2020/2021 Federal & CA Tax Update

Tom Wagstaff
Partner

OVERVIEW

I. Individuals
II. Paycheck Protection Program
III. Business
IV. Retirement

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MAJOR TAX LEGISLATION 2020

SECURE ACT

Dec. 2019

Apr. 2020

CARES ACT

(Includes PPP 1)

PAYCHECK PROTECTION FLEXIBILITY ACT

June 2020

Dec. 2020

ACRRA ACT

(Includes PPP 2)

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INDIVIDUALS

ECONOMIC IMPACT PAYMENTS (CARES ACT)

Payments *not* subject to tax

- Economic impact payments are treated as an advance against a 2020 federal tax credit. Therefore, they are not taxable for federal or state purposes.

Payment amounts

- The base credit amount is:
  - $1,200 per qualifying individual ($2,400 for married taxpayers filing jointly); plus
  - $500 per qualifying child (defined under IRC§152(c)) under the age of 17.

(CARES Act§ 2201 ; IRC § 6428)

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ECONOMIC IMPACT PAYMENT AGI & PHASEOUT LEVELS

Filing status…	Phaseout begins at AGI of…	Credit phased out at…
MFJ	$150,000	$198,000 if no children (add $10,000 for each qualified child)
HOH	$112,500	$146,500 if one child (add $10,000 for each additional qualified child)
Single & MFS	$75,000	$99,000

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ECONOMIC IMPACT PAYMENTS (ACRRA)

- The Additional Coronavirus Response and Relief Act (ACRRA) also provides another round of economic stimulus payment to qualified individuals in addition to those provided under the CARES ACT. (ACRRA §272; IRC § 6428A)
- However, there are some differences between payments authorized under the ACRRA and those authorized under the CARES ACT.

CARES ACT VS ACRRA

Differences in EIP Payments Authorized Under CARES ACT & ACRRA

Issue	CARES Act	ACRRA
Amount of Payment	$1,200 per qualifying individual plus $500 per qualifying child who is under the age 17 at the end of 2020	$600 per taxpayer ($1,200 for MFJ) plus $600 per dependent who is under age 17 at the end of 2020
Based on AGI	From 2018 or 2019(depending on whether the taxpayer's 2019 tax return was filed prior to payments being issued)	From 2019

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Issue	CARES Act	ACRRA
AGI Limits	Full payments for taxpayers with AGI as follows: $75,000 single taxpayers $112,500 HOH $150,000 MFJ Payment phased out by $5 for every $100 (or 5%) over the AGI threshold and completely phased out at: $99,000 single taxpayers $146,500 HOH $198,000 MFJ if no children Add $10,000 for each qualified child	Full payments for taxpayers with AGI as follows: $75,000 single taxpayers $112,500 HOH $150,000 MFJ Payment phased out by $5 for every $100 (or 5%) over the AGI threshold and completely phased out at: $87,000 single taxpayers $136,500 HOH $174,000 MFJ if no children Add $12,000 for each qualified child

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DISASTER RELIEF PAYMENTS

Emergency financial aid grants under the CARES Act for unexpected expenses, unmet financial needs, or expenses related to the disruption of campus operations on account of the COVID-19 pandemic, such as unexpected expenses for food, housing, course materials, technology, health care, or childcare, are qualified disaster relief payments. (IRC §139) As such, they are not includible in income.

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PAID SICK & FAMILY LEAVE ARE TAXABLE

Disaster relief payments under IRC§139 do not include wage replacements.

For example:

- If an employer provides funds to its employees to help the employees meet living expenses due to a stay-at-home order (e.g., food or rent), then such payments can be deductible by the employer and excluded from the employee's income.

Thus, the sick leave and family leave payments, which are treated as wages, under the FFCR are not excludable under IRC§ 139 and are taxable.

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EMERGENCY FINANCIAL AID GRANTS EXPANDED UNDER YEAR-END STIMULUS BILL

Qualified emergency financial aid grants made after March 26,2020:

- Are excludable from a student's taxable income; and
- Will not be treated as a qualified scholarship, an educational assistance allowance, or other payment that will reduce the amount of the student's American Opportunity Tax Credit (AOTC) or Lifetime Learning Credits (ACRRA § 227)

A "qualified" emergency financial aid grant is:

- Any emergency financial aid grant awarded by an institution of higher education under §3504 of the CARES ACT.

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NO PERSONAL EXEMPTION DEDUCTION

- TCJA temporarily suspended the personal and dependent exemption deduction.
- For tax year 2020, it remains at Zero.

California nonconformity

California provides personal exemption credits rather than a deduction. (R&TC §17054) These credits are phased out when a taxpayer's federal AGI exceeds a threshold amount. (R&TC§17054.1)

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FILING REQUIREMENTS

With the suspension of the personal and dependent exemption deduction, generally every individual must file an income tax return if:

- Their gross income for the tax year is greater than their standard deduction amount; or
- They have self-employment income in excess of $400

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KIDDIE TAX RULES

The kiddie tax rules for 2020 and beyond are the same as those that were in effect prior to 2018.

Children who meet the following listed requirements must attach Form 8615 to their income tax return. If the requirements are met, the child's unearned income is taxed at their parents' highest marginal income tax rate. *All of the following must be met:*

- The child's unearned income was more than $2,200 (for 2019 and 2020 tax years);
- The child meets one of the following age requirements:
  - Under age 18 at the end of the tax year;
  - At least age 18 at the end of the tax year and didn't have earned income that was more than one-half of the child's support; or
  - Was a full-time student at least age 19 and under age 24 at the end of the tax year and didn't have earned income that was more than one-half of the child's support

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PARENTS' ELECTION TO REPORT CHILD'S INTEREST & DIVIDENDS

- Instead of filing Form 8615 and attaching it to their child's income tax return, parents can elect to report their child's income on their own return using Form 8814, Parents' to Report Child's Interest and Dividends.
- Parents are eligible to make the election if their child *meets all* of the following conditions:
    - At the end of the tax year the child was under age 19 (or under age 24 if a full-time student);
    - The child's gross income was less than $11,000 for the tax year (2019 and 2020 tax years);
    - The child had income only from interest and dividends (including capital gain distributions and Alaska Permanent Fund dividends)

