**SUPPLEMENT TO ACCOMPANY**

**FEDERAL TAXATION**

**2021 EDITION**

**Pratt-Kulsrud-Burton**

**Changes introduced by the**

**Coronavirus Preparedness and Response Supplemental Appropriations Act Families First Coronavirus Response Act**

**Coronavirus Aid, Relief, and Economic Security Act**

**Paycheck Protection Program and Health Care Enhancement Act**

**Payroll Protection Program Flexibility Act**

**Pratt-Kulsrud-Burton Tax Series**

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**INTRODUCTION**

At this writing, August 6, 2020, most of the world continues to grapple with the far-reaching effects of the Covid-19 pandemic. But while officials are doing what they can to contain the spread of the disease, the federal government also is trying to address the drastic toll the pandemic has had on the economy. Thus far, Congress and President Trump have worked together to enact five pieces of legislation that impact our tax laws.

On March 6, 2020, President Trump signed into law the *Coronavirus Preparedness and Response Supplemental Appropriations Act of 2020* (CPRSAA), the first bill to address the economic impact of Covid-19 on the U.S. economy. The new law provided $8.3 billion of new funding for the country’s response to the coronavirus, including vaccine development, support for state and local governments, and assistance for affected small businesses.. In addition, it provided that Medicare recipients can now consult with their providers by telephone or teleconference from home, thereby reducing the risk of exposure associated with visits to medical care facilities. Lastly, it authorized the Small Business Administration (SBA) to provide so-called Economic Injury Disaster Loans (EIDLs). It did not contain any tax provisions.

On March 18, 2020, Congress passed the second piece of legislation related to Covid-19, the *Families First Coronavirus Response Act* (FFCRA). FFCRA and two of its component parts, the *Emergency Paid Sick Leave Act* (EPSLA) and the *Emergency Family and Medical Leave Expansion Act* (EFMLEA), dramatically change the rules concerning sick pay. FFCRA generally requires most employers to provide up to 10 weeks of paid sick leave to employees that must leave their jobs due to the coronavirus. Moreover, Congress eliminated the burden that this might impose on businesses by allowing them to reduce the amount of their payroll taxes (the 6.2% FICA portion) by the amount used for sick pay. FFCRA also provides funding for increased COVID-19 testing, making it free for those without insurance. The provisions of FFCRA are temporary, and generally expire on December 31, 2020.

On March 27, 2020, President Trump signed into law the third and most far reaching package of aid to date. This measure, the *Coronavirus Aid, Relief, and Economic Security Act* (CARES), provides $2 trillion for the fight against the pandemic. The CARES Act (the Act) contains unprecedented financial assistance for both individuals and businesses. To start, the government put money in the hands of most individuals—stimulus payments in April—to help them weather the financial storm brought on by the virus. The Act also created the Paycheck Protection Program (PPP) through which businesses can obtain so-called PPP loans from their local lenders that they need not repay as long as the money is used to keep employees on the payroll or for certain other expenses. Moreover, the law makes the debt cancellation nontaxable if certain tests are met.

On April 24, 2020, Congress and the President acted again. By this time. much of the relief—the PPP loans—provided by the CARES Act was exhausted. It took less than a month. Consequently, on April 24, 2020, President Trump signed the *Paycheck Protection Program and Health Care Enhancement Act*. The Enhancement Act provides additional funding of $484 billion. The bulk of this relief, $370 billion, replenishes the PPP loan program. In addition, Congress, reeling from complaints that too much of the CARES funding went to large businesses with relationships with large banks, also took steps in the Enhancement Act to ensure that this would not happen again. The new law reserves $60 billion for loans to be made by small banks, credit unions, minority-owned banks, and other small lenders. The Enhancement Act also adds another $75 billion for reimbursements to hospitals and health care providers for coronavirus-related expenses as well as lost revenue. Finally, the Enhancement Act provides $25 billion for coronavirus testing. Trump’s signing of the new legislation comes as Washington policymakers are already debating what the next relief package would look like.

On June 5, 2020, the *Paycheck Protection Program Flexibility Act of 2020* (PPFA) was enacted to relax the requirements that employers must meet to qualify for loan forgiveness provided by the PPP loan program. Prior to enactment of the PPPFA, a PPP borrower could apply for loan forgiveness for up to the amount of PPP loan proceeds expended on authorized uses during the 8-week period immediately following receipt of the loan. The PPPFA extends this 8-week “forgiveness period” to payments made for 24 weeks after the date of disbursement of the PPP loan to the PPP borrower, but in no event ending later than December 31, 2020.

At this writing, Congress is considering an extension of the provisions of the CARES Act, including a second stimulus check.

This supplement updates the 2021 text for these revisions as well as other items of note since publication. In this regard, prior to the close of 2019, Congress enacted the *Setting Every Community Up for Retirement Enhancement Act* (the SECURE Act) that made several changes to the tax law. Selected items are included in the discussion below. All of the relevant changes made by the SECURE Act are reflected in the 2021 Edition of the text. However, as we went to press for the 2021 edition, the enactment of the 2020 legislation mentioned above (Coronavirus Preparedness and Response Supplemental Appropriations Act of 2020, Families First Coronavirus Response Act, Coronavirus Aid, Relief, and Economic Security Act, Paycheck Protection Program and Health Care Enhancement Act, Paycheck Protection Program Flexibility Act) had not occurred and are not reflected in the 2021 edition.

**Table of Contents.** The changes are discussed in the following pages and are referenced to the 2021 edition by chapter and page. A Table of Contents can be found on page 6.

**Special Thank You:** The editors would like to acknowledge and thank Professors Jim Angelini of Suffolk University and Ramon Fernandez of St. Thomas University. Their thoughtful insights and comments helped not only us, but hopefully you, gain a better understanding of how this new legislation with all of its complications affects individuals and businesses.

Tax Highlights of the

*Coronavirus Preparedness and Response Supplemental Appropriations Act* (P.L. 116-123, 3/6/2020)

*Families First Coronavirus Response Act*  (P.L. 116-127, 3/18/20)

*Coronavirus Aid, Relief, and Economic Security Act* (P.L. 116-136, 3/27/20),

*Paycheck Protection Program and Health Care Enhancement Act* (P.L. 116-139, 4/24/20)

*Paycheck Protection Program Flexibility Act* (P.L. 116-142, 6/5/20)

The legislation identified above made a number of changes designed to provide relief to individuals and businesses affected by the coronavirus pandemic. Many of these changes have tax ramifications. The legislation:

* Establishes the Paycheck Protection Program that provides federal loans to help struggling businesses. Moreover, in most cases, businesses are not required to repay these loans. Additional funding was provided by the Enhancement Act.
* Reduces or eliminates payroll taxes for businesses (i.e., their share of FICA). Any employer or self-employed individual (including nonprofits) whose business was fully or partially suspended in 2020 due to government orders associated with COVID-19 or that experienced a significant decline in gross receipts may be eligible for relief. The Act creates an employee retention credit of as much as $5,000 per employee to offset payroll tax costs (i.e., the 6.2% tax on wages or self-employment income) paid after March 12, 2020, and before January 1, 2021. If the credit amount exceeds the employer’s liability, the excess is refundable to the employer. It is estimated that the credit will provide a total benefit of about $54.6 billion.
* Requires businesses to make sick and family leave payments for up to 10 weeks. Exceptions exist for businesses that have (1) more than 500 employees or (2) 50 or fewer employees.
* Allows penalty-free access to retirement accounts if for virus-related financial hardships.
* Provides that employer payments of student loans of their employees are nontaxable.
* Creates a special charitable contribution deduction of up to $300 for individuals taking the standard deduction (i.e., an above the line deduction).
* Suspends the required minimum distribution (RMD) rules for retirement plans for 2020.
* Allows taxpayers to withdraw up to $100,000 from retirement plans without the 10% additional tax penalty for early distributions if they are coronavirus-related.
* Temporarily suspends the 80% taxable income limitation for NOLs.
* Eliminates the carryforward rule for NOLs arising in 2018, 2019, and 2020 so they can be carried back to the five previous tax years to provide immediate relief.
* Suspends the excess business loss rules.
* Accelerates refunds of previously generated corporate alternative minimum tax credits.
* Relaxes the business interest limitation of §163(j), increasing it from 30% to 50% of income.
* Makes a technical correction so that “qualified improvement property” (QIP) is now properly classified as MACRS 15-year assets and, therefore, eligible for 100% bonus depreciation.
* Provides an “employee retention credit” to encourage employers to maintain headcounts even if employees cannot report to work because of issues related to the coronavirus.
* Includes a variety of non-tax provisions to assist with mitigation and response as follows:
* Aid to state and local governments,
* Funding for health care providers,
* Substantial expansion of unemployment insurance and
* Large supplemental funding package for agencies of the federal government

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**CHAPTER 1: AN OVERVIEW OF FEDERAL TAXATION**

**Stimulus Payments (also known as Recovery Rebates).** See the discussion in Chapter 4.

**Employee Retention Credit.** See the discussion in Chapter 11.

**Tax Rate Schedules.** The tax rate schedules for 2020 as revised by Rev. Proc. 2019-44 are shown at the end of this supplement. The CARES Act did not make any changes to these rates.

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**Employment Taxes: Deferral of Payment of Employer Share of Payroll Taxes.** The Act generally allows most employers and self-employed individuals to defer payment of the employer share of Social Security taxes (the 6.2% portion up to the maximum wage base of $137,700 for 2020 (up to $8,537.40)) incurred between the date the Act is enacted and December 31, 2020. The CARES payroll tax deferral does not include the employer’s portion of Medicare taxes or any amounts withheld from employees (income tax withholdings and employee’s share of Social Security and Medicare).

Taxes that were due to be submitted on March 27, 2020 or later are eligible for deferral. There is no maximum amount of qualifying payroll taxes that can be deferred. Such amounts are to be paid over the following two years, with half due on December 31, 2021, and the other half due on December 31, 2022. (Act §2302(a)(1) and (b)). Unlike other provisions in the CARES Act, the size of the employer (e.g., number of employees) is irrelevant.

**Example 1.** For the first three months of 2020, FXG Corporation paid its employees total wages of $400,000. It’s share of Social Security taxes was $24,800 (6.2% x $400,000). The corporation is allowed to postpone payment of the tax over the next two years, $12,400 (50% x $2,480) is due on December 31, 2021 and the remaining $12,400 is due on December 31, 2022.

**Example 2.**  Andrea, a self-employed taxpayer, has $100,000 of net profit from a Schedule C business. Therefore, her self-employment tax is $14,130 (15.3% x .9235 x $100,000). Under this new provision, if elected, she can choose to pay 50% of this tax by 12/31/21 and the other 50% by 12/31/22 (i.e., without incurring any interest or penalties).

As the examples above illustrate, the benefits of postponing payment of the payroll taxes are potentially huge. Initially, there was uncertainty about certain aspects of the calculation. As discussed below, employers generally are allowed to reduce the payroll taxes they must pay by the amount of any sick pay they are required to pay under FFCRA (i.e., the payroll tax credit). In addition, employers are entitled to a credit based on employee retention (i.e., the employee retention credit). The question in computing the amount of employment taxes that could be deferred (above) was whether such taxes had to be reduced by these credits. The IRS has explained that such credits are not taken into account.

**Effect of Paycheck Protection Program Loans (PPP Loans) on Deferral of Payroll Taxes.** Special rules may impact the employer’s deferral of payroll taxes. As discussed in Chapter 6, businesses may apply and receive loans from the Small Business Administration to help them stay afloat during the coronavirus pandemic. Generally, a business is not required to repay these loans as long it does not layoff employees and uses the funds for qualified expenses (e.g., salaries, rent, mortgage interest, or utilities), Moreover, the cancellation of these loans does produce cancellation of indebtedness income (i.e., the cancellation does not yield taxable income).

Employers that have applied for a PPP loan can continue to defer the payment of its payroll taxes until that point when they receive a decision from their lender that its PPP loan is forgiven. At that point, the employer is no longer able to defer additional payroll taxes. However, the payroll taxes that were deferred until that time continue to be deferred and are due on the applicable dates described above. If the application for a PPP loan is denied, the employer can continue to defer any obligation for employment taxes under the rules above.

**Reduction of Payroll Taxes for Payments of Qualified Sick Pay and Medical Leave Wages.**

As discussed in Chapter 7, the Act allows employers to reduce their payroll tax obligations by a credit for the amount of qualified sick pay and family and medical leave wages paid. For a complete discussion see Chapter 7.

**Employee Retention Credit Against Payroll Taxes.** As discussed in greater detail in Chapter 13 of this supplement, a key pillar of the Act is to provide employers whose operations were impacted by the virus with some tax relief. Employers that qualify are entitled to a refundable credit designed to eliminate its share of FICA (6.2% share of Social Security taxes). In effect, employers impacted by COVID-19 need not pay their share of FICA. Employers must meet one of two tests: (1) their operations were fully or partially suspended during a calendar quarter due to an order from an appropriate governmental authority limiting commerce, travel or meetings (for commercial, social, religious, or other purposes) due to COVID-19 or (2) they suffered a decline in gross receipts of at least 50% for the calendar quarter as compared to the same quarter in the prior year. The credit is equal to 50% of *qualified* wages paid or incurred for **each** employee between March 13, 2020, and December 31, 2020. The maximum credit is $5,000 per employee. See Chapter 13 for more details.

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**Unemployment Benefits Increase.** The Act expands eligibility for unemployment insurance and provides people with an additional $600 of unemployment compensation per week on top of the unemployment provided by each state. The benefit expired on July 31, 2020 and as of August 6 has not been extended by Congress.

**Excise Taxes: Distilled Spirits Excise Tax, Alcohol, and Hand Sanitizer: Suspension of Alcohol Taxes on Spirits.**  The Act suspends a tax (an excise tax of between $2.70 and $13.50 per gallon) normally imposed on alcohol that is used in the production of hand sanitizer (see <https://news.bloombergtax.com/daily-tax-report/hand-sanitizer-shortage-prompts-distillers-to-seek-tax-exemption>).

**CHAPTER 4: TAX CONSIDERATIONS FOR DEPENDENTS;   
 FILING STATUS; DETERMINATION OF TAX FOR AN INDIVIDUAL; FILING REQUIREMENTS**

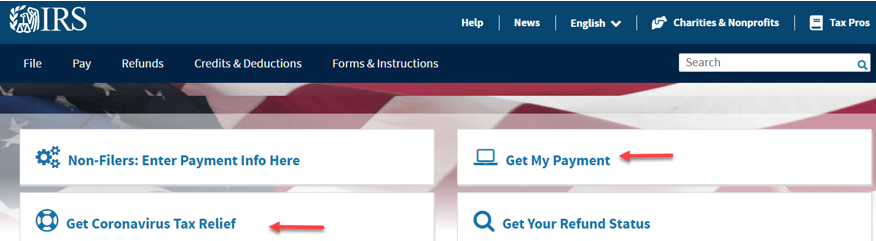
**Economic Impact Payments for Individuals.**

The Act provides that Congress will be putting cash—so-called recovery rebates or stimulus payments—into the hands of most Americans immediately. These payments are not taxable.

