Butterfield + Co.
CPAs, Inc.

December 28, 2020

To our Clients and Friends,

On Sunday, December 27, 2020, President Trump signed the Consolidation Appropriations Act, 2021 (CAA, 2021 or H.R. 133) into law. Highlights of CAA, 2021 include $600 payments to individual taxpayers with adjusted gross income (AGI) of $75,000 or less (or $112,500 AGI for heads of households), payments of $1,200 to joint filers with AGI of $150,000 or less, and an additional $600 payment for each qualifying child. For businesses, additional time is provided for paying previously deferred payroll taxes, another round of Paycheck Protection Program (PPP) loans is available, and borrowers with PPP loans may take deductions for expenses paid with PPP loan proceeds. The legislation also extends numerous expiring tax provisions for both individuals and businesses.

The tax provisions and the PPP extension appear in three separate bills that were part of the 5,593-page CAA, 2021, as follows:

I. The Covid-Related Tax Relief Act of 2020, which extends and modifies earlier Covid relief provisions from the Families First Coronavirus Response Act (Families First Act) and the Coronavirus Aid, Relief, and Economic Security Act (CARES Act);
II. The Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act, which extends and modifies the Paycheck Protection Program;
III. The Taxpayer Certainty and Disaster Tax Relief Act of 2020, which extends numerous expiring tax breaks and adds several new ones.

I. Covid-Related Tax Relief Act of 2020

Additional 2020 Recovery Rebates for Individuals and Amendments to Earlier Recovery Rebates. The provision provides a refundable tax credit in the amount of $600 per eligible family member. The credit is $600 per taxpayer ($1,200 for married filing jointly), in addition to $600 per qualifying child. The credit phases out starting at $75,000 of modified adjusted gross income ($112,500 for heads of household and $150,000 for married filing jointly) at a rate of $5 per $100 of additional income.

The provision also provides for the Treasury to issue advance payments based on the information on 2019 tax returns. Eligible taxpayers treated as providing returns through the nonfiler portal in the first round of Economic Impact Payments, provided under the CARES Act, will also receive payments. The Treasury may issue advance payments for Social Security Old-Age, Survivors, and Disability Insurance beneficiaries, Supplemental Security Income recipients, Railroad Retirement Board beneficiaries, and Veterans Administration beneficiaries who did not file 2019 returns based on information provided by the Social Security Administration, the Railroad Retirement Board, and the Veterans Administration.

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

In general, taxpayers without an eligible social security number are not eligible for the payment. However, married taxpayers filing jointly where one spouse has a social security number (SSN) and one spouse does not are eligible for a payment of $600, in addition to $600 per child with an SSN. The provision aligns the eligibility criteria for the new round of Economic Impact Payments and the credit for the Economic Impact Payments provided by the CARES Act.

Advance payments are generally not subject to administrative offset for past due federal or state debts. In addition, the payments are protected from bank garnishment or levy by private creditors or debt collectors. Additionally, the provision instructs the Treasury Department to make payments to the territories that relate to each territory's cost of providing the credits.

Tax Treatment of PPP Loans. The provision provides that gross income does not include any amount that would otherwise arise from the forgiveness of a PPP loan. This provision also (1) overrides current law which prevents the deduction of expenses paid with tax-exempt income by allowing businesses to deduct business expenses paid with the proceeds of a PPP loan that is forgiven, and (2) provides that the tax basis and other attributes of the borrower's assets will not be reduced as a result of the loan forgiveness. The provision is effective as of the date of enactment of the CARES Act.

Extension of Credits for Paid Sick and Family Leave. The provision extends the refundable payroll tax credits for paid sick and family leave, enacted in the Families First Coronavirus Response Act (Families First Act), through the end of March 2021. It also modifies the tax credits so that they apply as if the corresponding employer mandates were extended through the end of March 2021. This provision is effective as if included in Families First Act.

Election to Use Prior Year Net Earnings from Self-Employment in Determining Average Daily Self-Employment Income for Purposes of Credits for Paid Sick and Family Leave. An election is available for an individual who elects the credit for paid sick or family leave to use prior year net earnings from self-employment income, rather than current year earnings, in calculating the income tax credit available.