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CAPITAL GAINS

Individual Long-Term Capital Gains Rates (IRC §1(h))		
Rate	**Taxable Income breakpoint for 2020**	**Taxable income breakpoint for 2021**
0%	Single: $40,000 MFS: $40,000 MFJ: $80,000 HOH: $53,600 Estates & Trusts: $2,650	Single: $40,400 MFS: $40,400 MFJ: $80,800 HOH: $54,100 Estates & Trusts: $2,700
15%	Single: $441,450 MFS: $248,300 MFJ: $496,600 HOH: $469,050 Estates & Trusts: $13,150	Single: $445,850 MFS: $250,800 MFJ: $501,600 HOH: $473,750 Estates & Trusts: $13,250
20%	No breakpoint	No breakpoint

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ALIMONY

- Alimony is not deductible by the payor spouse nor included in the recipient spouse's gross income if the divorce or written separation agreement is executed after December 31, 2018 (IRC § § 71,215).
- In California, a separation or property settlement agreement can be executed and effective before a divorce becomes final.

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EXCLUSION FOR STUDENT LOAN PAYMENTS MADE BY EMPLOYER

- Payments made by an employer on an employee's student loan that are made after March 27, 2020, and before January 1, 2026 my be excluded from the employee's gross income. (CARES Act§2206; TCDTRA §120; IRC §127(c))

- The employer student loan payments are treated as an employer educational assistance program under IRC §127, which is subject to a $5,250 maximum per calendar year.

- The employer can deduct the payments as a business expense and is not required to pay payroll and workers' compensation expenses on the payments (as would be required if paid as wages). The employee essentially receives $5,250 in "free" income.

- The exclusion applies to payments made either directly to the lender or to the employee on any qualified education loan (as defined in IRC §127(d)1)incurred by the employee for the employee's education. The payments are not excluded if the student loan was for a family member, including the spouse of the employee.

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TUITION & FEES DEDUCTION

The Further Consolidated Appropriations Act of 2020 retroactively extended the above the line deduction for higher education tuition and fees through 12/31/2020(IRC §222).

MAGI	Maximum deduction
Less than $130,000 (MFJ) Less than $65,000 (Single, HOH) No deduction allowed for MFS	$4,000
$130,000-$160,000 (MFJ) $65,000-$80,000 (Single, HOH) No deduction allowed for MFS	$2,000

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HEALTH SAVINGS ACCOUNTS

Inflation-Adjusted Limitations for HSAs						
	2019		2020		2021	
	Family	Self only	Family	Self only	Family	Self only
Contribution limit	$7,000	$3,500	$7,100	$3,550	$7,200	$3,600
Additional catch-up contribution for taxpayer age 55 or older	$1,000 per qualifying spouse	$1,000	$1,000 per qualifying spouse	$1,000	$1,000 per qualifying spouse	$1,000
Minimum health insurance deductible	$2,700	$1,350	$2,800	$1,400	$2,800	$1,400
Maximum out of pocket	$13,500	$6,750	$13,800	$6,900	$14,000	$7,000

STANDARD DEDUCTION – IRC §63

Standard Deductions (Rev. Proc. 2016-55, TCJA)		
Filing Status	**2020**	**2021**
MFJ & Qualifying Widow(er)	\$24,800	\$25,100
HOH	\$18,650	\$18,800
Single	\$12,400	\$12,550
MFS	\$12,400	\$12,550

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MEDICAL EXPENSES – IRC §213

Medical mileage rate	• For 2020, the rate is 17 cents (Notice 2020-05) For 2021, the rate is 16 cents (Notice 2021-02)
7.5% threshold made permanent for all filers	• The 7.5% medical expense threshold has been made permanent by the TCDTRA. (IRC §213; TCDTRA§101)
CA conformity	• California uses federal AGI to compute this threshold and taxpayers will use 7.5% of *Federal* AGI.

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LONG-TERM CARE INSURANCE

- For 2020, up to $5,430 in premiums paid for long-term care insurance, per person, can qualify as a deductible for medical expense.

- For 2021, amount is $5,640.

- Self employed may include their qualified long-term car insurance premiums in the self-employed health insurance deduction, subject to the maximum amounts. (IRC §162(1)(1))

LIFETIME CARE CONTRACTS

- Many retirement communities require large lump-sum fees when a retiree moves into the community. These are often referred to as "lifetime care contracts," "founder's fees," or "life-care fees" and can be partly allocated to deductible medical expenses.
- In order to give rise to a medical expense deduction in the year a taxpayer moves into a retirement community, the agreement must require that the taxpayer pay a specific fee as a condition for the retirement community's promise to provide lifetime care that includes medical care.
- Retirement communities often provide a statement to their new residents to prove how much of the lifetime care contract is allocable to medical care.

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INTEREST

- For tax years 2018 through 2025, taxpayers may treat no more than $750,000 as *acquisition indebtedness ($375,000 for married taxpayers filing separately)*. (IRC §163(h)(3))

- Interest on *home equity debt* is not deductible for tax years 2018 through 2025, no matter when the debt was incurred, under the additional changes made by the TCJA.

QBI DEDUCTION

- IRC §199A allows taxpayers to claim a deduction of up to 20% against QBI. Taxpayers whose taxable income is above a phaseout threshold may have their QBI deduction limited or completely phased out.
- Taxpayers whose income is below the phaseout range receive a QBI deduction of 20% of the less of:
  - QBI; or
  - Taxable income before the IRC §199A deduction and after reduction for net capital gains.
  - How much of a taxpayer's QBI deduction is phased out depends on many factors, including whether a taxpayer's QBI is deemed to be from a specified service trade or business (SSTB) and/or the amount of W-2 wages and the unadjusted basis of assets immediately before acquisition (UBIA).

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CHILD TAX CREDIT

- The TCJA provides for the following credits through December 31, 2025:
  - An increase in the Child Tax Credit to $2,000 per qualifying child. Up to $1,400 of the child tax credit will be refundable per qualifying child.
  - An additional nonrefundable credit of $500 for qualifying dependents that are not qualifying children.