Most people did not have to do anything to receive a payment. Eligible taxpayers who filed a tax return for either 2019 or 2018 and chose direct deposit for their refund receive a stimulus payment automatically —the amount is not mailed but rather deposited directly into the taxpayer’s bank account. Direct deposit also is used where an individual did not file a tax return but receives Social Security benefits (retirement or disability) or Railroad Retirement benefits. The stimulus payments began about the middle of April. For those looking at their bank statements, the deposit should be labeled: IRS Treas. 310.

Those who filed paper returns will have to wait a little longer for their stimulus payment. The IRS estimates that it will begin mailing the first round of paper checks the week of May 4. It will then send out approximately 5 million checks per week, with lower-income individuals getting first priority. For that reason, it could take months for all the checks to be delivered.

Others, who are not identified in the programs above, can submit a form on the IRS's website that includes direct deposit information so that it need not be mailed.



In addition, the IRS has launch a new tool called [Get My Payment](https://www.irs.gov/coronavirus/economic-impact-payments) (see above), which allows individuals to check the status of their stimulus check and the date it should be received. If an individual does not have direct deposit information on file with the IRS, individuals can also use Get My Payment to enter their bank account information to get their money faster.

The IRS began getting out payments and on the morning of April 13, social media was flooded with reports of people who had already seen $1,200 (or more) appear in their bank accounts. On Twitter, the No. 1 trending topic in the U.S. was #stimulus deposit. Who knew the IRS could be so popular!

The amount of the stimulus payment that a person receives is based on the individual’s filing status and AGI. The payment amounts are shown below.

Stimulus Payment AGI  
 Status Amount Phase-out Begins

Single or head of household $1,200 $ 75,000   
 Eligible to file jointly 2,400 150,000   
 Each qualifying child less than 17 500 112,500

The amount received is reduced as the individual’s AGI exceeds certain thresholds based on their filing status. The thresholds at which the various phase-outs begin are shown above. For example, a married taxpayer with two children below the age of 17 and AGI of $112,500 would receive a payment (i.e., a credit) of $3,400 ($2,400 + $500 + $500). A single person with an AGI below $75,000 receives a payment of $1,200. The phase-out procedure for high income individuals is discussed below (e.g., the amount of the payment is zero when AGI exceeds $198,000 for a married couple and $124,000 for singles).

As seen in the table above, the Act also provides a stimulus payment of $500 for each qualifying child under age 17. Eligibility for the $500 payment is determined using the rules for the child tax credit (see below). Note that the Act does not provide a $500 payment for those dependents for whom the partial tax credit of $500 is normally available (a child 17 or older who is a full-time students less than 24). A family of four including two children under age 17 normally will receive a payment of $3,400 ($2,400 + $500 + $500). A head of household with one qualifying child would receive $1,700 ($1,200 + $500). However as explained below, the amount of the payment is reduced when the taxpayer’s AGI exceeds certain levels. For example, a married couple without children who has an AGI exceeding $198,000 would not receive a payment.

Technically, the rebate is an advanced payment of a refundable credit against taxes that will otherwise be due for the 2020 tax year (§ 6428(b)). Assuming a taxpayer receives the advanced payment of the credit to which he or she is entitled during 2020, no credit is claimed on the 2020 tax return. However, as noted above, taxpayers do not have to wait until they file their returns for 2020 to obtain this credit. An advance rebate of the credit will be deposited directly in the taxpayer’s account or mailed in the form of a check. As discussed further below, when the IRS computes the stimulus payment, it uses the AGI that they have available when it computes the credit (i.e., 2019 if the 2019 return has been filed, otherwise 2018).

Since the payment represents a refundable credit, taxpayers receive a check regardless of whether they actually have a tax liability for 2020 equal to (or greater than) the amount of the check received. The payment will not need to be repaid, nor is it includible in the recipient’s gross income (i.e., it is not taxable). As the IRS website suggests, individuals who have no income at all, as well as those whose income is entirely derived from “non-taxable means-tested benefit programs” such as Supplemental Security Income (SSI) benefits, are nevertheless eligible for the advance rebate (or credit).

**Eligibility for Credit (Stimulus Payment).**  For purposes of the payment (i.e., credit), an "eligible individual" is any individual other than a nonresident alien or an individual for whom a §151 dependency exemption could be claimed. In other words, a dependent is not entitled to the payment. However, the dependent’s parents normally are eligible for and receive the $500 payment. Estates and trusts, which are entitled to an exemption deduction, are not eligible for the credit (§6428(d)).

**Payments for Qualifying Child.** For purposes of the $500 payment, a qualified child is

1. A US citizen, US national, or US resident;
2. The taxpayer’s son, daughter, stepchild, adopted child, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them who was under age 17 at the end of the tax year and who lived with the taxpayer for more than half of year;
3. Did not provide over half of his or her own support for the year;
4. Is claimed as a dependent on the taxpayer’s tax return; and
5. Has a social security number (or, other identification number) that is reported on the tax return.

**Phase-out of the Credit.** As noted above, the total rebate to which a taxpayer is entitled is phased out at a rate of 5% for each dollar of AGI (e.g., $5 for each $100) that exceeds certain levels based on the taxpayer’s filing status as shown below. For taxpayers that had not filed their returns for 2019 at the time the IRS computes their rebate, the phase-out is based on AGI for 2018. If the 2019 return has already been filed, the phase-out is based on AGI for 2019. Observe that taxpayers who knew their 2019 AGI would be greater than their 2018 AGI might postpone filing their 2019 return in order to get a larger rebate. Apparently, no mechanism exists to either (1) repay the excess payment, or (2) recognize the excess amount as income.

AGI Phase-out AGI exceeding  
Marital status Payment Phase-out begins range Phase-out complete

Joint return $2,400 $150,000 $48,000 $198,000  
Head of household 1,700 102,500 34,000 136,500  
All other 1,200 75,000 24,000 $99,000

A married couple with no qualifying children normally would receive a stimulus payment of $2,400. However, if they have an AGI on their 2019 tax return of $174,000 (i.e., $24,000 or 50% of the $48,000 phase-out range from $150,000 to $198,000), their rebate checks would be reduced by 50% from the normal $2,400 to $1,200 ($2,400 – (5% x ($174,000 - $150,000 = $24,000) = $1,200). In addition, the normal $500 rebate checks for each of their qualifying children would be reduced to $250 each.

**Impact on eligibility for federal income-targeted programs**: These rebate checks will not affect an individual’s eligibility for federal income-targeted programs since they are considered a tax refund and will not be counted towards eligibility for federal programs.

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**Due Dates for Filing Returns.**

To keep dollars in the hands of individuals during the pandemic, the IRS changed moved the due dates of tax return. As of May 8, 2020, the due date as well as the payment date for an individual’s 2019 tax return was moved to July 15, 2020. The relief also applies to estimated tax payments for the 2020 tax year that had been due on April 15, 2020 but are now due on July 15, 2020. However, the due dates for other returns remained unchanged.

**CHAPTER 6: INCLUSIONS AND EXCLUSIONS**

**Page 6-34**

**Educational Assistance Plans: Employer Payment of Student Loans.**

Under current law (§ 127), an employee may exclude up to $5,250 of tuition payments made by an employer sponsored educational assistance program. The exclusion is not available for payment of the education for the employee’s spouse or dependents. In addition, the payment is not only excluded for income tax purposes but also is exempt from payroll taxes (employer and employee). The CARES Act expands the reach of this program to include employer payments of existing student loan debt. Thus, if an employer agrees to pay a student’s loans and does it before 2021, the benefit is not taxable. The limitation of $5,250 was not changed. The provision is effective for student loan payments made before January 1, 2021. Obviously, this rule provides a potentially huge benefit for employers and employees but it expires on December 31.

**Example 3**. An accounting firm pays $3,000 for an MST course taken by one of its employees during 2020. In addition, the firm pays off $4,000 of the employee’s outstanding student loans. Given the $5,250 cap, the employee can exclude $5,250 while the remaining $1,750 ($3,000 + $4,000 = $7,000 - $5,250 = $1,750) would be included in the employee’s wages. The employer can deduct the payment just like compensation except it is not subject to employment taxes.

“Eligible student loan repayments” are payments by the employer of principal or interest with respect to any “qualified higher education loan” for the education of the employee (but not of a spouse or dependent). The payment may be paid to the employee or directly to a lender. See  
§ 221(d)(1) and § 127(c)(1)(B).

As discussed in Chapter 11 (page 31), § 221 allows a deduction for up to $2,500 of interest on student loans per year. To prevent a double benefit, a taxpayer cannot deduct interest on a student loan that is paid by an employer for which the exclusion is allowable. Note that the deduction for student loan interest phases out once the taxpayer’s AGI (computed with certain modifications) exceeds $140,000 for joint returns or $70,000 for all other returns.

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**Cancellation of Indebtedness**

Add to the list of exclusion situations (discussed further below):

* The cancellation of Economic Injury Disaster Loans
* The cancellation of Paycheck Protection Loans

**Economic Injury Disaster Loans (EIDLs).**

Beginning March 30, 2020, businesses that suffered due to pandemic could seek financial assistance by applying to the Small Business Administration (SBA) for a so-called Economic Injury Disaster Loan (EIDL or disaster loan). Such loans were added by CPRSAA, the first piece of legislation concerning COVID-19. Only businesses with 500 or fewer employees are eligible to apply. Before the coronavirus, these loans were intended for businesses that have suffered due to natural disasters (e.g., hurricanes) but the Act extends them to businesses that can show they have suffered severe economic hardship because of the coronavirus pandemic. In the past, a business was required to prove that it was unable to obtain loans elsewhere. However, this requirement has been waived.

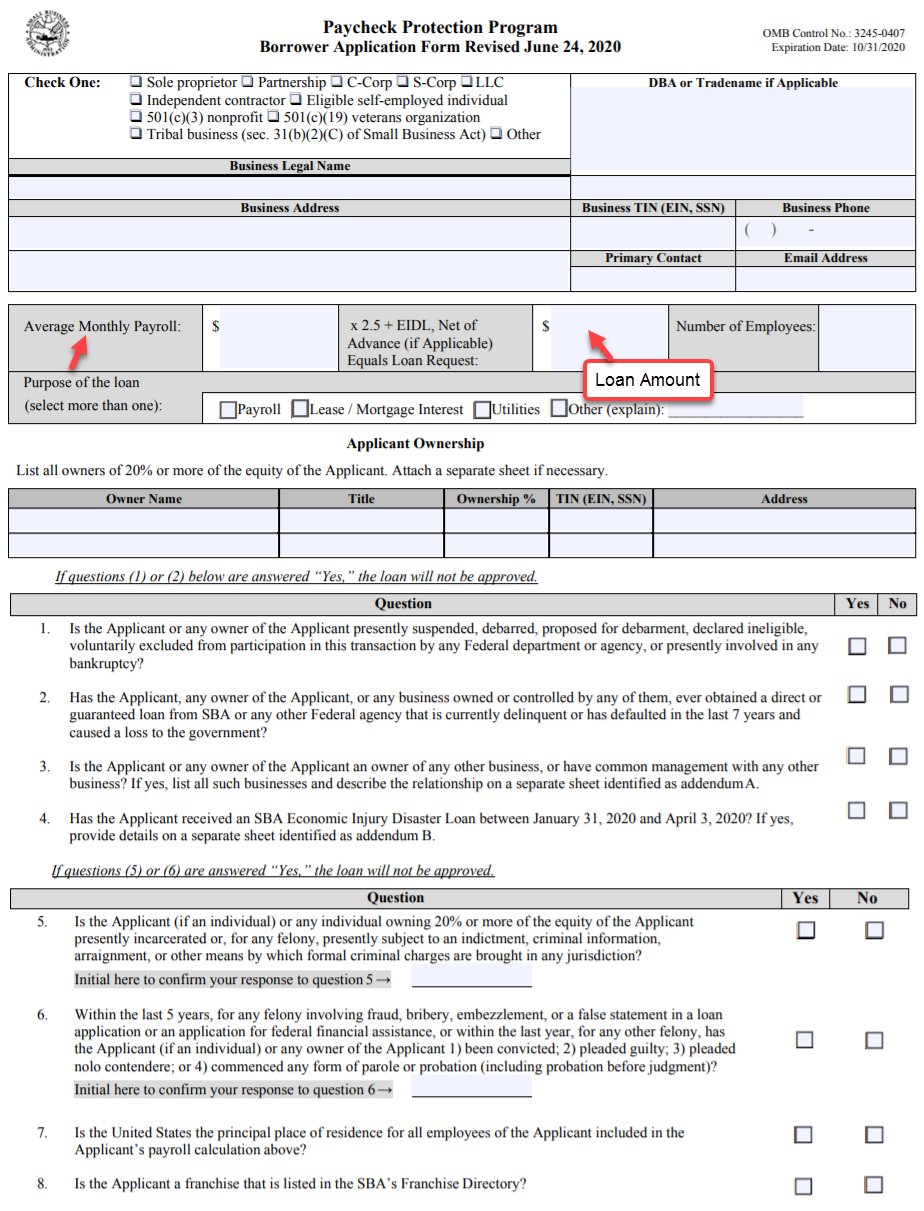
The EIDL program allows eligible businesses to borrow up to $2 million dollars at an interest rate of 3.75% or less. One of the attractive features of a disaster loan is that borrowers are eligible to request an emergency advance while their application is being processed. Originally, the SBA would advance the business up to $10,000. However, on April 14, 2020: the SBA reduced the amount of the advance to $1,000. In addition, the $10,000 (or $1,000) advance does not have to be repaid even if the application is ultimately denied. The SBA tries to provide the advance within three days of receipt of a borrower’s application.

Independent contractors who work for a separate business (e.g. real estate brokers) can qualify for an EIDL if they are able to prove they are separate from that business (e.g. the brokerage firm). Businesses that have obtained a disaster loan must take these loans into account when applying for a loan under the Paycheck Protection Program as discussed below.

**Paycheck Protection Program (PPP Loans)**

**PPP Loans in General.** The pandemic has wreaked havoc on small businesses and other organizations. Many are closing their doors, forcing them to layoff their employees. To help them survive and help their employees keep their jobs, the Act creates a loan opportunity through the so-called Paycheck Protection Program (PPP) (Act § 1102 amending the Small Business Act § 7(a)). As the name of the Act suggests, the purpose of the law is to ensure that people’s paychecks are protected. This government loan—up to $10 million—is intended to help companies cover eight weeks of their payroll costs.

The PPP loans are loans approved by the SBA and made by authorized lenders (e.g., federally insured depository institutions (most banks), or lenders approved by the SBA). Businesses start the application process by contacting a lender and submitting an application form by June 30 (extended to August 8, 2020). The application form (as revised on June 24, 2020) can be found at <https://www.sba.gov/sites/default/files/2020-07/PPP-Borrower-Application-Form-508.pdf>.



The primary advantage of PPP loans is that amounts borrowed could turn out to be a loan in name only. As explained below, if an employer keeps its employees on the payroll (i.e., it does not fire or layoff employees) and uses the funds for qualified expenses (e.g., salaries, rent, mortgage interest, or utilities), the employer is not required to repay the loan. Moreover, the forgiveness of debt is nontaxable.

