02/26/2021

The Consolidated Appropriations Act Brings COVID-19 Relief (And More) to Individuals and Businesses

Late in 2020, Congress passed a $900 billion COVID-19 stimulus relief package with large bipartisan support. The relief package is part of the nearly 5,600-page Consolidated Appropriations Act (CAA), which also contains numerous other tax, payroll and retirement provisions. The following are key provisions that affect individual taxpayers and businesses.

Relief for Individuals

Recovery Rebates

The most headline-grabbing component of the CAA is the second round of direct payments for most individual taxpayers. The law calls for nontaxable “recovery rebates” of $600 per eligible taxpayer ($1,200 for married couples filing jointly), plus an additional $600 per qualifying child.

The payments begin phasing out at certain levels:

- $75,000 of modified adjusted gross income (MAGI) for single filers
- $112,500 for heads of household
- $150,000 for married couples filing jointly

Payments are reduced by $5 for every $100 of income above these thresholds, including the amounts for qualifying children.

The CAA expands eligibility for the payments to so-called mixed-status households, meaning those where not every family member has a Social Security Number (SSN). This change is retroactive to the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Eligible families who didn’t receive a payment in the first round because one spouse lacked an SSN can claim a credit for that payment on their 2020 federal tax returns.

The vast majority of people won't have to do anything to get an economic impact payment. The IRS will calculate and send the payment automatically to those who are eligible. The IRS will use the adjusted gross income [AGI] and dependents from the 2019 return to calculate the payment amount.

Because the rebates are based on 2019 tax returns, eligible taxpayers might receive a payment that’s less than the amount entitled under the law. For example, if your income was lower in 2020 or your family grew, you may be able to claim an additional credit for the difference on your 2020 tax return.

But, if you receive a payment and it turns out your actual 2020 income was over the income thresholds so that your payment should have been phased out, you are not required to repay the difference.

The rebates are included in income for tax purposes; it won't cause taxpayers to owe tax or decrease a refund for 2020.

Rebates are not allowed for any nonresident alien, anyone who qualifies as another person's dependent, and estates or trusts.

Unemployment Benefits

The CAA provides an extra $300 per week in unemployment benefits, over and above state unemployment benefits, for 11 weeks. It also extends the Pandemic Unemployment Assistance program for 11 weeks, which makes unemployment benefits available to workers who typically don’t qualify, including the self-employed, gig economy workers and others in nontraditional employment.

Housing Relief

The new law includes multiple types of relief for people struggling with their housing costs, including the following:

- Extension of the federal eviction moratorium through January 31, 2021
- Rental assistance for families affected by COVID-19
- Mortgage insurance premiums deduction extended through 2021 (subject to phase-out limits)

Retirement Relief

The CARES Act provides several forms of temporary relief related to retirement plan requirements. For example, it permits penalty-free withdrawals from certain retirement plans for expenses related to COVID-19 and lifts the limit on retirement plan loans. The CAA clarifies that money purchase pension plans are included in these temporary relief measures.

Unfortunately, the pandemic wasn’t the only disaster to befall taxpayers this year, and the CAA recognizes that. It includes tax relief for taxpayers in federally declared disaster areas for major disasters (not related to COVID-19) declared from January 1, 2020, through February 25, 2021, such as those impacted by the 2020 Northern California fires.

The relief under the CAA mirrors some of the relief afforded under the CARES Act. For example, it provides that residents of qualified disaster areas can take distributions of up to $100,000 from retirement plans without the normal 10% early withdrawal penalty. The distribution must be made by June 25, 2021.

The CAA also contains special rules for the recontribution of retirement plan distributions applied to a home purchase in a qualified disaster area and raises the limit for retirement plan loans made following a qualified disaster.

Be aware that the CAA doesn't extend the CARES Act's temporary waiver of required minimum distributions. Affected taxpayers should plan on resuming those distributions for 2021.

Earned Income and Child Tax Credits

The CAA includes a temporary change that could result in larger earned income tax credits (EITCs) and child tax credits (CTCs). It allows lower-income individuals to use their earned income from the 2019 tax year to determine their EITC and the refundable portion of their CTC for the 2020 tax year. This could produce larger credits for eligible taxpayers who earned lower wages in 2020 due to the pandemic.

Medical Expense Deductions

For tax years beginning before January 1, 2021, taxpayers could claim an itemized deduction for unreimbursed medical expenses that exceeded 7.5% of their (AGI). The threshold was scheduled to jump to 10% of AGI for 2021, which would make it more difficult to qualify for a medical expense deduction. The CAA permanently sets the threshold at 7.5% of AGI for tax years beginning after December 31, 2020.