AGI Phaseout

- The child tax credit and the other dependent credit begin to phase out for taxpayers with AGI in excess of $400,000 in the case of married taxpayers filing jointly and $200,000 for all other taxpayers.

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NONBUSINESS ENERGY PROPERTY CREDIT

The Further Consolidated Appropriations Act of 2020, signed into law on December 20,2019, retroactively extended the nonbusiness energy property credit through 2020, and the TCDTRA extended it again through 2021.

Residential Energy Efficient (SOLAR) Property (REEP) Credit

The credit for qualified solar electric property and qualified solar water heating property placed in service before January 1, 2023, is:

- 26% credit for property placed in service between 1/1/20 & 12/31/21
- 22% credit for property placed in service between 1/1/22 & 12/31/22

The TCDTRA extended the 26% credit through 2021, thus extending the complete phaseout of the residential energy efficient property credit through 2022.

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AFFORDABLE CARE ACT

Beginning January1, 2019 the ACA's individual shared responsibility payment is $0, effectively repealing the individual mandate.

California conformity

CA enacted SB 78 on 6/27/19. The bill provides that effective 1/1/20, CA residents must maintain monthly health care insurance coverage or be subject to state penalties.

Refund claims:

The U.S Supreme Court has agreed to hear *California v. Texas* (U.S Supreme Court Docket 19-840), which addresses the constitutionality of the ACA. If the Court holds that all, or a portion, of the ACA is unconstitutional, taxpayers may be entitled to refunds for the taxes imposed by the ACA. These include the extra .9% Medicare tax and the 3.8% net investment income tax that have been paid on PY returns. Refunds are limited to years where the statue of limitations is still open.

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NANNY TAX THRESHOLD

- For 2020, the nanny tax threshold is $2,200. For 2021, it is $2,300.
- This is the applicable wage threshold for the purposes of FICA withholding for wages paid to household employees.
- Report and pay the federal nanny tax on Schedule H.
- Even though this provision is commonly referred to as the “nanny tax,” it applies to any household employee.
- When the fall 2020 school year started, many schools were engaged in “distance learning” where students attended class online.
- Many parents, especially those with two full-time working spouses, were forced to hire tutors simply to manage their children and make sure they attended all their classes and did their homework.
- These workers are also subject to the nanny tax.

SECURE ACT EXPANDS ALLOWABLE EDUCATION EXPENSES

- Starting in 2018, the TCJA expanded nontaxable IRC§529 distributions to include up to $10,000 annually for K-12 tuition.
- The SECURE Act further expands the IRC §529 distribution rules. The list of qualified higher education expenses that are permitted for §529 account distributions now also include:
  - Costs, fees, and supplies associated with registered apprenticeships; and
  - Student loan repayments (limited to $10,000 over the student's lifetime). (SECURE Act §302(a) and (b); IRC §529(c)(8) and (9))

PRESIDENT BIDEN

What can we expect?

WHAT CAN WE EXPECT?

- Joe Biden has advocated numerous tax policy positions
- Repeal the reduced capital gains and qualified dividends tax rate for taxpayers making over $1million per year. Their gains would be taxed at the 39.6% tax rate (plus the 3.8% NIIT rate);
- Increase taxes on those earning more than $400,000 by:
  - Reinstating the 39.6% tax bracket for individuals earning more than $400,000 that was in place prior to the TCJA reduction to 37%
  - Phasing out the IRC§199A QBI deduction for households with taxable income excess of $400,000
  - Imposing Social Security payroll taxes on earning of $400,000 and above, creating a “donut hole” in the current Social Security payroll tax system, where wages between $137,700, the current wage cap, and the $400,000 would not be subject to FICA

CONT…

- Further limit itemized deductions by placing a cap on the tax benefit that can be received to 28% and reinstating the pre-TCJA overall limit on itemized deductions. In 2017 when the limit was still in effect, the phaseout threshold was $261,500 ($313,800 for MFJ)
- Repeal the step-up in basis for inherited properties (it is unclear whether the assets would be taxed at death or whether the beneficiary would receive a carryover basis)
- Increase the corporate tax rate from 21% to 28%
- Restore and make permanent the Energy Investment Tax Credit, Residential Energy Efficiency Credits, and the Electric Vehicle Tax Credit

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CONT…

- Adopt the ABC test for worker classification purposes (similar to California's AB 5)
- Establish first-time homebuyers and renters tax credits.
- Expand the EITC for childless workers age 65 and over.
- Biden has stated that tax changes are not at the top of his to-do list. Looking at the Obama and Trump administrations, it took more than a year to implement Obamacare and the TCJA. However, our country is facing massive deficits, so it seems inevitable that change will come.

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AMERICAN RESCUE PLAN (ARP)

$1.9 trillion stimulus package

Additional Stimulus Payments

The ARP would supplement the payments made last month with additional checks of $1,400 brining the recent total to the $2,000 preferred by both Biden & Trump. Expands eligibly to adult dependents.

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EXTENSION OF REQUIRED FAMILY LEAVE/PAY

While the CAA extended the credit provisions until March 31,2021, it did NOT extend the requirement for employers to pay family and sick leave.

Biden's plan would extend the paid family/sick leave program through September 2021, while making several tweaks, including:

- Eliminating the exemptions for employers with fewer than 50 and more than 500 employees.
- Increasing the total paid leave to 14 weeks, at a maximum benefit of $1,400 per-week.
- Extending the benefits to healthcare workers, federal workers, and first responders.

The payroll credit would remain available only to those employers with fewer than 500 employees.

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CHILD TAX CREDIT

Expands credit to as much as:

- $3,600 per child under 6
- $300 for children age 6-17
- The credit would be fully refundable

Biden's plan would increase the credit for 2021 to a maximum of $4,000 for one child or $8,000 for two or more children.

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SMALL BUSINESS RELIEF

While not technically a tax provision, Biden’s proposal to earmark $15 billion for grants to over one million small businesses will certainly interest the regular readers of the Forbes’ Taxes page.