The normal treatment of debt cancellation is found in §61(a)(11), which provides that the reduction or cancellation of indebtedness generally results in cancellation of debt (COD) income to the debtor. An "identifiable event" determines when a debt has been reduced or canceled. For example, an identifiable event includes a creditor accepting less than full payment as a complete discharge of a debt or events or simply circumstances result that remove the likelihood that a debt will be paid. The PPP creates a significant exception to this basic rule, generally providing that the debt forgiveness is not considered taxable income. As explained below, the PPP provides special rules for determining the amount of eligible forgiveness.

At first glance, it may appear that the PPP is too good to be true. However, this cloud does indeed have a silver lining. Tony Nitti, the famous tax-guru who writes for Forbes, summed up the PPP perfectly. According to Nitti, “free money is hard to pass up, and so last week, businesses were clamoring for Friday to arrive so they could grab their piece of the pie.” (See Tony Nitti, “Paycheck Protection Program Loans: Three Things The SBA And Banks Need To Agree On Now.” *Forbes*, April 5, 2020) <https://www.forbes.com/sites/anthonynitti/2020/04/05/paycheck-protection-program-loans-three-things-the-sba-and-banks-need-to-agree-on-now/#573860c21a32>.

Nitti was right. The rush for the loans was so great that the money—about $349 billion—quickly ran out. According to Treasury Secretary Steven Mnuchin and SBA Administrator Jovita Carranza there were “more than 14 years’ worth of loans in less than 14 days,” before the funds ran dry. But, on April 24, 2020, Congress agreed for another round of funding and enacted the Paycheck Protection Program and Health Care Enhancement Act that added $321 billion. (See Anne Sraders, “14 years in 14 days: Inside the chaotic rollout of the SBA’s PPP loan plan to save America’s small businesses.” *Fortune*, April 29, 2020. See <https://fortune.com/2020/04/29/sba-ppp-paycheck-protection-program-loans-small-business-administration-inside-chaos/>

There is a long list of requirements that police the road to tax-free forgiveness under the PPP. To get a sense of these requirements, see the loan application form in full at <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Application-3-30-2020-v3.pdf> The loan program is discussed below.

**PPP Loans: Eligible Recipients: Who Can Apply for a PPP Loan?** PPP loans are available to eligible recipients, including businesses (e.g., corporations, partnerships, self-employed persons), nonprofits, veterans organizations, and Tribal businesses. Loan applications are considered only if the applicant has no more than 500 employees at any time during the 25 weeks starting on the date the loan was originated (normally the date the taxpayer and the bank sign the loan agreement). Specifically, the organization can apply only if it meets the following requirements (Act § 1102(a)(2)(A)(iv) and ((v)):

(1) The business was operational as of February 15, 2020;

(2) The principal place of business is in the U.S. and

(3) The qualified organization has no more than 500 employees (subject to certain exceptions).

The 500-employee limit was intended to restrict the loans to small businesses but initially it was applied to each location. This approach did not necessarily restrict loans to small businesses since a company might have multiple locations, none of which had more than 500 employees (e.g., Ruth’s Chris Steak House has over 100 restaurants in different locations and each location employs no more than 500), (Act §1102(a)(1)(D)(i)(I) and §1102(a)(1)(D)(iii)).

The implementation of this rule sparked significant controversy (see Davis and Haddon, “How Ruth’s Chris Got an Extra Helping of Small Business Aid Money.” *Wall Street Journal*, April 4, 2020 and Pcheco and Francis, “Public Companies Got $500 Million in Small Business Loans.” *Wall Street Journal*, April 20, 2020). According to SEC filings, 424 publicly traded companies received PPP loans (e.g., Ruth Chris, Shake Shack, Potbelly; for a complete list see <https://factba.se/sba-loans> ). Apparently, Treasury Secretary Steven Mnuchin objected, explaining that the “intent of this money was not for big, public companies that have access to capital.” No doubt succumbing to public pressure, Ruth Chris, Shake Shack and other companies ultimately returned $20 million (see Sarah Hansen, “Ruth’s Chris Steak House Returns $20 Million PPP Loan As Treasury Issues New Guidance.” *Forbes,* April 23, 2020).

But Mnuchin had more to say On May 5, 2020, he announced that any company that received a PPP loan of more than $2 million would be audited for compliance with the program’s terms before any loan forgiveness would be permitted. Apparently, five *publicly* held companies were given a specific deadline to return their money, May 14, to give the money back with no questions asked. Otherwise, Mnuchin wanted them to explain why they should be allowed to keep the money. After the uproar, the SBA issued new guidance making it less likely that publicly traded companies could access the second round of funding created by the Enhancement Act (see <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.

**PPP Loans: Authorized Uses.** The loans can be used for

• Payroll costs (see below), including benefits but not federal taxes;

• Interest on mortgage obligations, incurred before February 15, 2020;

• Rent, under lease agreements in force before February 15, 2020; and

• Utilities, for which service began before February 15, 2020.

The SBA also cautioned, that the loan application should not include any costs for health benefits, retirement benefits or state and local taxes on income. Apparently, however, some loan applications have included the employer’s share of any health insurance.

It is worth noting that at the time of this writing, the Inspector General reported that the SBA ignored certain Congressional mandates in implementing the loan program. The report chastised the SBA for failing to issue guidance to lenders that should have instructed them to give priority to borrowers in underserved and rural markets, including minority and women owned businesses. Moreover, the report found that the SBA issued rules that required borrowers to use the majority of their loan funds (75%) on payroll costs to receive full forgiveness even though the Act did not mandate any specific amount be dedicated for payroll expenses. Amara Omeokwe. “SBA Veered From Guidelines on Small Business Loans, Report Says.” *Wall Street Journal*, May 8, 2020 <https://www.wsj.com/articles/sba-veered-from-guidelines-on-small-business-loans-report-says-11588971101>

**PPP Loans: Computation of Amount.** Under the CARES Act (§1106(b)), the taxpayer’s PPP loan is limited. As seen in the application form above, the loan cannot exceed 2.5 times the employer’s average monthly payroll costs (see calculation below) plus any disaster loans obtained after January 31 that are refinanced into a PPP loan. The maximum loan is $10 million. Note that prior to the SBA guidance, a single company could obtain the maximum loan for each business location so a business with multiple locations could obtain multiple loans.

The average monthly payroll normally is calculated based on the employer’s 12 months of payroll costs prior to the application date—although some applicants have reported that they have used and the banks have accepted the 2019 calendar year average. That *average* monthly payroll number is then multiplied by 2.5. The multiplier of 2.5 or 250% represents the fact that the loan is designed to cover 2 ½ months of payroll costs. For example, assume the employer’s total payroll cost for the year was $240,000, in which case the average monthly payroll cost for the prior 12 months would be $20,000 ($240,000/12). As a result, the employer would qualify for a $50,000 PPP Loan (2.5 x $20,000 average payroll cost).

For purposes of computing the loan, payroll costs are limited to certain expenses incurred during the 8 weeks that begins when the loan originated (the “covered period”).

Payroll costs include (Act § 1102(a)(1)(A)(viii))

* Wages, salary, or similar compensation to an employee or independent contractor (up to $100,000 plus amounts paid for unemployment taxes, premiums for group health plans, contributions to retirement plans and state or local taxes asses on compensation such as unemployment taxes)
* Cash tips or equivalent
* Vacation, parental, family, medical or sick leave
* Allowances for dismissal or separation

Payroll costs do not include:

* Compensation of any individual employee in excess of an annual salary of $100,000
* Federal payroll taxes
* Compensation of an employee whose principal place of residence is outside the U.S.
* Qualified sick leave or family medical leave for which a credit is allowed under the Act
* Payments to independent contractors

***PPP Loan Amount*.** The maximum amount of a PPP loan is limited to the lesser of (a) or (b):

a. (1) 250% of the employer’s ***average*** ***monthly*** ***payroll costs*** (listed above) for the 1-year period   
 ending on the loan application date

+ (2) Any disaster loan taken out after January 31, 2020 that has been refinanced into a   
 paycheck protection loan.

Payroll costs and disaster loans

b. $10 million

**Example 4.**  THX Inc. (an S or C corporation) applies for a PPP loan from First Bank on April 1, 2020. The business had payroll costs $600,000 for the prior 12 months (April 1, 2019 through March 31, 2020), for a monthly average of $50,000 ($600,000/12). Under the guidelines above, the business is entitled to a fully guaranteed federal loan of $125,000, the lesser of: (1) $125,0000 ($50,000 in average monthly payroll costs x 250%) or (2) $10 million. In effect, the loan covers 2 ½ months of the payroll costs as based on the average of the prior 12 months.

**PPP Loans: Amount of Tax-Free Cancellation.** No doubt the most important feature of PPP loans is that the borrowers may never have to repay. The SBA generally forgives PPP loans as long as employers keep their employees on the payroll for eight weeks and the loan proceeds are used for authorized expenses. These expenses include not only the costs of payroll, but also those for rent, mortgage interest, or utilities. Most importantly, as noted above, the debt forgiveness is not treated as taxable income to the employer (Act §1106(i)).

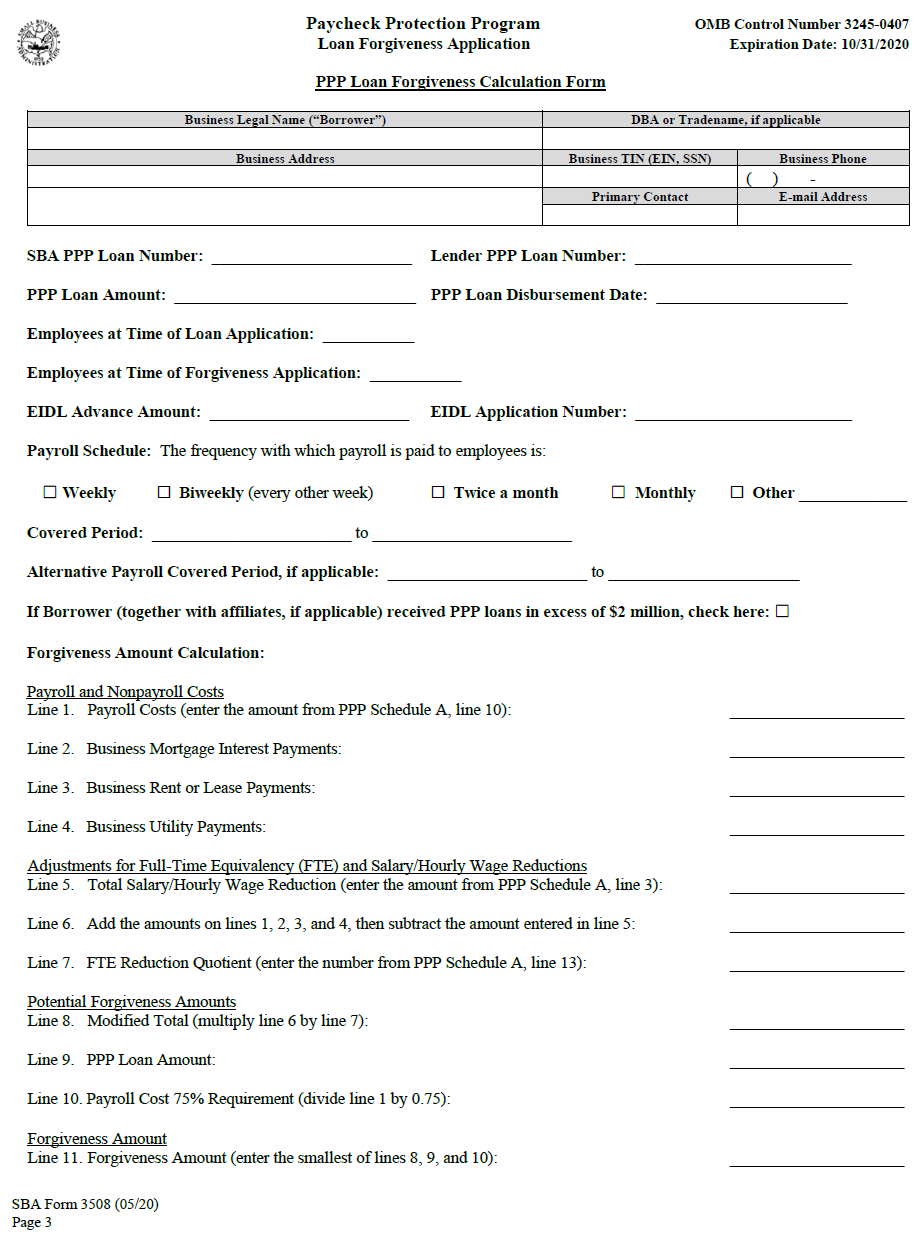
Technically, a business (an “eligible recipient”) that seeks forgiveness of the PPP loan must be able to verify that the amount of the loan for which forgiveness is requested “was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered lease obligation or to make covered utility payments.” (Act §1106(e)). If the business fails to meet these standards, the business must repay the loan. In that regard, the loan has a modest interest rate of 1% and a maturity of 2 years. (Act §1106(d)(2))

The Act provides that the amount of the PPP loan that is eligible for forgiveness is the sum of the certain “costs incurred and payments made” during the “covered period” (the 8-week period beginning on the date a PPP loan originates). However, some employers found it difficult to spend all of the proceeds on authorized expenses, thereby forfeiting the forgiveness privilege. Importantly, the PPPFA extended the period for eligible payments to 24-weeks. Qualifying costs include:

* Payroll costs;
* Any payment of interest on any mortgage obligation (not including any prepayment of or payment of principal on a mortgage obligation) that was incurred before February 15, 2020;
* Any payment of rent under a leasing agreement in force before February 15, 2020;
* Any utility payment, including payment for distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020.

**PPP Loans: Loan Forgiveness Application.**  To determine how much a borrower actually must repay, the borrower must complete and submit a “Loan Forgiveness Application” to the banker or lender from whom the loan was obtained (see below). The borrower uses this form to compute the amount of the loan to be forgiven and, at the same time, how much must be repaid The loan application instructions contain a number of clarifications including, calculation of FTEs, rent, utility expenses, documentation and more.

**PPP Loan Forgiveness Application Form.** See the form on the next page.



The Application reflects a three-step approach used by the SBA to compute the amount of forgiveness. In effect, if 100% of the loan was used properly, 100% of the loan is cancelled. To the extent that the loan was not used properly, the forgiveness is reduced proportionately and repayment is required. As noted earlier, cancellation of the debt is considered nontaxable. Completion of lines 1-10 and the accompanying schedules yields the amount that is forgiven.

***Computing the Potential Forgiveness Amount (Lines 1-4).***

Consistent with the requirement that the loan must be used for certain expenses, the first step in completing the application is determining the total payroll and qualifying non-payroll costs (interest, rent and utilities) (lines 1-4). These include only such costs that the business has spent over the 8-week period since it received its PPP funds (extended to 24 weeks by the PPPFA). The sum of these costs ultimately becomes part of the “potential forgiveness amount” (line 8).

