January 1, 2022.

Individual provisions

The COVID-Related Tax Relief Act of 2020 (COVIDTRA) and the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTR), both part of The Consolidated Appropriations Act, 2021 (CAA, 2021), contain numerous provisions related to individual income tax. Below is a summary of some of those provisions.

New recovery rebate

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act, PL 116-136) provided for direct payments/rebates to certain individual taxpayers. These were referred to as Economic Impact Payments (EIPs).

New law. The COVIDTRA contains a new program, which it refers to as "additional 2020 recovery rebates."

The provision provides a refundable tax credit to eligible individuals in the amount of $600 per eligible family member. The credit is $600 per taxpayer ($1,200 for married filing jointly), in addition to $600 per qualifying child. The credit phases out starting at $75,000 of modified adjusted gross income ($112,500 for heads of household and $150,000 for married filing jointly) at a rate of $5 per $100 of additional income. The term "eligible individual" does not include any nonresident alien, anyone who qualifies as another person's dependent, and estates or trusts.

The credit is available on the taxpayer's 2020 return. The provision provides for Treasury to issue advance payments based on the information on 2019 tax returns. Eligible taxpayers treated as providing returns through the nonfiler portal in with respect to their EIP, will also receive payments.

In general, taxpayers without an eligible Social Security number are not eligible for the payment. However, married taxpayers filing jointly where one spouse has a Social Security Number and one spouse does not are eligible for a payment of $600, in addition to $600 per child with a Social Security Number.

Taxpayers receiving an advance payment that exceeds the amount of their eligible credit will not be required to repay any amount of the payment. If the amount of the credit determined on the taxpayer's 2020 tax return exceeds the amount of the advance payment, taxpayers will receive the difference as a refundable tax credit.

Advance payments are generally not subject to administrative offset for past due federal or state debts. In addition, the payments are protected from bank garnishment or levy by private creditors or debt collectors.

<u>Amendments to CARES Act Economic Impact Payment rules</u>

The CARES Act provided for direct payments/rebates to certain individual taxpayers. These were referred to as Economic Impact Payments (EIP).

New law. The COVIDTRA makes the following changes to the CARES Act EIP:

...The $150,000 limit on adjusted gross income before the credit amount starts to decrease, which, under the CARES Act applied to joint returns, also applies to surviving spouses.

...Changes the requirement, in order to be eligible for an EIP, with respect to providing IRS with the taxpayer's identification number, to conform to that requirement under the new rebate described above under "New Recovery Rebate."

<u>$250 educator expense deduction applies to PPE</u>

Eligible educators (i.e., kindergarten through grade 12 teachers, instructors, etc.) are allowed a $250 above-the-line deduction for certain otherwise allowable trade or business expenses paid by them.

New law. COVIDTRA 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 described in Code Sec. 62(a)(2)(D)(ii). Such regulations or other guidance will apply to expenses paid or incurred after March 12, 2020.

<u>Emergency financial aid grants</u>

An individual taxpayer may claim the American opportunity tax credit and/or the Lifetime Learning credit for higher education expenses at accredited post-secondary educational institutions paid for themselves, their spouses, and their dependents. However, under Code Sec. 25A(g)(2), higher education expenses paid for by tax-exempt income cannot be used to claim either of these credits.

New law. COVIDTRA excludes certain CARES Act emergency financial aid grants from the gross income of college and university students. This provision also holds students harmless for purposes of determining their eligibility for the American Opportunity and Lifetime Learning tax credits.

Effective date. This provision applies to qualified emergency financial aid grants made after March 26, 2020, the date of enactment of the CARES Act.

Disclosures to prevent certain taxpayers from being subject to private tax collection

Code Sec. 6306(d)(3) excludes supplemental social security (SSI) and social security disability insurance (SSDI) beneficiaries from the IRS private debt collection program beginning on January 1, 2021.