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PAYCHECK PROTECTION PROGRAM

PPP LOANS

- The CARES ACT authorized $349 billion for the Paycheck Protection Program

Key benefits of the program include:

- The loans may be forgiven for amounts used to cover specific operating expenses such as payroll costs, rent and mortgage, and utilities for earlier of 24 weeks or December 31, 2020, from the date the loan was funded, if the business retains its workforce at specified salary levels;
- Loan payment deferral until the bank receives the loan forgiveness amount from the SBA (10 months if no loan forgiveness application is submitted);
- No personal guarantees or collateral requirements; and
- Waiver of Small Business Administration fees.

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FOLLOW-UP LEGISLATION

- Paycheck Protection Program and Health Care Enhancement Act (H.R. 266; P.L. 116-139),signed by the President on April 24, 2020, added an additional $320 billion to the Paycheck Protection Program.
- June 5,2020 - Paycheck Protection Program Flexibility Act
- July 4,2020 - The Paycheck Protection Program Extension

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THE ORIGINAL LOANS

The maximum loan amount is equal to the lesser of:

- 2.5 times the average monthly payroll costs; *OR*
- $10 million

CONSOLIDATED APPROPRIATIONS ACT OF 2021

- The ACRRA, which is contained in the Consolidated Appropriations Act of 2021 (H.R. 133), reopens the PPP loan program. The program is now extended to March 31, 2021, with an additional $284.45 billion in funding for PPP loans, with set-asides for certain businesses.
- The bill also clarifies the deductibility of expenses paid with forgiven PPP loan amounts and revises the eligibility requirements for the loans. (ACRRA §323)

This new round of PPP funding makes the following new PPP funds available to borrowers:

- New "second draw loans" for smaller businesses whose gross receipts have dropped; and
- Supplemental funding for original PPP loans where the loan amount would have changed due to new rules that have been released.
- The bill also makes changes to the existing PPP loan provisions adopted under the CARES ACT, including allowing a simplified loan forgiveness application process and expanding the expenses that are qualified and eligible for loan forgiveness.

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SECOND DRAW LOANS

The ACRRA creates a second loan from the Paycheck Protection Program, called a "PPP second draw" loan for smaller and harder-hit businesses, with a maximum loan amount of $2 million per eligible entity. These are loans for businesses that can show significant losses in 2020 over 2019.

In order to receive a second draw PPP loan, eligible entities must:

- Employ not more than 300 employees (including part-time and seasonal employees); 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. (If the entity was not in business during all of 2019, then the business must show a 25% reduction in gross receipts during any quarter in 2020 from the 2019 calendar quarters it was in operation. If the application is submitted on or after January 1, 2021, then the fourth quarter of 2020 may be used as well.)(ACRRA §311)

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SELF-EMPLOYED BORROWERS

Schedule C Filers

- The maximum loan amount (and loan forgiveness) is based on the taxpayer's 2019 Schedule C. Self-employed individuals with no employees determined their monthly payroll costs by dividing their Schedule C, line 31 net profit amount, up to a $100,000 maximum, by 12. If the line 31 net profit amount is zero, the individual was ineligible for a loan.
- If the self-employed individual had employees in 2019, the monthly employee payroll costs were added to the amount just determined. These payroll costs were based on the 2019 IRS Form 941 taxable Medicare wages and tips, plus any excluded pretax employee contributions for health insurance or other fringe benefits, up to a $100,000 maximum per employee.

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SUPPLEMENTAL FUNDING REQUESTS

- Borrowers can also submit supplemental PPP loan requests in all cases where their original PPP loan amount would have changed due to new rules that have been released.
- This applies to partnerships where the original loan did not include the self-employment earning of the partners.
- But it also applies to borrowers that returned their original loans or took reduced loans to qualify for other benefits that are no longer limited for PPP recipients, such as the Employee Retention Credit. (ACRRA §312)
- Borrowers must request this additional funding before forgiveness is granted on their original PPP loan. (ACRRA §312(a)(2))
- So, borrowers that may want to borrow additional funds should wait to apply for forgiveness and attempt to withdraw forgiveness applications that have already been submitted.

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LOAN TERMS

The loans will again be based on 2.5 times the borrower's average monthly payroll costs for the one-year period prior to the loan, or calendar-year 2019, with a maximum of $2 million. (ACRRA§311)

Entities in industries assigned to NAICS code 72 (Accommodation and Food Services) may receive loans of up to 3.5 times average monthly payroll costs. This is welcome relief to hotels and restaurants.

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PPP LOAN FORGIVENESS

- Eligible loan recipients may have all or a portion of their loan forgiven if the loan proceeds are used for specified purposes.
- The borrower must apply for loan forgiveness within 10 months after the last day of the "covered period". (SBA 2020-0038) For most borrowers, the end of the covered period will be near the end of 2020.

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AMOUNT ELIGIBLE FOR FORGIVENESS

The amount that may be forgiven is equal to the following costs incurred and payments made during the covered forgiveness period beginning on the date their loan is funded:

- Payroll costs;
- Mortgage interest on a mortgage taken out by the borrower for real or personal property that was in place prior to February 15, 2020 (not including prepayments);
- Rent on a real or personal property lease taken out before February 15, 2020; and
- Utilities for service established before February 15, 2020.

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To qualify for full forgiveness, at least 60% of the loan proceeds must be used for payroll costs. However, because the purpose of the program is to help employers maintain the employment of their employees (to protect paychecks), loan forgiveness may be reduced if:

- The employer reduces its number of full-time equivalent employees (FTEEs); or
- The employer reduces any of its employee's rate of pay.

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ELIGIBLE EXPENSES EXPANDED

The following expenses are now considered allowable and forgivable uses for PPP loan funds:

Covered operations expenditures: Payment for any business software or cloud computing service that facilitates any of the following:

- Business operations;
- Product or service delivery;
- The processing, payment, or tracking of payroll expenses;
- Human resources;
- Sales and billing functions; or
- Accounting or tracking of supplies, inventory, records, and expenses;

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Covered property damage costs: Costs related to property damage due to public disturbances that occurred during 2020 that are not covered by insurance or other compensation;

***Covered supplier costs*:** Amounts paid to a supplier for goods essential to operations of the entity that are made pursuant to a contract, purchase order, or order for goods in effect prior to taking out the loan (before or during the loan covered period for perishable goods); and

Covered worker protection expenditures: Expenses to help a loan recipient comply with federal health and safety guidelines or any equivalent state and local guidance related to COVID-19 during the period between March 1, 2020, and the end of the national emergency declaration. These include, but are not limited to, the purchase, maintenance, or renovation of assets that create or expand:

- A drive-through window facility;
- An indoor, outdoor, or combined air or air pressure ventilation or filtration system;
- A physical barrier such as a sneeze guard;
- An expansion of additional indoor, outdoor, or combined business space;
- An onsite or offsite health screening capability; or
- Other assets necessary to comply with various regulatory agency requirements.