***Reduction for Cutting Employees and Salary Cuts (Line 5).***

This tentative forgiveness amount is then adjusted to the extent the employer lays off workers or cuts salaries (line 5). The tentative amount to be forgiven is reduced if the employer (1) reduced the pay for returning employees more than 25% or (2) failed to bring back the same number of full-time equivalent employees (FTEs) that it had before the pandemic. The application waives this reduction if the business later brought back the same number of employees by June 30, 2020 (extended to December 31 by the PPPFA). Adjustments are allowed for employees that declined to return to their jobs. The result is the “Potential Forgiveness Amounts.”

***Reduction for Cutting Payroll (Line 8 -10).***

The third and final step ensures that 75% of loan forgiveness is attributable to payroll costs. To illustrate, assume a business had a PPP loan of $100,000. It secures total forgiveness if it used $75,000 for payroll. However, its actual payroll costs were $70,000 and eligible non-payroll costs were $30,000. In such case, the payroll costs are only 70% of the $100,000 total and do not meet the 75% rule. Thus, the $30,000 in non-payroll costs are reduced so that payroll costs are 75% of the amount forgiven. As a result, the maximum forgiveness is $93,333 ($70,000/75% = $93,333). This calculation effectively trims the non-payroll costs from $30,000 to $23,333 such that the forgiveness request of $93,333 consists of 75% payroll costs ($70,000) and 25% non-payroll costs ($23,333).

**Example 7**. KWL Inc., a C corporation, has payroll costs over the prior 12-month period of $240,000. Its average monthly payroll is $20,000 ($240,000/12). The maximum loan amount is 2.5 times the average monthly payroll or $50,000 ($20,000 by 2.5). The company applied and received a loan of $50,000. For the 8-week period after it received the loan, the company uses $40,000 for payroll costs, $9,000 for rent and $2,000 on utilities for total qualifying expenses of $51,000. In this case, the company has qualifying expenses of $51,000 (including payroll costs that exceed 75% of the loan) that exceed the $50,000 loan. Consequently, the entire loan is forgiven. In addition, the debt forgiveness in this case is nontaxable.

**Example 8.** Same facts as Example 7 above. KWL borrowed $125,000 but incurred only $100,000 in payroll costs (80% of the loan amount), mortgage interest, and utility payments during the 8 week period after the loan origination date. The business is eligible to have only $100,000 of the $125,000 loan forgiven. The forgiveness of $100,000 of the debt does not result in any COD income for tax purposes. Payments on the remaining $25,000 of the loan will not be due for two years. The interest rate on the $25,000 loan remaining cannot exceed 1% annually.

**Example 9.** Same facts as in Example 8 above. If the employer reduced its average workforce during the covered period, the amount of forgiveness is reduced. For example, if the employer employed 80 employees during the covered period and when it normally employed 100, only 80% of the loan would be forgiven. A special calculation is used to determine the average number of employees (Act § 1106(d)(2)(B)).

**PPP Loan Fraud.** As many predicted, the Paycheck Protection Program would be an easy target for crooks. For those who were willing to risk going to jail, all they had to do was find a lender who would fund their PPP loan application and voila, free money. For the most part, the lender had no risk since the loan was backed by the federal government. Lenders were guaranteed that they would be repaid in one way or another. However, the SBA recognized the problem early on and issued warnings, promising that it would bring enforcement actions against any engaged in fraud. It didn’t take long. Here are a few examples.

* May 5, 2020: the Criminal Division of the Department of Justice brought the first (of what appears to be many) charges against suspects who made fraudulent loan requests of over $500,000. (See Kelly Phillips Erb, "Feds Announce First Arrests In Country Linked To PPP Loan Fraud." *Forbes*, May 10, 2020 <https://www.forbes.com/sites/kellyphillipserb/2020/05/10/feds-announce-first-arrests-in-country-linked-to-ppp-loan-fraud/#17149dcd59de>).
* May 13, 2020: Federal prosecutors struck again, charging a sole proprietor of a Texas business with “wire fraud, bank fraud, false statements to a financial institution, and false statements to the SBA.” Apparently, the proprietor “allegedly sought $10 million in PPP loan proceeds by fraudulently claiming to have 250 employees with an average monthly payroll of $4 million.” In addition he “sought approximately $3 million in PPP loan proceeds by fraudulently claiming to have 250 employees with an average monthly payroll of approximately $1.2 million.” However, the Texas Workforce Commission had no records of employee wages paid in 2020 by the accused or his business. (See Bruce Brumberg, “Federal Charges Of PPP Loan Fraud Are Here To Remind You These Loans Are Not “Free Money.” Forbes, May 14, 2020 <https://www.forbes.com/sites/brucebrumberg/2020/05/14/federal-charges-of-ppp-loan-fraud-are-here-to-remind-you-these-loans-are-not-free-money/#3bdeecaded53>).
* May 21, 2020: Charges were brought against a Chinese national with trying to fraudulently obtain $20 million in PPP loans. According to numerous reports, Mr. Muge Ma, a 36-year-old known as "Hummer Mars" residing in Manhattan, allegedly presented applications to five banks saying he had two companies with hundreds of employees who needed help. Ma represented himself and one of his companies as a test-kit manufacturer for COVID-19 and a medical supplier, neither of which were true, prosecutors said. The bulk of the loans which were approved before the fraud was found were frozen by investigators before Ma could receive them.

Given how quickly the program was rolled out, there no doubt that there will be those who inadvertently did not follow the rules. Unfortunately, these businesses will find themselves trying to distinguish their legitimate claims from those who have committed actual fraud.

**PPP Loans: Payroll Costs for Self Employed Individuals and Partners in General.** Taxpayers can get a PPP loan equal to 250% of their average monthly payroll costs. Payroll costs generally include wages and salary and other benefits up to $100,000 per employee. However, self-employed individuals (sole proprietorships) and partners in partnerships do not receive wages or salaries or a “paycheck” in the normal sense. Consequently, the computation of their payroll cost is a bit different. On April 14, 2020, the SBA issued guidance on how the maximum PPP loans for self-employed individuals and partners are to be computed.

***Payroll Costs for Self-Employed Individuals*.**  In determining the maximum PPP loan that a self-employed person can obtain, the total payroll cost is the sum of two components:

(1) Schedule C net income, not to exceed $100,000, and

(2) Payroll costs for other employees

The computation is shown below.

Schedule C Income for 2019 < $100,000)/12 = Average monthly net profit  
 Outstanding amount of any disaster loan (EIDL) to be refinanced  
+ Payroll costs for other employees/12 = Average payroll cost  
= Total payroll cost   
x 250% or 2.5  
= Maximum PPP Loan for self-employed person not to exceed $10 million

If a self-employed person does not have employees or a disaster loan outstanding, then the total annual payroll cost is simply the individual’s self-employment income reported on Schedule C. Note that the annual limit in computing payroll costs for a self-employed person as well as an employee is $100,000 per person.

**Example 10.** Sam Smart, a CPA, teaches continuing education tax courses for accounting firms and also holds his own workshops. To make ends meet, he also drives for Uber and take jobs from Taskrabbit. His net income shown on his Schedule C for 2019 was $96,000. He has no employees so there are no additional payroll costs to be considered. His maximum PPP loan is $20,000 [($96,000/12 = $8,000 average payroll cost) x 2.5)].

***Payroll Costs for Partners in Partnerships*.** Unlike self-employed individuals, partners (including LLC members) do not apply for a loan individually. The partnership makes the application. For purposes of computing payroll costs for the partnership loan amount, the partnership includes (1) the net income of the partnership plus (2) the payments made to the partners plus (3) payroll costs for other employees. For this purpose, payments to partners are included only if they are active participants in the business as evidenced by the fact they have self-employment income from the partnership as reported in Box 14 of their K-1. Payments made to partners who are merely passive investors are not included in the calculation. The computation of the PPP loan is shown below.

Partnership net income/12  
+ Average payroll costs for other employees/12)  
= Total average monthly payroll cost   
x 250% or 2.5  
= Maximum PPP Loan for partnership not to exceed $10 million

As seen in the example below, all things being equal, the amount qualifying as payroll costs (and, therefore, the amount of the PPP loan) can differ depending on whether the individual operated as a partnership or an S Corporation.

**Example 11**. Assume a partner has reported at least $100,000 of self-employment income in Box 14 of her K-1 (which is a combination of Box 1 “Ordinary Business Income” and Box 4 “Guaranteed Payments”). On the other hand, assume an owner/employee of an S corporation pays herself $50,000 in wages (i.e., as shown on Form 1120S, Line 7), while having $50,000 in Box 1 “Ordinary Business Income” of the K-1. In this case, the partner and the shareholder both have the same total income of $100,000. However, as calculated below, the partner would have twice the amount eligible for a PPP loan as compared to the S corporation owner/employee who only includes wages in the computation (and may have been trying to minimize the salary amount so as to save on employment taxes).

Partner: [($100,000/12 = $8,333) x 2.5] = $20,833.33 Maximum PPP Loan

S shareholder [($ 50,000/12 = $4,166) x 2.5] = $10,416.67 Maximum PPP Loan

***Deductibility of Business Expenses Paid with PPP Loans.***  See Page 7-43 of this supplement below.

**PPP Loans: Guaranty.** To encourage lenders to make these loans, the loans are fully guaranteed by the federal government through December 31, 2020. Collateral is not required nor are personal guarantees. Thus, if a business defaults on the loan, the government repays the loan.

**PPP Loans: A Final Problem.** While the PPP program seems to be on target, as many have note, there is one major drawback: when businesses receive their loan, they may not be operating. As Mr. Nitti points out, (see Nitti, Tony. “Ten Things We Need To Know About Paycheck Protection Program Loan Forgiveness.” *Forbes*, April 15, 2020 <https://www.forbes.com/sites/anthonynitti/2020/04/15/ten-things-we-need-to-know-about-paycheck-protection-program-loan-forgiveness/#3e3a64603291>

business owners who rushed to get a PPP loan will be faced with the realization that to achieve full forgiveness, they will need to pay employees NOT to work. And given the recent increase to unemployment pay, those same employees may prefer not to be paid by their employer, as in many cases, collecting unemployment will prove more lucrative. Given this reality, many business owners were hopeful that they would have flexibility in choosing their 8-week covered period, allowing them to wait out the shelter-in-place order, get their employees back to work, and maximize the payroll that would be incurred during that stretch, and by extension, the subsequent debt forgiveness.

That won’t be the case. The SBA recently clarified that the 8-week period begins on the date the borrower receives the disbursement of the loan, and the bank is required to make the disbursement within 10 days of loan approval. As a result, a business that took out a PPP loan in the past week has to start the clock immediately upon receipt of the funds, regardless of whether their business has even restarted operations.

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**Government Transfer Payments: Exclusion of Employer Disaster Relief Payments (§ 139)**

Employers can help employees who have suffered financial loss due to the pandemic by creating a program that utilizes qualified disaster relief payments. Section 139 and its special rules provide that so-called qualified disaster payments are not taxable. Moreover, the costs of such payments are deductible by the employer as an ordinary and necessary business expenses.

Section. 139(b)(1) defines a qualified disaster relief payment as any amount paid to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster (provided amounts are not reimbursed by insurance or otherwise). Under this definition, childcare expenses resulting from school closures and costs incurred to enable an employee to work from home would most likely qualify.

In addition, qualified payments include those for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster,

A qualified disaster eligible for this treatment includes an event declared a major disaster or an emergency under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act) (Rev. Rul. 2003-29). On 3/13/20, President Trump made an emergency declaration under the Stafford Act regarding the COVID-19 pandemic. Therefore, qualified disaster relief payments related to COVID-19 are eligible for tax-free treatment under § 139.

**CHAPTER 7: OVERVIEW OF DEDUCTIONS AND LOSSES**

**Page 7-9**

**Family and Medical Leave Payments and Sick Pay.**

In the world of work, the relationship between employers and employees is not always rosy. Indeed, there are labor laws designed to regulate that relationship to ensure that employers observe the rights of their employees and treat them fairly. One area that causes confusion and tension is that of family and medical leaves. The problem is simple: can employees temporarily leave their job due to medical and family circumstances without fear of losing it? Of course, the related question is whether employees should be entitled to paid sick leave.

As mentioned in the text in Chapter 13, Congress addressed the issue of sick leave with the enactment of the Family and Medical Leave Act (FMLA) in 1993. The FMLA generally requires employers with more than 50 employees to allow their employees up to 12 weeks of ***unpaid*** leave for qualified medical and family reasons without fear of losing their jobs. The FMLA did not contain any tax provisions.

It should be emphasized that the FMLA of 1993 did not require employers to pay employees while they were on leave. It did not require **paid sick leave,** although some employers offered it and some states may have required it. What it did do was mandate that employers must grant their employees up to 12 weeks of job protected sick leave. As a result, employees legally can take up to 12 weeks of leave due to health reason and not worry about losing their jobs.

Perhaps, the first tax development with respect to sick leave occurred with the enactment of the TCJA of 2017 that created a special credit to help subsidize an employer’s cost of paying for family and medical leave. No doubt some hoped that the credit would encourage more employers to offer paid sick leave programs. The dramatic upheaval brought by COVID-19 prompted Congress to revisit this area in the enactment of FFCRA (*Families First Coronavirus Response Act*), the first piece of legislation in response to COVID-19. FFCRA generally requires certain employers to provide sick pay.

**Paid Sick Leave: Background.** As noted above, prior to FFCRA, there was no federal law in the U.S. that required sick pay for the private sector employees (except for an executive order signed by President Obama for businesses that do business with the federal government). Still, it is not uncommon to hear employees say that they are taking a sick day, for which they may or may not be paid. However, payments for sick leave are usually required for public sector workers—both federal and state employees, who are provided paid sick leave as part of their employment agreements.

As reported by Workest, (<https://www.zenefits.com/workest/the-definitive-list-of-states-and-cities-with-paid-sick-leave-laws/>, an analysis in 2018 by the Bureau of Labor Statistics found that about 61 percent of Americans workers in the private sector had sick pay while 39 percent of American did not. In that regard, currently 11 states and Washington D.C., as well as over 30 localities, require paid sick leave. However, things are changing. For example, recently, on April 3, 2020, the state of New York, in response to the millions of jobs lost due to COVID-19, amended its labor laws to require all New York employers to provide paid (or unpaid) sick leave for their employees See <https://www.littler.com/publication-press/publication/new-york-enacts-statewide-sick-leave-law>.

**FFCRA and Sick Leave.**

On the federal front, the enactment of FFCRA was a milestone concerning sick leave. FFCRA now **requires** most employers to provide **paid sick leave** but only if its employees are directly impacted by the COVID-19. As a result, most of America’s nearly 159 million workers will be able to get *paid* time off if they or their families are directly affected by COVID-19. Moreover, FFCRA modifies the tax law to give employers credits for these payments that can be used to reduce their payroll tax liabilities. This arrangement effectively eliminates the employer’s cost of the sick pay that they are required to pay under federal law.

Technically, FFCRA contains two pieces of legislation that require paid sick leave. The new law is confusing because there are two separate programs that concern sick pay and there are subtle differences between them. Note that at the conclusion of this discussion, there are charts that summarize and compare the two programs. The two programs are:

(1) **The Emergency Paid Sick Leave Act** (**EPSLA**, Act § 5101) that requires certain employers to provide up totwo weeks of *paid sick leave*and.

