SHARTSIS FRIESE LLP

Client Alert: Tax Changes in Light of COVID-19

In response to the COVID-19 emergency, on March 13, 2020, President Trump announced his determination that the coronavirus pandemic was an emergency, directing the Treasury to extend certain due dates. Congress soon followed, leading to the enactment of, on March 18, 2020, the Families First Coronavirus Response Act (FFCRA), and on March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

Together, these responses provide taxpayers with tax relief (and frequently, refunds) offsetting in part the economic harms caused by the COVID-19 emergency. Further, certain preexisting areas of the tax law have taken on a changed importance in light of the outbreak. These changes in the law include due date delays, tax assistance for paying employees, business tax changes, and individual tax changes. This alert is to provide our clients with important and timely information on some of the most relevant changes to the law.

Tax Due Date Delays

- **Federal Deferral**: The IRS has announced that the April 15, 2020 filing deadlines for federal income tax returns, gift tax returns, and associated payments (including for self-employment, GST, and estimated income taxes), have been extended to July 15, 2020. Retirement plan contributions and health savings account contributions relating back to 2019 have also been extended, as have certain other tax events keyed to a taxpayer's income tax return due date.

- **California Deferral**: The California Franchise Tax Board has delayed income tax deadlines to match the federal deferral noted above.

Tax Assistance for Paying Employees

- **Payroll Tax Relief**: Many of the changes in the tax law focus on incentivizing and assisting employers to continue to pay their employees (including under new sick, family, and medical leave mandates). Importantly, when it comes to ensuring workers are paid, tax benefits are just one of three avenues the CARES Act makes available to small employers; Small Business Administration (SBA) loans and providing employees with enhanced unemployment benefits are the others. These three avenues face various limitations in their ability to be used simultaneously. Employers will need to determine which avenues best meet their goals.

- **<u>Employment Tax Credits for Sick and Family Leave</u>**: Eligible employers with fewer than 500 employees will receive a 100% tax credit against certain employment taxes for qualified sick leave wages and qualified family leave wages. To qualify, these wages must be paid in the period beginning April 1, and ending December 31, 2020. Comparable credits are provided to self-employed individuals. Significantly, excess credits are to be refunded.

  The amounts are not to exceed $200 per individual (or $511 for certain kinds of leave) per day, with 10 days per year per employee. These credits may be advanced before being in fact earned in order for relief to arrive sooner.

- **<u>Employment Tax Credits for Retaining Employees While Having Substantially Reduced Business</u>**: Except for employers receiving a paycheck protection loan from the SBA, during the time an eligible employer has a business operating at reduced capacity, the employer may receive a 50% tax credit for certain wages paid to employees (not to exceed $10,000 per employee). Wages counted for the sick and family leave credits will not be counted again for these purposes. As above, excess credits are to be refunded.

  For employers with more than 100 employees, the only wages that count are those paid to an employee who cannot work because of the reduced capacity; smaller employers count wages even for employees unaffected by the reduced capacity. An employer is operating at reduced capacity (1) when it is ordered fully or partially suspended by a governmental authority because of COVID-19, or (2) during the period beginning in a quarter in which the employer receives less than 50% of its gross receipts from the prior year until a quarter with the employer receiving more than 80% of its prior year equivalent.

- **<u>Payroll Tax Deferral</u>**: Except for employers who have their SBA paycheck protection loans forgiven (under the special forgiveness provisions applicable to such loans), employer-side payroll taxes for the period of CARES Act passage to December 31, 2020 (including half of self-employment taxes) may be deferred. Half of the deferred amount is due December 31, 2021, and the other half a year later.

- **<u>Qualified Disaster Relief Payments to Employees</u>**: While not a change in the law, employers should be aware that individuals may exclude qualified disaster relief payments from their income. This includes payments from employers to employees to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster, which will include COVID-19 in California.

Thus, employers (or even charitable entities associated with employers) may, with proper planning, assist suffering employees in a tax-advantaged manner.

Business Tax Changes

- **Temporary Disablement of Loss and Deduction Limitations**: In order to create refunds and lower income tax burdens, the CARES Act temporarily deactivates certain loss limitations or enhances deductions and credits.

    - Net operating losses (NOLs) from businesses in 2018, 2019, and 2020 may now be carried back up to five years, and may offset up to 100% of taxable income. (Returns for filed years would be amended to claim the losses for such years.) As an exception, income caused by the 2017 "repatriation" transition tax may not be offset; further, taxpayers may elect to exclude years with such transition tax income from the carryback. Technical fixes as to the NOL rules also apply. REITs and life insurance companies are subject to special carryback provisions.

    - The business interest deduction limitation for 2019 and 2020 now allows a deduction equaling the taxpayer's business interest plus 50% (up from 30%) of the taxpayer's adjusted taxable income (ATI) (essentially, for the years in question, EBITDA for tax purposes). Further, for 2020, the taxpayer may use its 2019 ATI to determine the limit (reflecting that 2020 income will likely be far lower). Special rules apply to translate the rules to partnerships.

    - Corporate charitable deductions will be provided for contributions of cash of up to 25% of taxable income (instead of the usual 10%). Food inventory is also favored (as discussed later for the individual charitable deduction changes).