Extension of Certain Deferred Payroll Taxes. On August 8, 2020, the President Trump issued a Presidential Payroll Tax Memorandum allowing employers to defer withholding employees' share of social security taxes or the railroad retirement tax equivalent from September 1, 2020, through December 31, 2020, and requiring employers to increase withholding and pay the deferred amounts ratably from wages and compensation paid between January 1, 2021, and April 30, 2021.

Under the Payroll Tax Memorandum, the deferral is only available with respect to any employee with wages or compensation, as applicable, payable during any bi-weekly pay period of less than $4,000, calculated on a pre-tax basis, or the equivalent amount with respect to other pay periods. This equates to wages of $104,000 per year. The Payroll Tax Memorandum provides that the amounts deferred are not subject to any penalties, interest, additional amounts, or additions to the tax. The Payroll Tax Memorandum also authorizes Treasury Secretary Mnuchin to issue guidance to implement these orders and directed him to explore avenues, including legislation, to eliminate the obligation to repay the deferred taxes. Under the Payroll Tax Memorandum, penalties and interest on deferred unpaid tax liability would begin to accrue on May 1, 2021.

The new legislation extends the repayment period through December 31, 2021. Additionally, penalties and interest on deferred unpaid tax liability will not begin to accrue until January 1, 2022.

Clarification of Educator Expense Deduction for PPE. The provision requires the IRS to issue guidance or regulations providing that personal protective equipment and other supplies used for the prevention of the spread of Covid-19 are treated as eligible expenses for purposes of the educator expense deduction. Such regulations or guidance will be retroactive to March 12, 2020.

Emergency Financial Aid Grants. This provision provides that certain emergency financial aid grants under the CARES Act are excluded from the gross income of college and university students. The provision also holds students harmless for purposes of determining eligibility for the American Opportunity and Lifetime Learning tax credits. The provision is effective as of the date of enactment of the CARES Act.

Clarification of Tax Treatment of Certain Loan Forgiveness and Other Business Financial Assistance Under the Coronavirus Relief Legislation. This provision clarifies that gross income does not include forgiveness of certain loans, emergency EIDL grants, and certain loan repayment assistance, each as provided by the CARES Act. The provision also clarifies that deductions are allowed for otherwise deductible expenses paid with the amounts not included in income by this section, and that tax basis and other attributes will not be reduced as a result of those amounts being excluded from gross income. The provision is effective for tax years ending after date of enactment of the CARES Act.

Authority to Waive Certain Information Reporting Requirements. This provision gives Treasury authority to waive information filing requirements for any amount excluded from income by reason of the exclusion of covered loan amount forgiveness from taxable income, the exclusion of emergency financial aid grants from taxable income or the exclusion of certain loan forgiveness and other business financial assistance under the CARES act from income.

Application of Special Rules to Money Purchase Pension Plans. The CARES Act temporarily allows individuals to make penalty-free withdrawals from certain retirement plans for coronavirus-related expenses, permits taxpayers to pay the associated tax over three years, allows taxpayers to recontribute withdrawn funds, and increases the allowed limits on retirement plan loans. This provision clarifies that money purchase pension plans are included in the retirement plans qualifying for these temporary rules. The provision applies retroactively as if included in Section 2202 of the CARES Act.

Election to Waive Application of Certain Modifications to Farming Losses. This provision allows farmers who elected a two-year net operating loss carryback prior to the CARES Act to elect to retain that two-year carryback rather than claim the five-year carryback provided in the CARES Act. This provision also allows farmers who previously waived an election to carry back a net operating loss to revoke the waiver. These clarifications are aimed at eliminating unnecessary compliance burdens for farmers. The provision applies retroactively as if included in the CARES Act.

II. Paycheck Protection Program - Second Draw Loans

Section 311 of the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act creates a second loan from the Paycheck Protection Program (PPP), called a "PPP Second Draw" loan for smaller and harder-hit businesses, with a maximum loan amount of $2 million. In order to receive a PPP Second Draw loan, eligible entities must: employ not more than 300 employees, have used or will use the full amount of their first PPP; and must demonstrate at least a 25% reduction in gross receipts in the first, second, or third quarter of 2020 relative to the same 2019 quarter (although applicable timelines for businesses that were not in operation in Q1, Q2, and Q3, and Q4 of 2019 are provided). Applications submitted on or after January 1, 2021 are eligible to utilize the gross receipts from the fourth quarter of 2020.