(2) **The Emergency Family and Medical Leave Expansion Act** (**EFMLEA**, Act § 3101), which, in its so-called *family and medical leave*program, expands the Family and Medical Leave Act of 1993 (FMLA) mentioned above. In so doing, the EFMLEA increases the benefits beyond that required by the paid sick leave rules of EPSLA (i.e., two weeks of sick pay). EFMLEA’s family and medical leave program generally requires 12 weeks of leave (10 of them paid) for certain COVID-19 related reasons. [**Note:** the FMLA of 1993 requires up to 12 weeks of unpaid leave (see FMLA of 1993 (29 United States Code § 2611(a)(1) that provides that an “employee shall be entitled to a total of 12 workweeks of leaving . . .”)).

These two acts, EPSLA and EFMLEA, work in different ways to assist working families facing health emergencies arising out of the coronavirus.

**Which Employees Are Covered?** The criteria for which employees are covered by EPSLA’s **paid sick leave** requirement and the criteria for which employees are covered by EFMLEA’s **family and medical leave** program are not identical. For the paid sick leave program of EPSLA, all employees are covered, regardless of how long they have worked (even a day) or whether they are part-time. On the other hand, EFMLEA’s expanded family and medical leave program only covers those employees who have worked for at least 30 days. Both Acts, both programs, apply to part-time employees. **Note**: neither program requires employers to provide paid sick leave for employees who are health care providers or emergency responders.

**Which Employers Are Required to Pay Sick Leave?** Generally, FFCRA covers both private employers with less than 500 employees and certain public employers (“covered employers”). However, as discussed below, small businesses (less than 50 employees) who do not want to pay for sick leave can elect to exempt themselves from certain provisions of FFCRA.

***Large Employers (More than 500 Employees)*.** The new legislation does not necessarily reach the nation’s larger companies. Neither EPSLA’s paid sick leave requirement nor EFMLEA’s family and medical leave program apply to employers with more than 500 employees. These businesses, which may or may not already offer paid time off, are not subject to the legislation. However, some large businesses that had not offered these benefits in the past--including Walmart and McDonald’s—have announced temporary coronavirus-related sick pay policies. While the federal rules do not apply to larger companies, a number of states who are adopting their own emergency sick leave statutes are thinking otherwise. Interestingly, some of these states do not exempt large employers. In addition, proposals in Congress would remove this 500-employee cap and force such businesses to pay sick leave. For this reason, experts are cautioning employers with more than 500 employees to monitor potential legislation at the state and federal levels.

***Small Business Exemption.*** Similar to its treatment of large employers, FFCRA does not always reach the workers of the country’s smaller businesses. Under certain circumstances, employers with fewer than 50 employees (small businesses) are *not* required to provide paid leave when an employee’s leave is necessary to care for a child whose school or place of care is closed, or whose child care provider is unavailable due to COVID–19 related reasons. In other words, these businesses are exempt from having to pay sick pay in these situations. However, this exemption is available only if the leave payments would jeopardize the viability of the business as a going concern. If businesses wish to avoid paying sick leave based on the viability argument, the regulations of the Department of Labor indicate that an officer of the business must document that one or more of the following is true:

(1) The requested leave would cause the business’s expenses and financial obligations to exceed its available business revenues and cause the business to cease operating at even a minimal capacity;

(2) The absence of the employees requesting leave would entail a substantial risk to the financial health or operational capabilities of the business because of their specialized skills, knowledge of the business, or responsibilities; and

(3) There are not sufficient workers who are able, willing, and qualified, and who will be available at the time and place needed, to perform the labor or services provided by the employee or employees requesting leave, and this labor or services are needed for the small business to operate at a minimal capacity.

To emphasize, the exemption for small businesses is only an exception from the obligation to provide paid leave to an employee who requests leave due to school or childcare closures (e.g., so the employee can be home to take care of his or her child because the child’s school or facility that provided childcare is closed). Small businesses must still provide paid sick leave to an employee who needs leave because he or she: (1) is subject to a quarantine or an isolation order; (2) has been advised by a health care provider to self-quarantine; (3) is experiencing COVID-19 symptoms and is seeking a medical diagnosis; or (4) is caring for an individual subject to a quarantine order or has been advised to quarantine. There is no exception for small businesses in these situations. They are required to pay sick leave. They are only exempt from paying sick leave to those where schools or daycare facilities have closed.

***Number of Employees*.** Determining the number of employees is critical since the small business exemption is available only if the employer has less than 50 employees. Moreover, FFCRA does not apply to employers with more than 500 employees. For these purposes, the following employees are counted: all full- and part-time employees, employees on leave, temporary employees who are jointly employed by the employer and another employer (a staffing company), and day laborers supplied by a temporary agency when the employee’s leave is taken.

**Sick Pay Required.** For employers with 50 but not more than 500 employees, the small business exemption is not available and sick pay is required. FFCRA’s paid sick pay program (i.e., EPSLA (FFCRA Act § 5101(a))) *requires* covered employers (those with at least 50 and less than 500 employees) to provide all **eligible** employees up to **2 weeks** (10 days or 80 hours) of **paid sick leave** at **full** **pay**, up to a **specified cap ($511/day) or a total of $5,110 (10 days x $511/day)**, An employee is **eligible** for sick leave payments if he or she is unable to work (or telework) because he or she:

(1) is subject to a Federal, State, or local quarantine or isolation order related to COVID-19,

(2) has been advised by a health care provider to self-quarantine due to concerns related to COVID-19,

(3) is experiencing symptoms of COVID-19 and seeking a medical diagnosis,

(4) is caring for an individual who is subject to a Federal, State, or local quarantine or isolation order related to COVID-19,

(5) is caring for a son or daughter under 18 because the child’s school or place of care has been closed or the child care provider is unavailable due to COVID-19, or

(6) is experiencing any other substantially similar condition specified by Health and Human Services

**Family and Medical Leave Payments and Sick Pay.** FFCRA’s family and medical leave program (i.e., EFMLEA (FFCRA Act § 3101)) expands the benefits from 2 weeks (per EPSLA) to 10 weeks for an employee in one particular situation, i.e., he or she is unable to work (or telework) due to a need for leave to care for a son or daughter under 18 years if the school or place of care has been closed, or the child care provider of such son or daughter is unavailable. (The IRS generally refers to wages in this case as “qualified leave wages.”)

Unlike the sick pay program of EPSLA, the Medical and Family Leave program provides that the first two weeks of leave (usually ten workdays) are unpaid. However, an employee may get paid sick leave under EPSLA, which requires two weeks of paid sick leave. Alternatively, an employee may be able to obtain sick pay provided to the employee pursuant to the employer’s preexisting policies for these two weeks of unpaid leave (e.g., vacation pay).

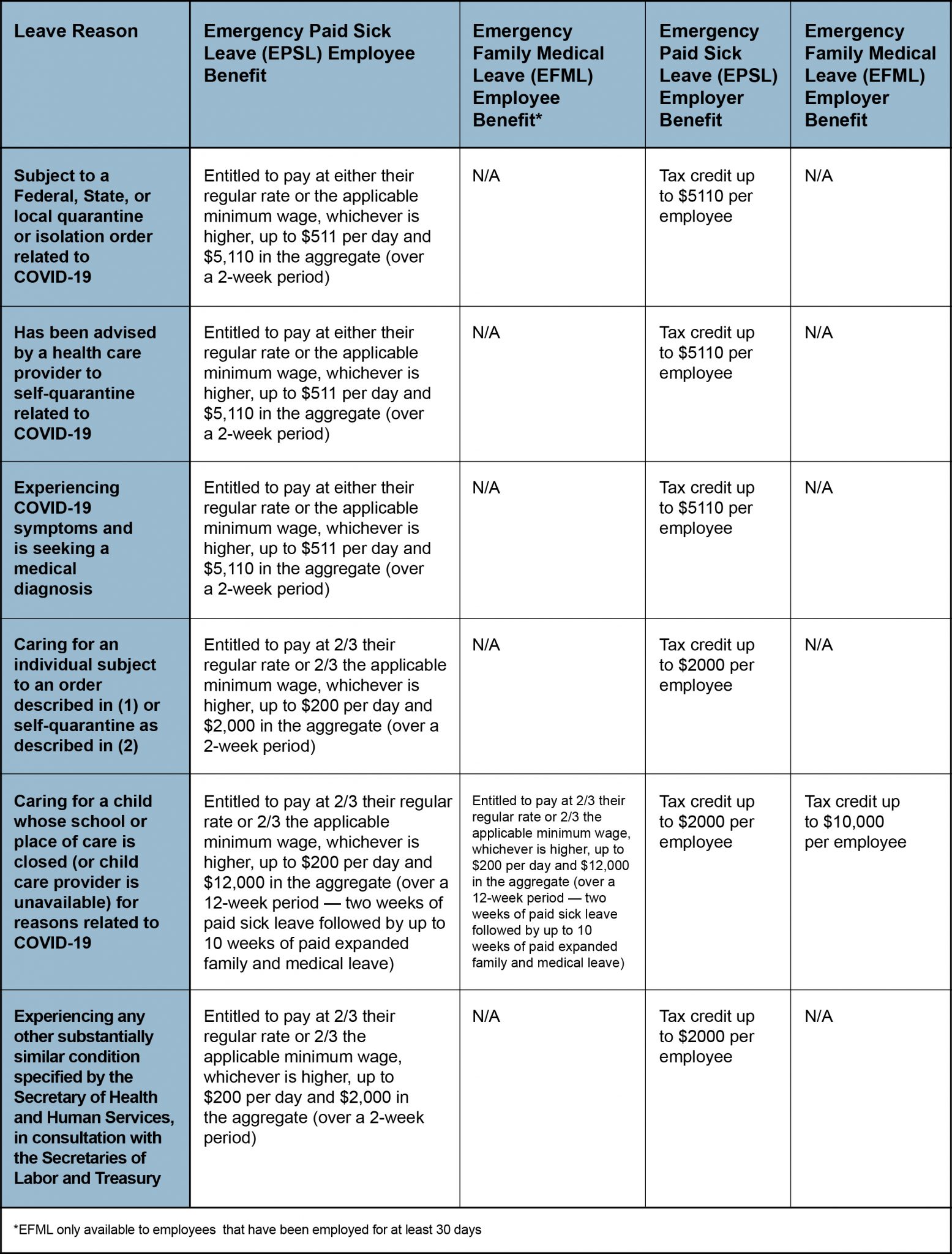
While the Medical and Family Leave program of EFMLEA does not provide paid sick leave for the first two weeks of leave, it does provide payment for the following period of up to ten weeks. The employee must be paid sick leave at **2/3 of the employee’s regular rate of pay** ***up to $200 per******day****.*  The total EFMLEA payment per employee for this ten-week period is **capped at $10,000** in the aggregate. As a result, assuming the employee could obtain two weeks of paid leave taken under EPSLA (10 days x $200 = $2,000) and $10,000 under EFMLEA, the total potential sick pay is $12,000. As noted above, an eligible employee may elect to use (or an employer may require that an employee use), expanded family and medical leave concurrently with any leave offered under the employer’s other policies that would be available for the employee to take to care for his or her child, such as policies for vacation or personal leave or paid time off.

***Employer Social Security Taxes on Qualified Wages.***  The qualified family leave wages are not subject to the employer portion of social security tax.

**Summary Tables.** These two programs are summarized below and a similar table on the next page. Note that the table on the following page also identifies the credit that an employer can get for sick pay. This is discussed later below.

|  |  |
| --- | --- |
| **Sick pay** **(EPSLA)** | **Family and Medical Leave (EFMLEA)** |
| Employee unable to work or telework due to | Employee unable to work (telework) due to |
| 1. Federal, state, local quarantine or isolation order | Must be employed (on payroll) for 30 days |
| 2. Self quarantining under advice of healthcare provider due to Covid-19 concerns | 1. Caring for child if school closed |
| 3. Obtaining diagnosis due to Covid-19 symptoms | 2. Caring for child if child care provider closed or unavailable due to Covid-19 |
| 4. Assisting a family member quarantined under order or advice of healthcare provider |  |
| 5. Caring for child if school closed or child care provider closed or unavailable due to Covid-19 |  |
| 6. Additional categories added by HHS |  |

|  |  |
| --- | --- |
| **Amount of  Sick Pay** | **Amount of  Family and Medical Leave Pay** |
| 1. Up to 2 weeks (80 hours) sick leave, maximum of $511 per day capped at $5,110 total. | 1. 2/3 of compensation up to $200/day for 10 weeks capped at $10,000 |
| 2. Care for family member w/coronavirus or child after school or day care closing,  $200/day ($2,000 per employee cap) | 2. Caring for child if child care provider closed or unavailable due to Covid-19, $200/day ($2,000 per employee cap) |



See <https://www.cshco.com/articles/summary-of-families-first-coronavirus-response-act/>)

**Credits for Sick Pay.**

**(Note:** While the discussion of tax credits is normally addressed with the general discussion of credits, for purposes of this supplement, the credits related to FFCRA’s sick pay requirements discussed above are considered below).

**FFCRA Credits for Sick Pay.** As noted above, FFCRA provides businesses with refundable tax credits to reimburse 100% of the costs of providing employees with required paid sick leave and expanded family and medical leave for reasons related to COVID-19. In effect, these credits operate such that employers should not incur any cost for the payments. The credits include the employer’s share of Medicare taxes as well as expenses to provide and maintain a group health plan (to the extent that the amounts are excluded from the employee’s gross income under § 106(a)).

According to the IRS, “Eligible Employers” can obtain the benefit of these payroll tax credits almost immediately by applying them against their federal payroll taxes that normally are paid quarterly (i.e., amounts withheld for employee income taxes, employment taxes including the employee and employer share for Social Security and Medicare). Generally, employers can claim the credits on their federal employment tax returns filed quarterly (e.g., Form 941, Employer's Quarterly Federal Tax Return). Form 941 is due by the last day of the month that follows the end of the quarter as follows:

The Quarter Includes . , , , . . Quarter Ends Form 941 Is Due

1. January, February, March March 31 April 30  
 2. April, May, June June 30 July 31  
 3. July, August, September September 30 October 31  
 4. October, November, December December 31 January 31

However, the IRS explains that taxpayers “can benefit more quickly from the credits by reducing their federal employment tax deposits.” Depending on the total taxes withheld, taxes normally are deposited monthly or semi-weekly (every two weeks). If there are insufficient federal employment taxes to cover the amount of the credits, an employer may request an advance payment of the credits from the IRS by submitting a Form 7200, Advance Payment of Employer Credits Due to COVID-19.

The IRS also explains that “Eligible Employers claiming the credits for qualified leave wages (and allocable qualified health plan expenses and the Eligible Employer’s share of Medicare taxes) must retain records and documentation related to and supporting each employee’s leave to substantiate the claim for the credits.