    - The non-corporate business loss limitation was added by the 2017 tax act, preventing non-corporate taxpayers from using business losses more than $250,000 ($500,000 for joint returns) in excess of business income for a year. For 2018, 2019, and 2020, this limitation is disabled. Further, the provision has certain technical corrections included.

    - Qualified improvement property (certain kinds of improvements to real property) now qualifies for bonus depreciation. This change is retroactive to late 2017.

    - Taxpayers should discuss with their accountants the availability of any quick refund procedures.

- **Government Payment Tax Treatment**: Several provisions clarify the tax treatment of the loans and other government payments included in the CARES Act.

- SBA paycheck protection loans received under the CARES Act will not cause taxable cancellation-of-indebtedness income on forgiveness resulting from the specific forgiveness provisions included in the Act.

- The taxability of small business grants under the CARES Act is unknown; without specific legal changes, they will presumably be taxable.

- The bill clarifies the treatment of certain investments from a $500B "bailout" fund will be used to lend, provide guarantees for, or otherwise invest in or provide liquidity to large businesses. This program may potentially extend to other businesses as well.

Individual Tax Changes

- **Recovery Rebate**: Eligible individuals will receive a refundable tax credit of $1,200 ($2,400 for joint filers) plus $500 (for each child eligible for a child tax credit). The credit phases out for single filers with adjusted gross incomes over $75,000 ($112,500 for heads of household, $150,000 for joint filers). To ensure rapid deployment, the credit automatically applies against the 2018, 2019, or 2020 tax year without individuals needing to file anything except their tax returns (or, for Social Security and Railroad Retirement Benefit recipients who have not needed to file returns, nothing at all).

- **Coronavirus-Related Retirement Plan Distributions**: Up to $100,000 "coronavirus-related distributions" may be withdrawn by individuals from their retirement plans without imposition of the 10% penalty for early withdrawals. Individuals may repay such distributions as "rollovers" to plans within three years, to help replace the lost tax advantages from making the withdrawals in the first place. Similarly, distributions are included in income ratably over three years (unless the taxpayer elects otherwise).

  "Coronavirus-related distributions" are those made before December 31, 2020, to an individual who is, or who has a spouse or dependent who is, sickened with novel coronavirus; or who suffers reduced ability to work (e.g., by furlough, business shutting down, or lack of child care) because of the virus and disease.

- **Retirement Plan Loan Liberalization**: The amount that can be borrowed from an employer retirement plan account (e.g., a §401(k)) is doubled (to $100,000), and the entire nonforfeitable portion of the account may be borrowed (instead of only half). Loan amounts due this year are deferred until next year.

- **Skipping Required Minimum Distributions**: Required minimum distributions from defined contribution plans, including IRAs, will not occur in 2020; plans which must be distributed within five years may disregard 2020 as one of those five years.

- **<u>Implementation for Retirement Plan Administrators</u>**: Special provisions apply to help retirement plan administrators know how to handle coronavirus withdrawal requests, and how and when to amend plans to handle the foregoing changes in law. SEP plans now have a longer period in which to make minimum contributions, although interest will be charged for any delay.

- **<u>Charitable Contribution Enhancements</u>**: A $300 cash contribution to a charity (other than to donor advise funds ("DAFs") and supporting organizations ("SOs")), beginning this year, is deductible "above the line" for standard deduction-takers. Further, cash contributions made this year (except to DAFs and SOs) are, for itemizers, 100% deductible, up to their present-year AGI. For all taxpayers, food inventory contributions are now subject to a 25% income limitation instead of their prior 15% limitation.

- **<u>Health-Related Provisions</u>**: A wider variety of health costs may now be covered under one's medical tax-advantaged account (an HSA, health FSA, MSA, or HRA). Health plans and health insurers will be generally required to cover, without cost-sharing, coronavirus protective service and diagnostic testing. High-deductible health plans can allow health benefits relating to coronavirus, as well as telemedicine, without a deductible. Various procedural requirements apply. Further, many non-tax changes also apply to healthcare, and are not discussed in this alert.

- **<u>Changed Environment for High Net Worth Estate Planning</u>**: With the decrease in interest rates and asset values, along with the charitable contribution enhancements noted above, high net worth individuals may find the current environment conducive to planning for the avoidance of future estate and gift taxes. This is because many powerful wealth transfer techniques operate more effectively in times of depressed interest rates and asset values.

FFCRA and the CARES Act were enacted quickly in response to COVID-19 and are subject to additional clarification and interpretation by Treasury, IRS, SBA and other federal regulatory agencies. The legislation is complex, but creates planning opportunities.

- For further information on the new provisions, how they may apply to you, and related planning, please contact any member of the Tax group: Geoffrey W. Haynes, Dashiell C. Shapiro, Kevin R. Leiske, and Mark E. Mullin.

- For information on and assistance with taking advantage of the changed environment for estate planning, please contact any member of the Family Wealth Planning group: Patrick R. McCabe, Richard S. Kinyon, April H. Rox, Charles G. Stephenson, Debra L. Kasper, Sarah M. King, Danielle T. Zaragoza, Florence M. Jao, and Mark E. Mullin.