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**These provisions are effective as if they were originally included in the CARES ACT. As a result, they apply to all PPP loans, except for loans where borrowers have already received forgiveness.*

FORGIVENESS COVERED PERIOD

Under the PPPFA, the loan forgiveness covered period was extended from eight weeks (beginning on the date the loan was funded) to a period ending the earlier of:

- 24 weeks; or
- December 31, 2020

Because loans are based on 2.5 months of payroll costs, spending the full amount during the original eight-week covered period was basically mathematically impossible. However, spending that amount in 24 weeks should be no problem for many borrowers.

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PAYROLL COSTS

"Payroll costs" means the sum of the following payments

- Salary, wages, or other compensation paid to an employee or sole proprietor, or employee-owners (up to $100,000 annual limit per worker). Note that payments made to independent contractors are not eligible. Independent contractors could apply for their own loans as sole proprietors, so payments to independent contractors do not count for loan calculation or forgiveness purposes;
- Payment of cash tips or equivalents;
- Vacation, parental, family, medical or sick leave;
- Termination allowances;
- Group health care benefits, including insurance premiums;
- Retirement benefit payments; and
- State or local payroll taxes (limited to state taxes imposed on employee payroll paid by the employer (such as unemployment insurance premiums)).

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MAXIMUM COMPENSATION

For employees:

- For borrowers using an eight-week forgiveness period: \$15,385 (8 ÷ 52 × \$100,000) per employee, plus covered benefits such as health care, retirement contributions, and state payroll taxes; and
- For borrowers using a 24-week forgiveness period: \$46,154 (24 ÷ 52 × \$100,000) plus covered benefits such as health care, retirement contributions, and state payroll taxes.(SBA 2020-0037)

For owners, even if the borrower uses a 24-week period, compensation is capped at 2.5 months of 2019 compensation, with a maximum of \$20,833 (2.5 ÷ 12 × \$100,000).

For Schedule C borrowers, using 2.5 months of 2019 compensation will allow them to qualify for 100% forgiveness.

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RETIREMENT & HEALTH CARE BENEFITS

Because many companies make annual contributions to retirement plans or pay annual health insurance premiums, there were questions about how much of those annual amounts would qualify for forgiveness if they were paid during the covered period.

The interim final rules issued by the SBA explained that forgiveness does not apply to retirement or health care benefits "accelerated" into the covered period. Only the amount of benefits proportional to the covered period qualify for forgiveness.

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NON PAYROLL COSTS

- Paid during the covered period; or
- Incurred during the covered period and paid on or before the next regular billing date, even if the billing date is after the covered period.
- Nonpayroll costs cannot account for more than 40% of the loan forgiveness.

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REDUCTIONS OF FORGIVENESS

One step in determining how much of a taxpayer's PPP loan will be forgiven is determining if the employer has a reduction in either of the following, which can result in a decrease in the amount that may be forgiven.

- Full-time equivalent employees (FTEEs); or
- Reductions in salaries or wages for individual employees.

Reduction of full-time equivalents

In general, a reduction in FTEEs during the covered period reduces the loan forgiveness amount by the same percentage as the percentage reduction in FTEEs. (SBA 2020-0032; instructions to loan forgiveness form) However, as discussed below, businesses may be exempted from this reduction if they meet certain requirements.

The FTEE reference period

A reduction occurs if the average number of FTEEs during the "reference" period was greater than the average number of FTEEs during the covered period. Borrowers who are not seasonal employers have the choice to use one of two reference periods:

- February 15, 2019, to June 30, 2019; or
- January 1, 2020, to February 29, 2020.

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INABILITY TO REHIRE EMPLOYEES

A reduction in FTEEs will not occur for any employee where:

- The borrower made a good-faith, written offer to rehire an individual who was an employee on February 15, 2020, and was unable to hire similarly qualified employees for unfilled positions on or before December 31, 2020;
- Any positions for which the borrower made a good-faith, written offer to restore any reduction in hours, at the same salary or wages, during the covered forgiveness period, and the employee rejected the offer (this would also include an employee who was laid off); or
- Any employees who during the covered forgiveness period were fired for cause, voluntarily resigned, or voluntarily requested and received a reduction of their hours.

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BUSINESS ACTIVITY

The forgiveness amount will not be reduced if the business cannot return to the same level of business activity the business was operating at before February 15, 2020, (by the end of the covered forgiveness period) due to compliance with requirements or guidance issued between March 1, 2020, and December 31, 2020, by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration, related to worker or customer safety requirements related to COVID–19. (PPPFA §3(b)(2))

For example, even if a restaurant is able to continue operating through take-out and delivery, it would qualify for the exemption if it can't operate at the same level of business because it's not allowed to have customers in the restaurant.

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DEDUCTIBILITY OF EXPENSES

The ACRRA makes it clear that no deduction may be denied, no tax attribute reduced, and no basis increase denied by reason of any PPP loan forgiveness under the CARES Act or the ACRRA. (ACRRA §276) This reverses the IRS's position taken in IRS Notice 2020-32 that taxpayers could not deduct expenses that were paid with forgiven PPP loans.

California conformity

For taxable years beginning on or after January 1, 2020, California does not treat the forgiveness as COD income but disallows deductions for any of the amounts paid with forgiven PPP debt. (AB 1577 (R&TC §§17131.8, 24308.6) Because California passed a law that specifically disallows deductions for expenses paid with PPP loan amounts that were forgiven, absent subsequent legislation enacted in 2021, these expenses will not be deductible on the California return.