New law. The IRS and Social Security Administration need statutory authority to share information to determine which taxpayers are SSI or SSDI beneficiaries and eligible for exclusion from the IRS private debt collection program. The provision provides the authority needed to share such information and make Code Sec. 6306(d)(3) work as intended.

Disclosure of tax return information related to education institutions

Code Sec. 6103(l)(13) allows disclosure of return information to carry out the Higher Education Act of 1965.

New law. COVIDTRA allows the IRS to share tax return information of student aid applicants, their parents, students, and borrowers with the Department of Education and further allows that tax return information be redisclosed to colleges and universities (and certain scholarship organizations) with the taxpayer confidentiality protections afforded under Code Sec. 6103.

Many of these provisions had been in Code Sec. 6103(l)(13) at one time but were deleted by the CARES Act.

Individuals may base 2020 refundable CTC & EIC on preceding year's earned income

Background. Under Code Sec. 24(d)(1)(B)(i), to the extent the child tax credit (CTC) exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15% percent of so much of the taxpayer's taxable earned income for the tax year as exceeds $2,500. And under Code Sec. 32(a), the earned income credit (EIC) equals a percentage of the taxpayer's earned income.

For both purposes, 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.

New law. Under the TCDTR, in determining the refundable CTC and the EIC for 2020, taxpayers may elect to substitute the earned income for the preceding tax year if that is greater than the taxpayer's earned income for 2020.

For joint returns, the taxpayer's earned income for the preceding tax year is the sum of each spouse's earned income for that preceding tax year.

An incorrect use on a return of earned income under TCDTR Sec. 211(a) (above) is a mathematical or clerical error for which IRS may make a summary assessment under Code Sec. 6213(b)(1).

The substitution of the previous year's earned income allowed under TCDTR Sec. 211(a) (above) has no other effect on the application of the Internal Revenue Code.

These changes apply to the taxpayer's first tax year beginning in 2020.

Certain Charitable Contributions Deductible by Non-Itemizers

For 2020, individuals who normally do not itemize deductions may take up to a $300 above-the-line deduction for cash contributions to qualified charitable organizations. This $300 limit also applies to married filers). A 20% penalty applies to tax underpayments attributable to any overstated cash contribution by non-itemizers.

New law. The TCDTR extends the above rule through 2021, allowing individual cash contributions of up to $300, ($600 for married filers) to be deducted above-the-line for cash contributions to qualified charitable organizations.

An increased penalty of 50% applies to tax underpayments attributable to any overstated cash contribution by non-itemizers under Code Sec. 170(p).

<u>Modification of Limitations on Charitable Contributions</u>

Under pre-TCDTR law, individuals could not take an itemized deduction of more than 60% of their contribution base on charitable contributions, of cash, made to 50% charities.

New law. For 2020 and 2021, the percentage limitation rules for individuals making qualified charitable contributions, in cash, to 50% charities do not apply.

<u>Temporary Special Rules for Health and Dependent Care Flexible Spending Arrangements</u>

A cafeteria plan may permit the carryover of unused amounts remaining in a health FSA as of the end of a plan year to pay or reimburse a participant for medical care expenses incurred during the following plan year, subject to the carryover limit (currently $550). This is sometimes referred to as the carryover rule.

New law. The TCDTR expands the carryover period for 2020, and 2021. The provision also allows employers to extend the grace period for plan years ending in 2020 and 2021 to 12 months after the end of such plan year for unused benefits and contributions to health flexible spending and dependent care flexible spending arrangements.

In addition, an employer may allow an employee who ceases to participate in the plan during calendar year 2020 or 2021 to continue to receive reimbursements from unused benefits or contributions through the end of the plan year in which the employee's participation ceased, including any extended grace period.

The TCDTR also provides a special carry forward rule for dependent care flexible spending arrangements where the dependent aged out during the pandemic.

Please let us know if you like to discuss any aspect of the new legislation. Please contact our office with any inquiries at 314-726-0626.

Sincerely,
Maher & Company PC