Charitable Contributions

Under the CARES Act, taxpayers who don't itemize their deductions on their tax returns can nonetheless claim a $300 "above-the-line" deduction for cash contributions to qualified charitable organizations in 2020. The CAA extends that deduction through 2021 and doubles the deduction for married filers to $600. Contributions to donor-advised funds and supporting organizations don't qualify for the deduction.

The CARES Act also loosened the limitations on charitable deductions for cash contributions made in 2020, boosting it from 50% to 100% of AGI. The CAA carries that over for 2021. Cash contributions remain limited to the excess of AGI over the amount of all other charitable contributions. Any excess cash contributions are carried forward to later years.

Student Loans

Under the CARES Act, employers can provide up to $5,250 annually toward employee student loan payments on a tax-free basis before January 1, 2021. The payment can be made to the employee or the lender. The CAA extends the exclusion through 2025.

The CARES Act also temporarily halted collections on defaulted loans, suspended loan payments and reduced the interest rate to zero through September 30, 2020. Subsequent executive branch actions extended this relief through January 31, 2021, which remains unchanged by the CAA.

Education Tax Credits

Qualified taxpayers generally can claim an education tax break with the American Opportunity Tax Credit (AOTC) and the Lifetime Learning Credit (LLC). While the two credits were previously subject to different phase-out rules, the CAA has now adopted a single phase-out for both, effective for tax years beginning after December 31, 2020.

The credits will phase out beginning at $80,000 for single filers and ending at $90,000. For joint filers, they will begin to phase out at $160,000 and disappear at $180,000.

The new law also repeals the higher education expense deduction. Instead, taxpayers can apply the LLC credit.

Discharged Mortgage Debt

The tax code provision allowing taxpayers to exclude the discharge of qualified debt on their principal residence up to $2 million (or $1 million for married individuals filing separately) from their gross income was scheduled to expire at the end of 2020. The CAA extends the exclusion through 2025. But it also reduces the maximum acquisition debt limits to $750,000 for individuals—and $375,000 for married individuals filing separately—for debt discharged after 2020.

Flexible Spending Accounts

The CAA allows unused amounts from 2020 Flexible Spending Accounts (FSAs) to roll over to 2021 and unused amounts from 2021 FSAs to roll over to 2022.

Grace periods for plan years ending in 2021 or 2022 may be extended by 12 months. For 2021, employees can make mid-year prospective changes in their FSA contribution amounts without a change in status.

However, these changes are voluntary for employers. If you have an FSA, check with your employer to see if it’s adopting the available relief.

Repayment of Deferred Payroll Taxes

In August 2020, then-President Trump issued an executive order allowing employees to defer their share of Social Security taxes. Subsequent IRS guidance allowed, but didn’t require, employers to suspend this withholding. If your Social Security taxes were deferred, the CAA includes a change that could affect your expected cash flow for 2021.

Originally, the IRS issued guidance requiring employees to pay any deferred employment taxes on a prorated basis from January 1, 2021, through April 30, 2021. The CAA gives employees the entire year in 2021 to make up those deferred payments. That means you could have modestly more cash flow than you would have without the law.

Relief for Businesses

Paycheck Protection Program

The CAA includes another $284 billion in funding for forgivable loans through the Paycheck Protection Program (PPP), for both first-time and so-called "second draw" borrowers. New loans can be made through March 31, 2021, or until the funding is exhausted. There are several noteworthy changes, including:

- Expanding the allowable uses for PPP funds
- Providing a simplified forgiveness process for smaller loans
- Clarifying the deductibility of expenses paid by PPP loans

The second draw loans are intended for smaller and harder-hit businesses. Eligible borrowers include businesses, certain nonprofits, self-employed individuals, sole proprietors, and independent contractors.

Borrower qualifications for second draw loans include:

- No more than 300 employees
- Have used, or will use, all of its first PPP loan
- Must demonstrate at least a 25% reduction in gross receipts in one quarter of 2020 compared with the same quarter in 2019

For loans of $150,000 or less, a borrower is not required to submit substantiation for the reduction in gross receipts of at least 25% with the loan application. However, the borrower will be required to submit to the lender documentation supporting the gross receipts reduction certification made by the borrower when seeking loan forgiveness.