**Page 7-43**

**Expenses and Interest Relating to Tax-Exempt Income.**

**Deductibility of Business Expenses Paid with PPP Loans.** As discussed earlier in this supplement (material for Page 6-50 of the text), forgiveness of PPP loans is generally nontaxable if the loan is used for qualified expenses (e.g., payroll costs, mortgage interest, rent and utilities.) While this seems quite favorable, there is trouble lingering below the surface. As noted in the text, § 265 provides that no deduction is allowed for expenses related to tax-exempt income. Early on in the continuing saga of PPP loans, tax pundits pointed out that if expenses related to PPP loan forgiveness are not allowed, this puts taxpayers in the same position as if their forgiven PPP loan were included in income and they were able to deduct all expenses. On April 30, 2020, the IRS released Notice 2020-32, IRB 2020-21, 05/01/2020 that takes that position. The Notice explains that a taxpayer that receives a loan through the Paycheck Protection Program (PPP) is not permitted to deduct expenses that are normally deductible under the Code to the extent the expenses were reimbursed by a PPP loan that was later forgiven. None of the legislation relating to the COVID-19 addresses the issue (e.g., FFCRA and CARES).

As might be expected, the Notice was met with great hissing and moaning. The AICPA has indicated that it believes strongly that the position of the Notice is contrary to Congressional intent. Chris Hesse, CPA, chair of the AICPA Tax Executive Committee, said: “In effect, the IRS guidance means that the taxability provision [Act § 1106(i)] has no meaning. Why waste the ink to say that for purposes of the Code, the loan forgiveness is not includible in income, if the government will just take away deductions in the same amount?” See Sally P. Schreiber. "AICPA Challenging Nondeductibility of PPP-Related Expenses.” *Journal of Accountancy*, May 1, 2020, <https://www.journalofaccountancy.com/news/2020/may/expenses-reimbursed-by-ppp-not-tax-deductible-paycheck-protection-program.html> In a letter dated August 4, the AICPA joined over 170 organizations to urge Congress to “include a technical correction addressing the tax treatment of loan forgiveness.”

**CHAPTER 9: CAPITAL RECOVERY: DEPRECIATION, AMORTIZATION   
 AND DEPLETION**

**Page 9-22**

**Leasehold Improvements Qualify for Bonus Depreciation**

The CARES Act includes a technical correction to the TCJA that allows the interior improvements of buildings (qualified improvement property or QIP as defined in § 168(e)(6)) to qualify for 100% bonus depreciation. The QIP amendments made by §2307 of the Act are retroactively effective for property placed in service after Dec. 31, 2017. In other words, it is as if this QIP provision had been included in the original version of the TCJA.

Technically, the CARES Act provides a correction to the TCJA, and specifically designates QIP as MACRS 15-year property, making it now eligible for bonus depreciation purposes (§ 168(e)(3)(E)(vii)). Also, QIP is assigned a 20-year class life for the Alternative Depreciation System (§ 168(g)(3)(B)). This designation for ADS purposes has implications where the taxpayer has made a “real estate trade or business election” to avoid the interest expense limitation under § 163(j) as discussed in Chapter 11 (see page 11-28). If the taxpayer makes such election, then the real estate involved (i.e., 27.5-year residential or 39-year commercial) as well as the QIP would have to be depreciated under the ADS.

**Example 12.**  JKB LLC, a partnership, purchased a warehouse in 1995 that now stands idle. They (or, their tenants) then proceed to do substantial improvements (i.e., QIP) to the interior of the building as the various units are rented out. These QIP assets would be classified as MACRS 15-year property and would, therefore, be eligible for bonus depreciation.

While this new rule is significant, it should be noted that QIP generally is eligible for immediate expensing under § 179 ($2,590,000 in 2020), if the activity qualified as a trade or business.

Note that § 179 immediate expensing, as well as bonus depreciation, for QIP requires that the commercial building to which these improvements relate must have previously been placed in service before these improvements are made. As a result, a new commercial building in which the improvements are made before receiving, for example, a certificate of occupancy would not be eligible to be classified as 15- year MACRS “qualified improvement property.”

**CHAPTER 10: CERTAIN BUSINESS DEDUCTIONS AND LOSSES**

**Page 10-13**

**Excess Business Losses (EBLs)**

The TCJA of 2017 created § 461(l) that limits so-called excess business losses (EBLs). The effect was to limit the amount of net business losses (e.g., losses of a sole proprietorship, S corporation or partnership) that can be deducted from an active—in contrast to passive—owner’s return. As explained in the text, the maximum loss allowed is $500,000 for joint returns and $250,000 for others. The loss in excess of the allowed amount (the excess business loss) becomes part of the taxpayer’s NOL and carried over under those rules. Generally, the rule (§ 461(l)(3)(A)) provides that an "excess business loss" is the excess of the:

1. Taxpayer's aggregate trade or business deductions for the tax year over

2. The sum of aggregate trade or business gross income or gain plus $250,000 (as adjusted for inflation).

The effect is that only the first $250,000 of loss is deductible without limitation but the remainder is an EBL and becomes part of the taxpayer’s NOL.

**Example 13.**  S, single, has $300,000 of interest income, a $500,000 loss from a partnership and $100,000 of income from an S corporation. The taxpayer materially participates in both the partnership and S corporation activities. Consequently, the passive loss limitations do not apply. Under pre-TCJA rules, the taxpayer would have a net loss of $100,000 ($300,000 interest - $500,000 partnership loss + $100,000 S corporation income). However, under the EBL rules, the two “business interests” are first combined to get an overall loss of $400,000 ($100,000 S corporation income - $500,000 partnership loss = $400,000), which is then limited by the EBL rules to $250,000. The $250,000 loss could offset the $300,000 of nonbusiness interest income for a net positive income of $50,000. The disallowed loss of $150,000 ($400,000 - $250,000), the EBL, is not permanently lost but is instead carried forward as a net operating loss (NOL).

**EBL Limitation Effective Date.** The CARES Act temporarily modifies the excess business loss limitation for noncorporate taxpayers so they potentially can deduct a greater amount of excess business losses arising in 2018, 2019, and 2020. In essence, the CARES Act postpones the effective date for the EBL rules retroactively from tax years beginning after December 31, 2017, to tax years beginning after December 31, 2020.

To the extent that a 2018 or 2019 tax return has been filed that reported an EBL (as illustrated in Example 13 above), a taxpayer (i.e., individual, trust, or estate) must evaluate amending the return to claim a refund of taxes or to report a net operating loss under Code §172.

The CARES Act provides several technical corrections to the EBL rules (effective when this provision is once again in effect for 2021 onward). As amended, wage income would not be includible as business income for purposes of the EBL limitation. In addition, deductions for capital losses are not included in the calculation of an excess business loss. Finally, capital gains are only included in the calculation to the extent of the lesser of (1) the net capital gain attributable to a trade or business or (2) capital gain net income. These technical amendments are retroactive to taxable years beginning after December 31, 2017 (i.e., so as if they were included in the original version of the TCJA).

**Page 10-14**

**Net Operating Losses**

**NOL Deduction: Carryback of NOLs for 5 Years Permitted and No 80% Limitation.** The CARES Act addresses several changes made by the TCJA concerning the use of NOLs.

Under the TCJA and as explained in the text, beginning in 2018:

* The 2-year carryback period (except for farming businesses) was eliminated. Therefore, NOLs occurring in 2018 and beyond could only be carried forward.
* NOLs occurring in 2018 and beyond were carried forward indefinitely. The 20-year carryover period was eliminated.
* The NOL deduction for NOLs occurring in 2018 and beyond was limited to 80% of taxable income.  However, NOL carryovers existing prior to 2018 were not subject to the 80% limit.

The CARES Act makes substantial changes to the TCJA rules. As noted above, under the TCJA changes, § 172(b)(1)generallyprovided that an NOL for any tax year must be carried *forward*.However, the CARES Actalters that approach and provides that NOLs arising in a tax year beginning *after* Dec. 31, 2017 and *before* Jan. 1, 2021 (i.e., losses for 2018, 2019 and 2020) can now be carried *back* to each of the *five* previoustax years (e.g., a 2018 NOL could be carried back to 2013). The hope of the legislation is that it might help businesses who have suffered due to the coronavirus pandemic.

**NOLs: Temporary Repeal of 80% of Taxable Income Limitation.** As noted above, the CARES Act provides additional relief for businesses affected by COVID-19 by *temporarily* removing the 80% taxable income limitation on the use of NOLs for taxable years beginning *before* January 1, 2021. However, the 80% limitation is reinstated for 2021.

The temporary repeal of the 80% limitation, when coupled with the new 5-year NOL carryback period is aimed at businesses that may struggle given the current economic conditions. The Act gives taxpayers the ability to utilize NOLs in prior taxable years beginning as early as in 2013 (e.g., an NOL incurred in a 2018 tax year could be carried back 5 years) without limitation. In so doing, the Act allows businesses to use NOLs to offset taxable income in those prior years that had been subject to a marginal tax rate as high as 35% for corporations (rather than 21%) and 39.6% for individuals. This, in turn, might provide additional cash flow and liquidity that may help businesses survive.

Although the net effect of easing the NOL rules will be positive for many businesses with applicable losses, that may not be true for all business owners. Some businesses may find that using the new 5-year NOL carryback rule limits their ability to use other deductions or credits based on taxable income that they may have claimed on prior year returns (e.g., foreign tax credits). For this reason, taxpayers that do not want to carry back any NOLs have that option. Taxpayer can make an election (i.e., under §172(b)(3)) to forego this carryback option by the extended due date of their return “for the first tax year ending after the enactment date (i.e., 3/27/20) of this law change.” In other words, an election made for a 2020 calendar tax year return wouldapply to any NOLs arising in either 2018 or 2019 that otherwise would be carried back for five years.

The amendments made by Act § 2303(b) apply to NOLs arising in tax years beginning after December. 31, 2017 and to tax years beginning before, on or after such date to which such NOLs are carried (Act § 2303(d)(2)).

**NOLs: Taxable Income Limitation and § 199A Qualified Business Income Deduction.** The qualified business income deduction is generally limited to 20% of taxable income before any consideration of the deduction for NOLs (except for any portion of the NOL that is attributable to excess business losses as discussed in Chapter 10). As noted above, for taxable years beginning *after* December 31, *2020*, the 80% of taxable income limitation on NOLs is reinstated. When determining taxable income for purposes of calculating the 80% limitation on NOLs, the QBI deduction is ignored.

**Example 14.** The year is 2021 and NOLs are generally limited to 80% of taxable income. A married couple has taxable income in 2021 of $100,000 before considering a QBI deduction of $15,000. They also have a pre-2018 NOL of $150,000. With the reinstatement of the 80% of taxable income limitation in 2021, the NOL would be limited to $80,000 (80% x $100,000 of taxable income before the QBI deduction).

**CHAPTER 11: ITEMIZED DEDUCTIONS**

**Page 11-13**

**Health Savings Accounts**

**Qualified Expenses: OTC Drugs, Telehealth and Menstrual Expenses.** As explained in the text, the tax law generally allows taxpayers to pay for medical expenses with pretax dollars through a Health Savings Account (HSA). For example, taxpayers can instruct their employer to withhold amounts from their paycheck that are stored in an HSA. In this way, the amounts are never subject to an income tax nor an employment tax (and most state income taxes). Alternatively, taxpayers can simply make contributions to an HSA and deduct them for AGI.

The predecessor to health savings accounts was created in 1996 to entice people to be more conscious of health care costs, and hence, use less of it. Proponents of HSAs believe that they are an important vehicle that help reduce the growth of health care costs and increase the efficiency of the health care system. Some have said that they are the most tax-preferred savings vehicle in American history.

The major drawback of an HSA is that it comes with a qualified High-Deductible Health Plan (HDHP). An HDHP typically has lower premiums but higher deductibles, meaning higher out-of-pocket costs than a traditional health plan. Also, HSAs must be created before old age sets in. Taxpayers enrolled in Medicare Parts A or B, or those that file for Social Security benefits after age 65, cannot make contributions to an HSA.

Payments of medical expenses by an HSA do not impact the individual’s taxable income if the distribution is used for qualified medical expenses (§ 223(d)). If any portion of a distribution is not used for qualified medical expenses, that portion is considered taxable income and is subject to a 20 percent penalty. The Act makes several changes to HSAs:

First, the Act eliminated the requirement that medical expenses must be prescribed in order to qualify. This appears to make payment of over-the-counter remedies qualified medical expenses but only for purposes of HSA distributions.

Second, the Act expands the definition of qualified medical expenses to include amounts paid for “menstrual care products” (§ 233(d)(2)). The Act explains that “menstrual care products” include tampons, pads, liners, cups, sponges, or similar products used by individuals with respect to menstruation or other genital-tract secretions. As a result, taxpayers who have a health savings accounts (HSAs), health reimbursement arrangements (HRAs), health flexible spending accounts (health FSAs), and Archer medical savings accounts (Archer MSAs) can contribute to such accounts and use those funds for such expenses on a pretax basis.

Finally, the Act addresses telemedicine. Many employers have utilized telemedicine as a part of their group medical program, either integrated with the group health plan or as a separate benefit. This is particularly true since the arrival of COVID-19. Prior to the Act, the IRS did not allow those expenses (e.g., the cost of telemedicine) to be reimbursed under a high-deductible health plan (HDHP) until the plan’s deductible was satisfied**.** In other words, if the deductible had not been satisfied, the cost of the televisit (i.e., a word so new that it’s not in most dictionaries) would not be a qualified medical expense. In such case, payment for a televisit by the HSA would be considered a taxable distribution and a 20% penalty also would be assessed. In effect, the cost of the televisit would be paid with after-tax dollars plus 20%. The Act alters that approach and allows a high deductible health plan to provide telehealth and remote care services before the deductible is reached for 2020 and 2021.

**Group Health Plans: Required Coverage of COVID-19 Expenses**. The Act requires that all group health plans must cover COVID-19 diagnostic testing and any related visits at no cost to consumers. The Act expands this coverage to include in vitro diagnostic testing for the detection of SARS, CoV-2 as well as COVID-19 provided such tests are approved, cleared or authorized by the FDA, furnished to a participant during an office visit (in person or by telehealth), urgent care visit, or emergency room visit resulting in an order for or administration of such test. The Act also requires group health plans to cover “qualifying coronavirus preventive service.” A qualifying coronavirus preventive service is an item, service or immunization that is intended to prevent or mitigate COVID-19. The requirement to cover a qualifying coronavirus preventive service takes effect 14 business days after the date on which a recommendation is made relating to such service.

**High Deductible Health Plans**. Pursuant to IRS Notice 2020-15, a high deductible health plan’s payment of testing or treatment for COVID-19 without a deductible will not affect such plan’s status as a high deductible health plan. High-deductible health plans (HDHPs) can pay for COVID-19 related testing and treatment without jeopardizing their status, regardless of whether the plan’s deductible has been met (Notice 2020-15 (03/11/20)).

**Page 11-28**

**Interest Expense**

**Deduction for Business Interest Expense: Increased Limitation.** The TCJA of 2017 limited the deduction of business interest to 30% of adjusted taxable income or ATI (§ 163(j)(10)). The total cap is the sum of (1) the taxpayer’s business interest income (if any); (2) 30% of the taxpayer’s adjusted taxable income; and (3) the taxpayer’s floor plan financing interest expense for the taxable year. Note that the disallowed interest can be carried over indefinitely.