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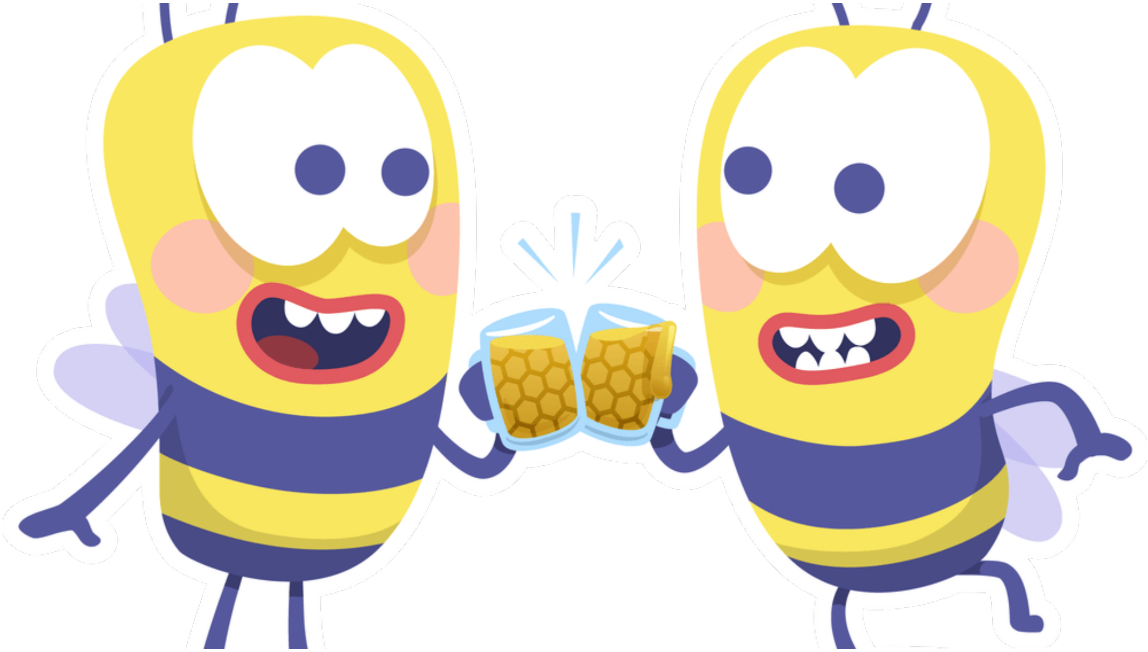
BUSINESS

Employment tax benefits related to COVID-19



EMPLOYMENT TAX BENEFIT RELATED TO COVID-19

- Delay of employer payroll tax payments
- Mandatory paid sick leave
- Mandatory paid family leave
- Employee retention credit

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DELAY OF EMPLOYER PAYROLL TAX PAYMENTS

Businesses may defer the employer's share of Social Security tax at 6.2% for the period March 27, 2020, through December 31, 2020.

- 50% due on 12/31/21; and
- 50% due on 12/31/22

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ELIGIBLE EMPLOYERS

- All employers may defer the deposit and payment of the employer's share of Social Security tax.
- Originally, under the CARES Act, taxpayers that received PPP loan forgiveness were ineligible for deferral.
- However, the prohibition was repealed by the Paycheck Protection Program Flexibility Act of 2020.

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EMPLOYEE SOCIAL SECURITY DEFERRAL

- IRS permitted employers to defer the withholding, deposit, and payment of the *employee's* portion of Social Security taxes paid
- Employers are not required to withhold the employee's portion of Social Security taxes even if the employee requests the deferral. However, if the taxes are deferred, employers must withhold and pay the deferred tax ratably from wages and compensation paid to the employees
  - **Deferral period:** September 1, 2020 through April 30, 2021;
  - **Repayment period:** May 1, 2021 through December 31, 2021

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MANDATORY PAID LEAVE UNDER THE FFCRA

- The mandatory paid sick leave and family leave under the FFCRA expired on December 31, 2020.
- Employers are no longer required to pay these FFCRA benefits, though if they do, they are entitled to the credits.

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PAID SICK LEAVE

- From April 1, 2020, through December 31, 2020, employers with fewer than 500 employees (including some government employers) must provide up to 80 hours of paid sick leave to each employee unable to work.

  - For an employee who is unable to work because of coronavirus quarantine or self-quarantine or who has coronavirus symptoms and is seeking a medical diagnosis, the eligible employee receives their regular rate of pay, up to $511 per day and $5,110 in the aggregate, for a total of 10 days;

  - For an employee who is caring for someone with coronavirus or is caring for a child because the child's school or childcare facility is closed, or the childcare provider is unavailable due to the coronavirus, the eligible employee receives two-thirds of their regular rate of pay, up to $200 per day and $2,000 in the aggregate, for up to 10 days.

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CONT.

- Employers will receive a refundable credit for the amounts paid to employees
- An additional credit determined based on costs to maintain health insurance for the eligible employee during the leave period, plus the employer's share of Medicare.
- All employees, including new hires and part-time employees

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PAID FAMILY LEAVE

- Until December 31, 2020, the FFCRA allowed employees who have worked more than 30 days for an employer who employs fewer than 500 employees to take up to 10 weeks of employer-paid family leave.

- An employee only qualifies if they are unable to work because they need to take care of their child, under 18 years of age, due to school or childcare closures related to a COVID-19 emergency declared by a governmental authority.

- There is a 10-day waiting period during which the employee may use employer sick pay or vacation pay, including the paid sick leave benefits provided under the FFCRA.

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AMOUNT OF CREDIT

- The credit may be claimed for 100% of the paid sick leave and paid family leave benefits paid under the FFCRA:
- Increased by:
    - The amount of the employer's qualified health plan expenses allocable to the paid sick leave wages if these expenses are excluded from the employee's gross income; and
    - The employer's 1.45% Medicare tax paid on such benefits; and
- Reduced by any credits claimed for the employment of qualified veterans or for research expenditures of qualified small business employees claimed by the employer

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EMPLOYEE RETENTION CREDIT UNDER THE CARES ACT

- The CARES Act provides a *refundable* credit against quarterly employment taxes equal to 50% of the qualified wages and compensation. Only wages paid after March 12, 2020, and before January 1, 2021, qualify for the credit.
- The maximum qualified wages per employee is $10,000, which equates to a maximum Employee Retention Credit of $5,000 per employee. There is no maximum number of employees who may lead to a credit.
- The Employee Retention Credit is in addition to the payroll tax credits available under the Families First Coronavirus Response Act for paid sick leave and family leave. However, the Employee Retention Credit may not be claimed for wages paid as paid sick leave or paid family leave benefits.