Eligible and Noneligible Entities. Entities eligible for the PPP Second Draw include businesses, certain non-profit organizations, housing cooperatives, veterans' organizations, tribal businesses, self-employed individuals, sole proprietors, independent contractors, and small agricultural co-operatives. Entities ineligible include entities listed in 13 C.F.R. 120.110 and subsequent regulations (except for entities from that regulation which have otherwise been made eligible by statute or guidance, and except for nonprofits and religious organizations); entities involved in political and lobbying activities including engaging in advocacy in areas such as public policy or political strategy or otherwise describes itself as a think tank in any public document, entities affiliated with entities in the People's Republic of China; and registrants under the Foreign Agents Registration Act.

Loan Terms. In general, borrowers may receive a loan amount of up to 2.5 times the average monthly payroll costs in the one year prior to the loan or the calendar year. Seasonal employers may calculate their maximum loan amount based on a 12-week period beginning February 15, 2019 through February 15, 2020. New entities may receive loans of up to 2.5 times the sum of average monthly payroll costs. Entities in industries assigned to NAICS Code 72 (Accommodation and Food Services) may receive loans of up to 3.5 times average monthly payroll costs. Businesses with multiple locations that are eligible entities under the initial PPP requirements may employ not more than 300 employees per physical location. Waiver of affiliation rules that applied during initial PPP loans apply to a second loan. An eligible entity may only receive one PPP Second Draw loan. Fees are waived for both borrowers and lenders to encourage participation. For loans of not more than $150,000, the entity may submit a certification attesting that the entity meets the revenue loss requirements on or before the date the entity submits their loan forgiveness application and non-profit and veterans organizations may utilize gross receipts to calculate their revenue loss standard.

Loan Forgiveness. Borrowers of a PPP Second Draw loan are eligible for loan forgiveness equal to the sum of their payroll costs, as well as covered mortgage, rent, and utility payments, covered operations expenditures, covered property damage costs, covered supplier costs, and covered worker protection expenditures incurred during the covered period. The 60/40 cost allocation between payroll and non-payroll costs in order to receive full forgiveness will continue to apply.

Lender Eligibility and Compensation. A lender approved to make loans under initial PPP loans may make covered loans under the same terms and conditions as the initial loans. The Administrator is authorized to reimburse a lender by a tiered structure: For loans up to $50,000, the lender processing fee will be the lesser of 50% of the principal amount or $2,500. For loans between $50,000 and $350,000, the lender fee will be 5%. For loans $350,000 and above, the lender fee will be 3%.

Churches and Religious Organizations. Churches and religious organizations are eligible for PPP Second Draw loans.

Safe Harbor on Restoring Full-time Employees and Salaries and Wages Applies. The rule of reducing loan forgiveness for a borrower reducing the number of employees retained and reducing employees' salaries in excess of 25% applies.

Maximum Loan Amount for Farmers and Ranchers. A specific loan calculation for the first round of PPP loans for farmers and ranchers who operate as a sole proprietor, independent contractor, self-employed individual, who report income and expenses on a Schedule F, and were in business as of February 15, 2020, is established. These entities may utilize their gross income in 2019 as reported on a Schedule F. Lenders may recalculate loans that have been previously approved to these entities if they would result in a larger loan. This provision applies to PPP loans before, on, or after the date of enactment, except for loans that have already been forgiven.

Seasonal Employer. Defines a seasonal employer to be an eligible recipient which: (1) operates for no more than seven months in a year, or (2) earned no more than 1/3 of its receipts in any six months in the prior calendar year.

Eligibility of News Organizations for Loans. Eligible FCC license holders and newspapers with more than one physical location are eligible for a PPP Second Draw loan, as long as the business has no more than 500 employees per physical location or the applicable Small Business Administration size standard; and makes eligible Code Sec. 511 public colleges and universities that have a public broadcasting station if the organization certifies that the loan will support locally focused or emergency information.