The CARES Act temporarily modifies this provision for tax years that begin in 2019 or 2020, The Act increases the ATI limitation, from 30% to 50%. In addition, the Act allows corporations to elect to use their 2019 ATI as their ATI in 2020 for purposes of this increased 50% threshold. This ensures that even though their earnings may be harmed by the COVID-19 outbreak, their otherwise increased business interest deduction will not be.

**Example 15.** CDB Inc. had ATI of $5 million in 2019 but a negative ATI in 2020. As a result, it normally would have no deduction for its business interest in 2020 since ATI was negative (50% x ATI $0 = $0). However, under the CARES Act, the business could elect to use its 2019 ATI for 2020. In such case, it could deduct $2.5 million of interest expense in 2020 (50% x $5 million ATI from 2019 instead of 2020). This may in turn generate a larger loss, and the company could use the favorable new NOL provisions to carry back the loss to 2019 and receive a refund on some or all of the taxes otherwise paid.

***Special rules for partnerships****.* For 2019, partnerships cannot take advantage of the 50% ATI limit but must use 30% of ATI. In this regard, recall that unused interest carries over. For 2020, the ATI limitation for partnerships increases from 30% to 50% of ATI (unless the partnership elects not to apply the higher limitation). The special rule for partnerships could be significant since LLCs often hold title to real estate with substantial mortgages and interest expense.

For 2019, a partner’s share of excess business interest expense (EBIE) is bifurcated. The partner may treat 50% of any EBIE allocated to the partner as automatically paid or accrued to them in the partner's 2020 tax year, thereby avoiding any § 163(j) limitations at the partner level (i.e., the partner can deduct that 50% portion regardless of the partner's ATI). The remaining 50% of 2019 EBIE is subject to the normal testing rules for EBIE at the partner level (i.e., the partner needs to receive an allocation of excess taxable income (ETI) from that same partnership in future tax years to potentially free up those amounts). The partner may elect not to apply this special rule.

Note that the increase in the ATI from 30% to 50% means the taxpayer should have additional interest expense that may be deducted and may give rise to, or increase, an NOL, which, as previously discussed, may now be carried back to offset the taxable income of five prior tax years.

Finally, if the additional deduction using the increased ATI limit would produce undesirable tax consequences for another tax provision, taxpayers may decide not to elect to apply the increased limitation.

**Page 11-43**

**Charitable Contributions: Limitations on Deductions**

**Charitable Contributions: New $300 Above-the-Line Deduction.** The Actallows taxpayers to claim contributions of up to $300 of *cash* contributions to public charities as a deduction for AGI (i.e., an above-the-line deduction) in 2020. Consequently, a taxpayer choosing to take the standard deduction in 2020 (e.g., $12,400 for single, $18,650 for head of households or $24,800 for joint filers) effectively increases this amount by $300 by making $300 of charitable contributions. Note that this deduction actually reduces AGI and, therefore, impacts deductions whose calculation involves AGI (§ 62(a)(22)).

**Increase in Limits on Contributions of Food Inventory**: Previously, a donation of “apparently wholesome food inventory” to a charitable organization that was used for the care of the ill, the needy, or infants was deductible in an amount up to its basis plus half the gain that would be realized had the food been sold (not to exceed twice the basis). In the case of a C corporation, the deduction could not exceed 15% of the corporation's income. In the case of a taxpayer other than a C corporation, the deduction could not exceed 15% of the taxpayer’s aggregate net income for that tax year from all businesses from which those contributions were made, computed without regard to the taxpayer's charitable deductions for the year. (§ 170(e)(3)(C)).

The Act provides that in the case of charitable contribution of food during 2020, the taxable income limit is also 25% rather than 15%. (Act § 2205(b)). The Act emphasizes that the food donations must be made to a charity. So, it would appear that, for instance, a restaurant that wanted to give excess food that would otherwise spoil would need to donate it first to a church or a school to be distributed, instead of inviting the general public to consume the food at the business’s location (or picking the food up and eating it elsewhere)

**Unlimited Charitable Itemized Deduction for Individuals.** As discussed in the text, for large contributions and contributions of property there is a long list of complex interrelated limitations that can apply (e.g., cash contributions subject to 60% of AGI, non-cash donations subject to 30% of AGI or 20% for certain others and more). However, the Act generally provides that for 2020 the limitation for cash contributions does not apply. In other words, after considering other current charitable contributions that are subject to various AGI limitations, individuals can claim an itemized deduction for charitable contributions of cash equal to 100% of their AGI. However, this 100% of AGI limit applies to cash contributions made directly to charitable organizations, not to contributions to donor advised funds, supporting organizations or private foundations. Moreover, any cash contributions that exceed the taxpayer’s AGI and which, therefore, are not deducted in 2020 generally can be carried forward subject to the 60% of AGI limit in the succeeding 5 years.

***Charitable Deduction******Limitations: Corporations***. Although not discussed in Chapter 11 (except in footnote 114), the charitable contribution deduction for C corporations generally is limited to 10% of taxable income (see Chapter 19). If a corporation's charitable contributions for a year did exceed the 10% limitation, the excess was carried over and deducted for each of the five succeeding years on a FIFO basis. The Act changes the limitation for C corporations to 25% of taxable income. See discussion in Chapter 19.

**CHAPTER 13: THE ALTERNATIVE MINIMUM TAX AND TAX CREDITS**

**Page 13-24**

**Overview of Tax Credits**

**Employee Retention Credit of $5,000 for Employers Closed Due to COVID-19**. To help employers and employees during the crisis, Congress created several tax credits. Among these is one for businesses and nonprofit organizations that were required to suspend or close its operations due to COVID-19, but that continue to pay its employees during the shut-down in hopes of retaining them. This so-called *retention credit* and the PPP loans are key elements of the CARES relief package (see Act § 2301 Employee Retention Credit for Employers Subject to Closure Due to COVID-19).

As noted below, the credit reduces or eliminate the employer’s share of FICA taxes attributable to employee wages and other compensation (i.e., 6.2% of wages). In short, it reduces or eliminates the amount of FICA taxes that the employer must pay. However, ***the credit is not available* if the taxpayer has received a PPP loan** (generally a loan equal to 2.5 times the businesses’ average monthly payroll but not to exceed $10 million as discussed in Chapter 6 above). Consequently, the taxpayer must choose between one or the other. Interestingly, it is estimated that the credit will provide an aggregate benefit to businesses of about $54.6 billion**.**

*Eligible Employer.* An employer is eligible for the retention credit if it meets *either* of two tests:

(1) *COVID-19 Shutdown*. The employer’s operations were fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious or other purpose) due to the virus or

(2) *Gross-Receipts-Decline (GRD)*. The employer’s gross receipts declined by more than 50% when compared to the same quarter in the prior year. Once an employer becomes an “eligible employer” on account of a “significant decline in gross receipts,” the employer remains an eligible employer for any succeeding calendar quarter until the employer’s gross receipts during that calendar quarter are 80% or more than the gross receipts in the comparable calendar quarter in the preceding year.

For tax exempt organizations, only the “fully or partially suspended operations” condition applies to receive the credit.

*Amount of Employee Retention Credit.* Eligible employers (e.g., those that shut down or have a significant decline in gross receipts) are allowed a refundable credit against its 6.2% cost of Social Security taxes (IRC § 3111(a). The amount of the credit is equal to   
**50% of** ***qualified* *wages*** **up to $10,000 of wages** or a **maximum credit of $5,000 *per employee*** (50% x qualified wages of $10,000). Assuming that the employer qualifies for a full year of the credit, the employer has a full credit against employee wages for employees whose total wages are equal to or less that $80,645.16 ($5,000/6.2%). The credit is computed based on qualified wages paid or incurred for each employee between March 13, 2020, and December 31, 2020. The fact that the employee may have been dismissed or furloughed is ignored. The amount of qualified wages taken into account for this purpose differs depending on whether the employer had more than 100 employees.

*Qualified Wages: More than 100 Employees.* In computing qualified wages, special rules apply if the business had an average of more than 100 full-time employees during 2019. First, qualified wages include *only* the wages of employees “who are furloughed or face reduced hours as a result of their employers' closure or reduced gross receipts.” Second, wages are qualified only if they were paid by the employer during the quarter for the period the business was shut down and the employees were not working due to COVID-19. (Act § 2301)

*Qualified Wages: No More than 100 Employees.* If the business had no more than 100 employees (100 or less) for 2019, the credit is calculated on all qualified wages paid after March 12, 2020. Qualified wages include (1) wages paid to employees during a shut-down and (2) wages paid for each quarter that the business suffered a sharp decline in year-over-year receipts, as described above (see *gross receipts decline)*.

In computing the amount of qualified wages in both situations, qualified wages include any “qualified health plan expenses” allocable to the wages, such as amounts paid to maintain a group health plan. In either case, however, the amount of qualified wages for each employee for all quarters may not exceed $10,000.

The retention credit is subject to numerous rules to prevent double-dipping.

* An employer's deduction for wages must be reduced by the amount of any retention credit.
* An employer may not take into account the following wages:
  + Wages of an employee for whom a work opportunity tax credit is claimed.
  + Wages taken into account under § 45S (income tax credit for paid family and medical leave).
  + Wages taken into account under §§ 7001 and 7003 of the Families First Act, which provides payroll tax credits for paid leave required to be provided by small employers.
  + Wages paid to certain related individuals specified in § 51(i)(1)

The retention credit requires an analysis of how a business has been affected by COVID-19 and if the COVID-19 shutdown or the gross-receipts-decline (GRD) tests have been met. The shutdown test requires that a business has been fully or partially suspended due to government action. If the business does not meet the GRD test, it may be unclear whether a business’ operations has been partially suspended. The GRD test also presents unique challenges. For example, employers must analyze gross receipts across all aggregated entities rather than by location (a change from rules associated with prior employee retention credits related to natural disasters).

The CARES Act requires employers to make a choice: obtain a PPP loan that is potentially forgivable or take the retention credit. In making the choice, there are two aspects of retention credit that deserve special consideration. First, the retention credit may substantially reduce or eliminate the FICA tax. Second, any tax that is due can be postponed to 2021 and 2022 (recall discussion for page 1-22 of this supplement concerning when 2020 payroll taxes are due: 50% due on December 31, 2021, and the other half due on December 31, 2022).

**Example 16.**  Alan Smith, CPA, conducts CPE workshops. He is the sole owner and employee of his own S corporation. This year he had to “partially suspend operations” due to the government-imposed restrictions on group meetings for May and June, 2020. This year the corporation paid him $80,645.16 in wages. Note that the FICA taxes paid exactly equals maximum allowable credit of $5,000 (i.e., 6.2% x $80,645.16 salary = $5,000). The taxpayer must determine whether he should seek a PPP loan or claim the retention credit of $5,000.

The taxpayer computes his retention credit under the rule for businesses with no more than 100 employees. Therefore, qualified wages include not only those paid to employees during a shut-down, but also wages paid for each quarter that the business suffered a sharp decline in year-over-year receipts. In this case, the business was shut down, so the wages are qualified. Thus, the credit is $5,000 (50% x qualified wages up to $10,000 of wages per employee or $5,000). Here, the retention credit of $5,000 is exactly equal to the FICA tax that must be paid and, consequently, would eliminate the expense.

The tax savings increases the company’s profits by a corresponding $5,000. Assuming that the taxpayer is the sole owner and employee of this S corporation and faces a marginal tax rate of 20% for federal income taxes and 5% for state income taxes, this $5,000 of additional profit flowing through on the K-1 would result in an increase of after-tax income of $3,750 (i.e., $5,000 – [(20% + 5% = 25%) x $5,000 =$1,250 in applicable income taxes]).

The taxpayer must determine whether he should obtain a forgivable PPP loan or claim the credit that puts $3,750 in his pocket after tax. Recall that the PPP loan helps cover payroll costs (wages up to $100,000 per employee, employee benefits, and state and local taxes). Employers can also use some of the funds (25%) to cover interest on mortgages, rent, and utilities. If the taxpayer got a PPP loan and uses it to pay the wages, he would not be required to repay the loan. In this situation, it appears that the taxpayer would be better off by seeking a PPP loan.

**Page 13-32 Credit for Paid Family and Medical Leave**

**Credit for Paid Sick Leave.** See Chapter 7 on changes relating to page 7-9 of the text.

**CHAPTER 18: EMPLOYEE COMPENSATION AND RETIREMENT PLANS**

**Page 18-7**

**Additional Taxes on Premature or Excess Distributions**

**Penalty-Free Withdrawals for Birth and Adoption Expenses**. The SECURE Act provides that distributions for the birth or adoption of a child (up to $5,000) are penalty-free withdrawals (i.e., not subject to the 10% penalty tax on early withdrawals). It also permits the participant to repay the funds to the plan or IRA. This change is effective for distributions made after 2019 and applies to both IRA distributions and qualified retirement plan distributions.

**Wavier of 10% Penalty for Early Withdrawal of Retirement Funds Due to Coronavirus**. See page 18-25 of this supplement.

**Page 18-8**

**Plan Loans**.

Many 401(k)s and other defined contribution plans allow participants to take out a plan loan of up to $50,000 or half of their own vested account balance. Normally, loans are then repaid over a five-year period through payroll deductions. The limit on loans made during the 180-day period beginning on the date the CARES Act is enacted is increased to the lesser of $100,000 or 100% of the participant’s account balance (which doubles the current limit of the lesser of  $50,000 and 50% of the participant’s account balance).  In addition, an individual with an outstanding loan may delay paying off the loan generally for one year. The remaining payments plus interest are re-amortized over the extended period.

**Example 17.** A taxpayer withdraws funds from her IRA or 401(k) plan during 2020 due to being infected by the virus. Not planning to replace these distributed funds back into their IRA or 401(k) plan, she must pay the associated income tax (but, no 10% penalty). She can pay the entire tax when filing their 2020 tax return. Or, instead, she can choose to pay this tax in equal installments in her 2020, 2021 and 2022 tax returns (presumably with no interest). What she cannot do is wait to pay the entire tax due (or, one-half each), for example, when they file their 2021 or 2022 tax returns.

**Page 18-21**

**Traditional IRA**

In late 2019, Congress reviewed the rules governing retirement plans and made several changes, hoping to help workers better save for their future. The new law, Setting Every Community Up For Retirement Enhancement Act (the SECURE Act) made a number of changes and are included in the discussion below. Additional changes were made by the CARES Act.

**Deductible Contributions to a Traditional IRA (SECURE Act)**

**Compensation for IRA Purposes: Certain Taxable Tuition**. The contribution to an IRA is normally $6,000 for 2020. However, the deduction cannot exceed the individual’s compensation. The Act expands the definition of compensation to include certain taxable nontuition fellowship and stipend payments effective 1/1/20.

**Repeal of Maximum Age for IRA Contributions**. The SECURE Act repeals the maximum age limit for traditional IRA *contributions*. Effective for contributions made to a traditional IRA after 12/31/19, there is no maximum age. In prior years, the age limit for contributions to a traditional IRA was age 70½.