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ELIGIBLE EMPLOYERS

- Employers eligible for the Employee Retention Credit are those that
  - Carried on a trade or business during the 2020 calendar year
  - Respect to any calendar quarter
    - Fully or partially suspended their operations due to orders from any governmental authority limiting
    - Experienced a significant decline in gross receipts for the calendar quarter

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SIGNIFICANT DECLINE IN GROSS RECEIPTS

- Significant decline in gross receipts applies to the first calendar quarter in 2020 for which gross receipts are less than 50% of gross receipts for the same calendar quarter in 2019.
- If gross receipts are less than 50% of gross receipts for the same calendar quarter in 2019, then the Employee Retention Credit is available for the entire quarter.
- An employer can claim the Employee Retention Credit through the end of the first quarter for which its gross receipts are greater than 80% of the gross receipts for the same calendar quarter in 2019.

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EMPLOYEE RETENTION CREDIT EXPANDED UNDER THE TCDTRA

- The TCDTRA modifies, expands, and extends the Employee Retention Credit.
- Wages paid with forgiven PPP debt are not included in payroll costs taken into account in computing the Employee Retention Credit.
- Coordination with PPP loans:
  - Under the CARES Act, PPP loan recipients were ineligible to claim the Employee Retention Credit.
  - The TCDTRA retroactively repeals this rule.
  - Under the TCDTRA, PPP loan recipients may now claim the Employee Retention Credit.

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CREDIT EXTENSION & EXPANSION

- Quarters beginning after December 31, 2020, the TCDTRA amends the CARES Act and:
  - Extends the credit to apply to qualified wages paid prior to July 1, 2021, (so the credit now applies to wages paid after March 12, 2020, through July 1, 2021);
  - Increases the credit rate from 50% of qualified wages to 70%; and
  - Increases the $10,000 qualified wage limitation to apply per quarter, rather than on an annual basis

**Remember, the TCDTRA is expanded through June 30, 2021, so the credit is only available for the first two quarters of 2021.*

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ELIGIBLE EMPLOYERS EXPANDED

- For calendar quarters beginning after December 31, 2020, the TCDTRA amends the CARES Act, and a *significant decline in gross receipts* is revised to apply to any employer if the gross receipts
    - For such calendar quarter are less than 80% of the gross receipts of such employer for the same calendar quarter in 2019.
    - At the election of the employer, for the immediately preceding calendar quarter, are less than 80% of the gross receipts for the corresponding calendar quarter in calendar year 2019.
- If the business wasn't in operation at the beginning of a calendar quarter in 2019, the taxpayer may use the 2020 comparable quarter.
- Employers with less than 500 employees are allowed for the credit.

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Business Losses

BUSINESS

NET OPERATING LOSSES

The TCJA made two major changes to net operating losses:

- For losses arising in tax years beginning after December 31, 2017, the NOL deduction is limited to 80% of the taxpayer's taxable income; and
- Carrybacks were no longer allowed

However, the CARES ACT provided two major modifications to the net operating

- Five-year carrybacks are allowed for NOLs incurred in 2018–2020; and
- The 80% taxable income limitation for the 2018–2020 taxable years is suspended
- Means that taxpayers can retroactively go back and use their 2018 and 2019 NOLs and carry them back five years to 2013 or 2014, respectively.

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IRC §179 EXPENSING

Assets placed in service in tax years beginning after…	Expensing limitation	Phaseout threshold
12/31/18	$1,020,000	$2,550,000
12/31/19	$1,040,000	$2,590,000
12/31/20	$1,050,000	$2,620,000

California nonconformity

Never conformed to the enhanced IRC §179 deduction but continues to have a maximum $25,000 expense limit and a $200,000 phaseout threshold.

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BONUS DEPRECIATION

- Full and immediate deduction of 100% of the cost of qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023.
- Qualified improvement property is now eligible for bonus depreciation.
- Qualified property placed in service after September 27, 2017, the TCJA removed the requirement that made bonus depreciation available only for new property.

California nonconformity

- CA never conformed to federal bonus depreciation.

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BUSINESS INTEREST LIMITATION

- The TCJA enacted IRC §163(j), which limits the net interest business expense deduction for all taxpayers other than small or "excepted businesses" to business interest income, 30% of adjusted taxable income (ATI) (50% for 2019 and 2020 tax years). ATI cannot be less than zero; and Floor plan financing interest.
- Small businesses are defined as those whose average gross receipts are less than $25 million, adjusted for inflation. The threshold is $26 million for 2019 and 2020.
- California does not conform to the IRC §163(j) limitation.

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CARES ACT MODIFICATIONS

- Temporarily eases the business interest expense limitation enacted by the TCJA.
- Increases the adjusted taxable income limit from 30% to 50% for the 2019 and 2020 taxable income.
- Allows all taxpayers to use their 2019 adjusted taxable income limit to calculate their 2020 interest expense limitation.
- Partners were allocated excess business interest for 2019, they may deduct 50% of that excess business interest expense in 2020 not subject to these limitations.
- Taxpayers are given the option to elect out of using the increased excess business interest expense limitation or to use 2019 adjusted taxable income.

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RETIREMENT

IRA CONTRIBUTION AMOUNTS

- An individual may make deductible contributions to an IRA up to the lesser of $6,000 or the individual's compensation if neither the individual nor the individual's spouse is an active participant in an employer-sponsored plan.
- Married couples can make a deductible IRA contribution of up to $12,000 if the combined compensation of both spouses is at least equal to the contributed amount.

Maximum IRA Contribution

2020	2021
$6,000	$6,000

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TAXPAYER ACTIVE IN EMPLOYER-SPONSORED PLANS

Beginning taxable year	Single, HOH, MFS (did not live with spouse)	MFJ	MFJ (lived with spouse at any time during year)
2020	$65,000-$75,000	$104,000-$124,000	$0-$10,000
2021	$66,000-$76,000	$105,000-$125,000	$0-$10,000

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TAXPAYER IS *NOT* AN ACTIVE PARTICIPANT, BUT SPOUSE IS

Beginning taxable year	2020	2021
AGI Phaseout range	$196,000-$206,000	$198,000- $208,000

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CONTRIBUTIONS AFTER AGE 70 ½

- For taxable years beginning after December 31, 2019, the SECURE Act removed the age restrictions for taxpayers to contribute to a traditional IRA.