Loan features include:

- Limited to 2.5 times average monthly payroll costs in 2020 or 2019, or the precise one-year period before the date on which the loan is made
- $2 million maximum loan amount
- Accommodation and food service businesses may receive loans for up to 3.5 times their average monthly payroll

Businesses can obtain only a single second draw loan, and businesses with multiple locations that are eligible under the initial PPP requirements can have no more than 300 employees per physical location.

The CARES Act, which created the PPP, limited the funds to payroll, mortgage, rent, and utility payments.

The CAA allows businesses to also apply the funds to:

- Covered operating expenses, including:
    - Software or cloud computing services that facilitate business operations
    - Product and service delivery
    - Payroll processing
    - Human resources
    - Sales and billing
    - Accounting or tracking supplies, inventory, records, and expenses
- Uninsured costs related to property damage, vandalism or looting during 2020 public disturbances
- Supplier costs according to a contract, purchase order or order for goods in effect before taking out the loan that are essential to the borrower's operations
- Worker protection expenses incurred to comply with federal or state health and safety guidelines related to COVID-19 (for example, personal protective equipment, ventilation systems and drive-through windows)

As with the first round of PPP loans, full forgiveness requires a 60/40 cost allocation between payroll and non-payroll costs. In other words, you must spend at least 60% of the funds on payroll over your covered period, which may range from eight to 24 weeks.

The CAA creates a simplified forgiveness application for loans up to $150,000. Such loans will be forgiven if the borrower signs and submits to the lender a one-page application form from the Small Business Administration (SBA).

The application must include, among other items:

- A description of the number of employees retained due to the loan
- The total amount of funds spent on payroll
- The total loan amount

Borrowers must retain relevant records regarding employment for four years and other records for three years.

The CAA also eliminates the previous requirement that borrowers deduct the amount of any SBA Economic Injury Disaster Loan (EIDL) advances from their PPP forgiveness amount.

Additionally, the CAA addresses some of the confusion that had arisen regarding PPP tax issues. It specifies that a borrower need not include any forgiven amounts in its gross income. And — contrary to the position taken earlier by the IRS — it states that borrowers can deduct otherwise deductible expenses paid with forgiven PPP proceeds. The CAA also provides that tax basis and other attributes aren't reduced by loan forgiveness (special rules apply to partnerships and S corporations). These tax provisions apply to second draw loans, too.

Other Financial Assistance for Businesses

The CAA provides $20 billion for new EIDL grants for businesses in low-income communities and $15 billion for live venues, independent movie theaters and cultural institutions.

On the tax front, it states that a borrower's gross income doesn't include forgiveness of certain loans, emergency EIDL grants and certain loan repayment assistance provided by the CARES Act.

As with PPP loans, you can deduct your otherwise deductible expenses paid with such forgiven amounts, which won't reduce your tax basis and other attributes; note that special rules apply to partnerships and S corporations. Similar treatment applies to targeted EIDL advances and Grants for Shuttered Venues.

Employee Retention Credit

To encourage businesses to maintain their workforces, the CARES Act created the Employee Retention Credit, a refundable credit against payroll tax for employers whose:

- Operations were fully or partially suspended due to a COVID-19-related governmental shutdown order, or
- Gross receipts dropped more than 50% compared to the same quarter in the previous year (until gross receipts exceed 80% of gross receipts in the earlier quarter)

Employers with more than 100 employees could receive the credit if they closed due to COVID-19. Those with 100 or fewer employees received the credit regardless of whether they were open for business.

The credit equaled 50% of up to $10,000 in compensation — including health care benefits — paid to an eligible employee from March 13, 2020 through December 31, 2020. The CAA extends the credit for eligible employers that continue to pay wages during COVID-19 closures or reduced revenue through June 30, 2021.

As of January 1, 2021, the CAA made the following changes to the credit:

- Hiked the credit from 50% of qualified wages to 70%
- Expanded eligibility by reducing the requisite year-over-year gross receipt reduction from 50% to only 20%
- Raised the limit on per-employee creditable wages from $10,000 for the year to $10,000 per quarter
- Raised the "large employer" threshold from 100 to 500 employees

The CAA includes some retroactive clarifications and technical improvements regarding the original credit, as well. For example, it provides that employers that receive PPP loans still qualify for the credit for wages not paid with forgiven PPP funds.