**Page 18-25**

**Distribution Requirements**

**Waiver of Required Minimum Distribution Rules.** The start date for any required minimum distribution (RMD) is changed from age 70½ to age 72. This change is effective for any IRA owner who turns 70½ in or after 2020. This will enable individuals to defer distributions (and the taxes due) until age 72. The change applies to both IRA distributions and qualified retirement plan distributions. However, as noted below, the CARES Act suspended the RMD for 2020.

**Limitation on Non-Spouse Stretch IRAs**. When an individual with an IRA or similar retirement plan dies, such plans (and the amounts they contain) pass to one or more beneficiaries identified in the plan document. Prior to the SECURE Act, beneficiaries would begin receiving distributions. In such case, the required minimum distribution (RMD) would be determined by using the beneficiaries life expectancy. For example, assume that Violet, age 92, died this year with a $100,000 in her IRA. At the time that Violet died, her life expectancy (according to the IRS tables) was about 10 years. In such case, her RMD had she lived would have been about $10,000 per year. However, she named her granddaughter, Jennifer, age 23, as the beneficiary Jennifer had a life expectancy at the time of Violet’s death of about 60 years. Upon Violet’s death, the RMD calculation uses the beneficiary’s (Jennifer) life expectancy of 60 years, in which case, the RMD would drop from about $10,000 per year to about $1,667 per year. In effect, this approach stretches the payout period and postpones the taxes such that the present value is nominal. Moreover, the IRA is growing every year. Obviously, for many, using the so-called stretch IRA has been a valuable tax planning idea.

The SECURE Act changes the "stretch period" applicable for inherited IRAs (other than those inherited by a spouse), from a lifetime distribution period to a 10-year maximum distribution period. There are exceptions to the 10-year maximum distribution period, including distributions to disabled or chronically ill beneficiaries, a beneficiary who is a surviving spouse, and a beneficiary who is no more than 10 years younger than the deceased participant or IRA owner. This change is effective for distributions with respect to participants/IRA owners who die after 12/31/19 and applies to both IRA distributions and qualified retirement plan distributions.

**Wavier of 10% Penalty for Early Withdrawal of Retirement Funds Due to Coronavirus.** As discussed earlier in the text (page 18-7), taxpayers normally must pay a 10% penalty on distributions before age 59 ½. However, there are a number of exceptions and the Act adds another.The Act waives the additional 10% penalty on early distributions of up to $100,000 from IRAs and defined contribution plans (such as 401(k) and 457(b) plans and SEPs) during 2020 but only if the distribution was needed due to the coronavirus—a so-called coronavirus-related distribution. It should be emphasized that distribution must be directly related to COVID-19. While the penalty is waived, an early distribution is fully taxable.

A “coronavirus-related distribution,” as defined under the CARES Act, is any distribution from an eligible retirement plan made: (i) on or after January 1, 2020 and before December 31, 2020, (ii) to an individual (a) who is diagnosed with COVID-19, (b) whose spouse or dependent is diagnosed with COVID-19, or (c) who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, had hours reduced, or other factors as determined by the Secretary of the Treasury during the COVID-19 pandemic.

Coronavirus-related distributions are limited to $100,000 and are included in income ratably over a three-year period beginning with the taxable year in which the distribution is made unless the individual elects to include it in income earlier (or makes a tax-free repayment of the distribution).

The individual may recontribute the amount withdrawn to the plan or IRA within three years of taking the distribution and such repayment will be treated as a tax-free rollover.

It should be emphasized that “coronavirus-related distributions” are taxable, despite not being subject to the 10% early withdrawal penalty. But, if a distributee wants to avoid the current taxation of such distributions he or she will need to pay back these amounts within the above-mentioned 3-year period. This is similar to the “60- day rollover rule” except the taxpayer instead has three years to recontribute the funds in order to avoid taxation of these distributions.

**Example 15**. V, suffering from the virus decides to withdraw funds from his IRA and 401(k) plan during 2020. The withdrawals are exempt from the 10% early withdrawal penalty. However, he must pay income tax on the distribution when filing his 2020 tax return. However, in 2023 (i.e., within three years of the original distribution date) he is able to recontribute an amount equal to the previously distributed amount back into his IRA or 401(k) plan. It appears that he could then file an amended tax return for the 2020 tax year and claim a refund (plus interest) allocable to the tax originally paid with regard to this “coronavirus-related distribution.”

**CHAPTER 19: CORPORATION: FORMATION AND OPERATION**

**Page 19-4**

**Comparison of Corporate and Individual Income Taxation.** Most of the legislative changes discussed in this supplement relating to an individual’s *business activities* also apply to corporations.

***Economic Impact Payments for Individuals.*** The new stimulus payments (see revisions in this update for Chapter 4 (page 8 of this supplement)) are reserved solely for individuals. The legislation did not provide any similar stimulus device for corporations.

***Paycheck Protection Program (PPP Loans)*.** This program is available to all businesses, including corporations. Normally, only small businesses (no more than 500 employees) can obtain a PPP loan. See revisions in this update for Chapter 6, page 6-50

***Sick Pay Requirements***. The legislation requiring businesses to provide sick pay as well as family and medical leave generally applies to all businesses, including corporations. However, the requirements do not apply to small businesses (fewer than 50 employee if payments would jeopardize the viability of the business). Nor do they apply to large businesses with more than 500 employees. For those corporations required to provide sick pay, they are eligible for the credits that reduce their payroll taxes.

***Payroll Tax Deferral*.** Corporate employers can defer payment of the employer portion of payroll taxes on wages paid through December 31, 2020.

***Employee Benefits*.** Corporations like other businesses can take advantage of some of the changes to provide benefits to their employees (e.g., tax-free payments of student loans as well as those for disaster relief).

***Leasehold Improvements Qualify for Bonus Depreciation***. See discussion on this topic in this update for Chapter 9, page 9-22.

**Page 19-11**

**Limitation on Deduction of Interest of Businesses.** See discussion on this topic in this update for Chapter 11, page 11-28.

**Page 19-12**

**Net Operating Losses.** See discussion on this topic in the update for Chapter 10, page 10-14.

**Charitable Contributions of Corporations.** See discussion on this topic in the update for Chapter 11, page 11-41.

**Contributions of Ordinary Income Property by Corporations.** See discussion of contributions on food inventory in the update for Chapter 11, page 11-41.

**Pages 19-18 and 19-19**

**Minimum AMT Credit.** As noted in the text, the Tax Cuts and Jobs Act of 2017 eliminated the alternative minimum tax for C corporations, starting in 2018. Although not discussed in this chapter, upon repeal of the AMT, C corporations were allowed to utilize any unused minimum tax credits for the AMT to reduce their tax liability over a four-year stretch through 2021. The Cares Act goes one step further, letting companies immediately claim a refund of any unused AMT credits on their return for either 2018 or 2019, rather than having to wait.

**Employee Retention Credit.** See discussion in the update for Chapter 13, page 13-25.

**CHAPTER 22: TAXATION OF PARTNERSHIPS AND PARTNERS**

**Page 22-14 Computation of Partnership Taxable Income**

**Deductibility of Business Interest Expense: Increased Limitation.**

The TCJA of 2017 limited the deduction of business interest to 30% of adjusted taxable income or ATI (§ 163(j)(10)). The total cap is the sum of (1) the taxpayer’s business interest income (if any); (2) 30% of the taxpayer’s adjusted taxable income; and (3) the taxpayer’s floor plan financing interest expense for the taxable year. Note that the disallowed interest can be carried over indefinitely.

The CARES Act temporarily modifies this provision for tax years that begin in 2019 or 2020, The Act increases the ATI limitation, from 30% to 50%. In addition, the Act allows corporations to elect to use their 2019 ATI as their ATI in 2020 for purposes of this increased 50% threshold. This ensures that even though their earnings may be harmed by the COVID-19 outbreak, their otherwise increased business interest deduction will not be.

**Example 14.** CDB Inc. had ATI of $5 million in 2019 but a negative ATI in 2020. As a result, it normally would have no deduction for its business interest in 2020 since ATI was negative (50% x ATI $0 = $0). However, under the CARES Act, the business could elect to use its 2019 ATI for 2020. In such case, it could deduct $2.5 million of interest expense in 2020 (50% x $5 million ATI from 2019 instead of 2020). This may in turn generate a larger loss, and the company could use the favorable new NOL provisions to carry back the loss to 2019 and receive a refund on some or all of the taxes otherwise paid.

***Special rules apply to partnerships***. For 2019, partnerships cannot take advantage of the 50% ATI limit but must use 30% of ATI. In this regard, recall that unused interest carries over. For 2020, the ATI limitation for partnerships increases from 30% to 50% of ATI (unless the partnership elects not to apply the higher limitation). The special rule for partnerships could be significant since LLCs often hold title to real estate with substantial mortgages and interest expense.

For 2019, a partner’s share of excess business interest expense (EBIE) is bifurcated. The partner may treat 50% of any EBIE allocated to the partner as automatically paid or accrued to them in the partner's 2020 tax year, thereby avoiding any § 163(j) limitations at the partner level (i.e., the partner can deduct that 50% portion regardless of the partner's ATI). The remaining 50% of 2019 EBIE is subject to the normal testing rules for EBIE at the partner level (i.e., the partner needs to receive an allocation of excess taxable income (ETI) from that same partnership in future tax years to potentially free up those amounts). The partner may elect not to apply this special rule.

Note that the increase in ATI from 30% to 50% means the taxpayer should have additional interest expense that may be deducted and may give rise to, or increase, an NOL, which, as previously discussed, may now be carried back to offset the taxable income of five prior tax years.

Finally, if the additional deduction using the increased ATI limit would produce negative tax consequences for another tax provision, taxpayers may decide not to elect to apply the increased limitation.

**Page 22-21**

**Excess Business Loss Limitation for Partnerships (EBLs).**

The CARES Act temporarily modifies the excess business loss limitation for noncorporate taxpayers so they potentially can deduct a greater amount of excess business losses arising in 2018, 2019, and 2020. In essence, the CARES Act postpones the effective date for the EBL rules retroactively from tax years beginning after December 31, 2017, to tax years beginning after December 31, 2020.

To the extent that a 2018 or 2019 federal income tax return has been filed that reported an EBL (as illustrated in Example 12 above), a taxpayer (i.e., individual, trust, or estate) must evaluate amending the return to claim a refund of taxes or to report a net operating loss under Code §172.

The CARES Act provides several technical corrections to the EBL rules (effective when this provision is once again in effect for 2021 onward). As amended, wage income would not be includible as business income for purposes of the EBL limitation. In addition, deductions for capital losses are not included in the calculation of an excess business loss. Finally, capital gains are only included in the calculation to the extent of the lesser of (1) the net capital gain attributable to a trade or business or (2) capital gain net income. These technical amendments are retroactive to taxable years beginning after December 31, 2017 (i.e., so as if they were included in the original version of the TCJA).

**Deduction for Qualified Business Income (QBI): Taxable Income Limitation.** The qualified business income deduction is generally limited to 20% of taxable income before any consideration of the deduction for NOLs (except for any portion of the NOL that is attributable to excess business losses). As noted above, for taxable years beginning *after* December 31, *2020*, the 80% of taxable income limitation on NOLs is reinstated. When determining taxable income for purposes of calculating the 80% limitation on NOLs, the QBI deduction is ignored.

**Example 13.** The year is 2021 and NOLs are generally limited to 80% of taxable income. A married couple has taxable income in 2021 of $100,000 before considering a QBI deduction of $15,000. They also have a pre-2018 NOL of $150,000. With the reinstatement of the 80% of taxable income limitation in 2021, the NOL would be limited to $80,000 (80% x $100,000 of taxable income before the QBI deduction).

**CHAPTER 23: S CORPORATIONS**

**Page 23-22.**

**Qualified Business Income Deduction.** See page 22-39 of this supplement above.

**Page 23-40.**

**Limitation on Excess Business Losses for S Corporations (EBLs).** As mentioned in the update for Chapter 22 of this supplement relating to partnerships (comments for page 22-38 in this supplement), the Act creates an additional limitation on the deduction of so-called excess business losses (§ 461(l)). The effect is to limit the amount of net business losses (e.g., losses from a sole proprietorship, S corporation or partnership) that can be deducted from an active—in contrast to passive—owner’s return. This is yet another barrier partners or S shareholders must navigate before they can deduct any losses that flow through. See a complete discussion for partnerships on page 9-38 of this supplement.

**2020** **Individual Tax Rate Schedules (Rev. Proc. 2019-44)**

**2020 Single**

If taxable income is % on Of the   
Over But not over The tax is + Excess Amount over

$ 0 $ 9,875 $ 0.00 10% $ 0  
 9,875 $40,125 987.50 12% 9,875  
 40,125 85,525 4,617.50 22% 40,125  
 85,525 163,300 14,605.50 24% 85,525  
 163,300 207,350 33,271.50 32% 163,300  
 207,350 518,400 47,367.50 35% 204,100  
 518,400 156,235.50 37% 518,400

# **2020 Married Filing Jointly and Surviving Spouses**

If taxable income is % on Of the   
Over But not over The tax is + Excess Amount over

$ 0 $ 19,750 $ 0.00 10% $ 0   
 19,750 80,250 1,975.00 12% 19,750  
 80,250 171,050 9,235.00 22% 80,250  
 171,050 326,600 29,211.00 24% 171,050  
 326,600 414,700 66,543.00 32% 321,450  
 414,700 622,050 94,735.00. 35% 414,700  
 622,050 167,307.50 37% 622,050

**2020 Head of Household**

If taxable income is % on Of the   
Over But not over The tax is + Excess Amount over

$ 0 $ 14,100 $ 0.00 10% $ 0  
 14,100 53,700 1,410.00 12% 14,100  
 53,700 85,500 6,162.00 22% 53,700  
 85,500 163,300 13,158.00 24% 85,500  
 163,300 207,350 31,830.00 32% 163,300  
 207,350 518,400 45,926.00 35% 207,350  
 518,400 154,793.50 37% 518,400

**2020 Married, Filing Separately**

If taxable income is % on Of the   
Over But not over The tax is + Excess Amount over

$ 0 $ 9,875 $ 0.00 10% $ 0  
 9,875 40,125 987.50 12% 9,875  
 40,125 84,200 4,617.50 22% 39,475  
 84,200 160,725 14,605.50 24% 84,200  
 160,725 204,100 33,271.50 32% 160,725  
 204,100 306,175 47,367.50 35% 204,100  
 306,17583,653.7537%306,175

**2020 Estates and Trusts and Kiddie Tax**

If taxable income is % on Of the   
Over But not over The tax is + Excess Amount over

$ 0 $ 2,600 $ 0.00 10% $ 0  
 2,600 9,450 260.00 24% 2,600  
 9,450 12,950 1,904.00 35% 9,450  
 12,9503,129.00 37% 12,950

LTCG Taxable Income \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Rate Single Married Filing Jointly Head of household Trusts & Estates

0% $ 0 - $ 40,000 $ 0 - $ 80,000 $ 0 - $ 53,600 $0 2,650   
 15\* 40,001 - 441,450 80,000 - 496,600 53,600 - 469,050 2,651 13,150  
 20\* Over 441,450 Over - 496,600 Over 469,050 Over 13,150

\*Rate could be increased by the net investment income tax of 3.8%, if AGI exceeds certain levels.

\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*