California conformity

- California does not conform to the SECURE Act provisions permitting a deduction for traditional IRA contributions after age 70½. This creates a basis in the IRA for California purposes.

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SPOUSAL IRA CONTRIBUTIONS

- A taxpayer who files a joint return can contribute to an IRA even if they don't have earned income as long as their spouse has sufficient earned income. (IRC §219(c)(2)) The total combined contributions of both spouses can't be more than the total earned income reported on the return.

- The spousal IRA contribution rule has been around long before the SECURE ACT, but it can be a great opportunity where one spouse is still working, and the other spouse is retired.

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CORONAVIRUS-RELATED DISTRIBUTIONS

- Taxpayers may make penalty-free coronavirus-related withdrawals of retirement funds of up to $100,000 in the aggregate between January 1, 2020, and December 31, 2020.
- In addition, the taxpayer may spread the withdrawn amount in taxable income over a three-year period beginning in 2020.
- Finally, the taxpayer can recontribute the amounts within three years and avoid taxable income altogether.

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QUALIFYING DISTRIBUTIONS

Distributions may be made from a plan as described in IRC §402(c)(8)(B), which includes:

- Individual retirement accounts;
- Individual retirement annuities;
- A qualified retirement plan, such as a 401(k), pension, and profit sharing plan;
- An annuity plan;
- An IRC §457 plan for government and nonprofit employers; and
- An annuity contract described in IRC §403(b).(CARES Act §2202(a)(4)(C))

Defined benefit plans are not included.

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CONT…

A coronavirus-related distribution is a distribution made:

- On or after January 1, 2020, and before December 31, 2020;
- To a person diagnosed with SARS-CoV-2 or COVID-19 by a test approved by the Centers for Disease Control and Prevention or whose spouse or dependent was so diagnosed; or
- To a person experiencing adverse financial consequences as a result of:
  - Being quarantined, furloughed, or laid off;
  - Having work hours reduced due to the virus;
  - Being unable to work due to a lack of child care;
  - The closing or reducing of hours of a business owned or operated by the individual due to such virus; or
  - Other factors determined by the Secretary of Treasury.

IRS Notice 2020-50

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RETIREMENT PLAN DISASTER RELIEF

- Penalty-free withdrawals from their qualified retirement accounts up to $100,000 are not subject to withholding.

Qualifying Distributions

- On or after the first day of the incident period of the qualified disaster and before June 25,2021.
- An individual whose principal place of abode is located in the qualified disaster area sustained an economic loss by reason.

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LOANS FROM QUALIFIED PLANS

RULES LIBERALIZED UNDER CARES ACT

Limits on plan loans increased

- Made from qualified plans is increased from $50,000 to $100,000 for loans.
- Under the CARES Act, as before, loans from qualified employer retirement plans are only permitted if the plan allows them.

Period for repayment extended

- Any qualified plan loan repayments due during the period beginning on March 27, 2020, and ending on December 31, 2020, are delayed for one year, and the five-year repayment requirement is extended to six years. This only applies so long as the taxpayer is still employed by the same employer.
- More time to roll over the loan balance to an IRA before the income is subject to tax.
- The repayment must be made by the due date for filing their tax return, including extensions.

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REQUIRED MINIMUM DISTRIBUTION CHANGES

RMDs DON'T BEGIN UNTIL AGE 72 (SECURE ACT)

- Must begin taking required minimum distributions from age 70½ to age 72.
- Taxpayers who make traditional IRA contributions after age 70½ cannot offset their RMDs for the same taxable year.

Example of post-age 70½ RMDs:

- Jessica is 75 years old and her 2021 RMD is $48,000, calculated using the fair market value of her IRA account as of December 31, 2020. Jessica's 2021 RMD amount is not affected by any IRA contributions she may make in 2021.

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RMDs WAIVED FOR 2020-CARES ACT

The CARES ACT waives the RMD requirement in 2020

2020 RMD suspension does not apply to defined benefit plans, but it does apply to:

- 401(k)s;
- Defined contribution plans (IRC §403(a) and (b));
- Tax-sheltered annuity plans (IRC §403(b));
- Defined contribution plans under IRC §457(b) maintained by a state or municipal government (the waiver does not apply to current or former employees of exempt organizations that maintain an IRC§457(b) plan); and
- An individual retirement plan such as a traditional, SEP, or SIMPLE IRA

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ROTH IRA PROVISIONS- IRC § 408A

ROTH IRA CONTRIBUTION AMOUNTS

Contribution that can be made to a Roth IRA is phased out based on the taxpayer's AGI, adjusted annually for inflation:

Filing status	2019	2020	2021
Single, HOH, or MFS and did not live with spouse at any time during the year	$122,000–$137,000	$124,000–$139,000	$125,000–$140,000
MFJ	$193,000–$203,000	$196,000–$206,000	$198,000–$208,000
MFS and lived with spouse at any time during the year	$0–$10,000	$0–$10,000	$0–$10,000

Roth IRA does not have an age limit

Consider funding a Roth IRA for children with earned income.

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BACK DOOR ROTH CONVERSIONS

Allows high-income individuals to make a nondeductible contribution to a traditional IRA and then convert the traditional IRA to a Roth IRA.

Example of aggregation rules:

Mary made a nondeductible $6,000 contribution to her IRA. Mary also has a rollover IRA with a balance of $600,000. When she converts the $6,000 to the Roth, her basis in his IRA accounts is $6,000. She must include all $606,000 in her taxable income computation.

Her taxable amount is <u>$5,940:</u>

$\$600{,}000 \div \$606{,}000 = 99\%$

$\$6{,}000 \times 99\% = \$5{,}940$

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THIS CONCLUDES THE 2020/2021 ANNUAL TAX UPDATE

THANK YOU!

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Your **freedom.**