Residential Real Estate Depreciation

The CAA provides welcome relief to taxpayers owning residential rental property placed in service prior to 2018 who otherwise were required to apply a 40-year ADS recovery period to these assets if the taxpayer elected to be excepted from the application of the IRC § 163(j) business interest limitation rules. For tax years beginning after December 31, 2017, the CAA assigns a 30-year ADS depreciation period to residential rental property even if it was placed in service before January 1, 2018 (when the 2017 Tax Cuts and Jobs Act (TCJA) first applied the more-favorable 30-year period) if the property (1) is held by a real property trade or business electing out of the limitation on business interest deductions and (2) wasn't subject to the ADS before January 1, 2018.

Deferred Payroll Taxes

Businesses were given the option to withhold their employees' share of Social Security taxes from September 1, 2020 through December 31, 2020. Those that did were originally directed to increase the withholding and pay the deferred amounts on a prorated basis from wages and compensation paid between January 1, 2021 and April 30, 2021. Under the CAA, such employers now have all of 2021 to withhold and pay the deferred taxes.

Non-COVID-19 Disaster Relief

The CAA also acknowledges the recent disasters not related to the pandemic, such as wildfires. Among other benefits, it provides employers in qualified disaster zones with a tax credit of up to $2,400 (40% of up to $6,000 of wages) per employee. The credit applies to wages paid regardless of whether services were actually performed in exchange for those wages. The CAA also modifies the CARES Act to allow corporations to make qualified disaster relief contributions of up to 100% of their 2020 taxable income.

Business Meals Deduction

For 2021 and 2022, employers can deduct 100% (up from 50%) for food and beverages as long as they're "provided by a restaurant." The IRS will likely issue guidance on the deduction, particularly the meaning of the term "provided by a restaurant."

Retirement Plans

The tax code allows "qualified future transfers" of up to 10 years of retiree health and life insurance costs from a company's pension plan to a retiree's health benefits or life insurance account within the plan. These transfers must meet certain requirements (such as being 120% funded) that pandemic-related market volatility has made too difficult to meet in some cases.

In response, in certain circumstances the CAA allows employers to make a one-time election on or before December 31, 2021 to end any existing transfer period for any taxable year beginning after the election.

The law also includes a partial termination safe harbor for retirement plans in light of 2020's pandemic-related workforce fluctuations. Plans won't be treated as having a partial termination (which would trigger 100% vesting for affected participants) if the number of active participants on March 31, 2021 is at least 80% of the number covered by the plan on March 13, 2020. The safe harbor applies to plan years that include the period beginning on March 13, 2020, and ending on March 31, 2021.

Charitable Deductions

The CARES Act included a provision that increases the limitation on corporations' cash charitable contributions from 10% of taxable income to 25%. The CAA extends this provision through 2021. Any excess corporate cash contributions will be carried forward to subsequent tax years. The limitation on deductions for donations of food inventory, which the CARES Act increased to 25% for 2020, is similarly extended through 2021.

Tax Extenders

The CAA incorporates several "extenders" of tax breaks, including:

- New Markets Tax Credit (through 2025)
- Work Opportunity Tax Credit (through 2025)
- Employer credit for paid family and medical leave (through 2025 for wages paid in tax years after 2020)
- Period for which an empowerment zone designation is in effect (through 2025)

However, the enhanced expensing rules and nonrecognition of gain on rollover of empowerment zone investments are terminated for property placed in service in tax years beginning after December 31, 2020. Empowerment zone tax-exempt bonds and employment credits also weren't extended beyond December 31, 2020.

California Conformity

California generally does not automatically conform to federal tax law changes. Although there are certain exceptions to this rule, such as the provisions related to retirement plans and S corporations, California generally does not conform to most of the CARES Act and CAA provisions. For instance, California does not conform to the federal Employee Retention Credit, COVID-19-related payroll credits (FFCRA paid leave credit), nor the income tax disaster-related credit. Taxpayers claiming federal relief provisions might be required to report corresponding adjustments on their California state income tax returns.

And There's More…

The CAA is one of the lengthiest pieces of legislation in congressional history, and the provisions outlined above are only a sampling of those that could affect you and your business.

California passed its own coronavirus relief package on February 23, 2021, that will provide $600 payments to low-income Californians while setting aside more than $2 billion in grants for struggling small businesses.

California Governor Gavin Newson signed the law as Congress is debating President Biden's $1.9 trillion coronavirus relief plan, a much larger national stimulus package, passage of which would increase the total federal funds spent on pandemic "relief" to more than $5.7 trillion.

To assist you with understanding these relief provisions, Seiler's COVID-19 Relief Advisory Service Team is available to answer your questions and help you make the most of these changes. For more information, please contact your Seiler tax advisor, or Advisory & Assurance partners Debbie McCall or Erin Hastings, at 650.365.4646.