Prohibition on Use of Loan Proceeds for Lobbying Activities. An eligible entity is prohibited from using proceeds of the covered loan for lobbying activities, lobbying expenditures related to state or local campaigns, and expenditures to influence the enactment of legislation, appropriations, or regulations.

III. The Tax Certainty and Disaster Relief Act of 2020

TAX EXTENDERS

The following tax provisions were permanently extended:

(1) Reduction in medical expense deduction floor from 10% of adjusted gross income (AGI) to 7.5% of AGI;
(2) Energy efficient commercial buildings deduction;
(3) Exclusion from income of certain tax benefits for volunteer firefighters and emergency medical responders;

(4) Repeal of deduction for qualified tuition and related expenses, replaced with increased income limitation on lifetime learning credit;
(5) Railroad track maintenance credit;
(6) Modification of the uniform capitalization rules and reduction of excise tax rate for beer, wine, and distilled spirits;
(7) Refunds in lieu of reduced rates for certain craft beverages produced outside the United States;
(8) Disallowance of reduced excise tax rates for smuggled or illegally produced beer, wine, and spirits;
(9) Minimum processing requirements for reduced distilled spirits rates; and
(10) Modification of single taxpayer rules with respect to beer, wine, and distilled spirits.

The following tax provisions were extended through December 31, 2025:

(1) Look-thru rule for related controlled foreign corporations;
(2) New markets tax credit;
(3) Work opportunity credit;
(4) Exclusion from gross income of discharge of qualified principal residence indebtedness;
(5) Seven-year recovery period for motorsports entertainment complexes;
(6) Expensing rules for certain qualified film and television and live theatrical productions;
(7) Oil Spill Liability Trust Fund financing rate;
(8) Empowerment zone tax incentives;
(9) Employer credit for paid family and medical leave;
(10) Exclusion from income for certain employer payments of student loans; and
(11) Carbon oxide sequestration credit.

The following tax provisions were extended through December 31, 2023:

(1) Residential energy-efficient property credit; and
(2) Energy credit under Code Sec 48.

The following tax provisions were extended through December 31, 2021:

(1) Credit for electricity produced from certain renewable resources;
(2) Treatment of mortgage insurance premiums as qualified residence interest;
(3) Credit for health insurance costs of eligible individuals;
(4) Indian employment credit;
(5) Mine rescue team training credit;
(6) Classification of certain race horses as three-year property;
(7) Accelerated depreciation for business property on Indian reservations;
(8) American Samoa economic development credit;
(9) Second generation biofuel producer credit;
(10) Nonbusiness energy property credit;
(11) Qualified fuel cell motor vehicles credit;
(12) Alternative fuel refueling property credit;
(13) Two-wheeled plug-in electric vehicle credit;

(14) Production credit for Indian coal facilities;
(15) Energy efficient homes credit;
(16) Extension of excise tax credits relating to alternative fuels; and
(17) Black Lung Disability Trust Fund excise tax.

OTHER PROVISIONS

Temporary Rule Preventing Partial Plan Termination. The provision provides that a qualified retirement plan will not be treated as having a partial termination under Code Sec. 411(d)(3) during any plan year which includes the period beginning on March 13, 2020, and ending on March 31, 2021, if the number of active participants covered by the plan on March 31, 2021, is at least 80% of the number of active participants covered by the plan on March 13, 2020.

Temporary Allowance of Full Deduction for Business Meals. Effective for amounts paid or incurred after December 31, 2020, the provision amends Code Sec. 274(n)(2) to provide that the 50% limitation on the deduction for food or beverage expenses does not apply to expenses for food or beverages provided by a restaurant and paid or incurred before January 1, 2023.

Temporary Special Rule for Determination of Earned Income. The provision provides that, if the earned income of a taxpayer for the taxpayer's first tax year beginning in 2020 is less than the taxpayer's earned income for the preceding tax year, the credits allowed under Code Sec. 24(d) and Code Sec. 32 may, at the taxpayer's election, be determined by substituting the taxpayer's earned income for the preceding tax year for the earned income for the taxpayer's first tax year beginning in 2020. For these purposes, in the case of a joint return, the earned income of the taxpayer for the preceding year means the sum of the earned income of each spouse for the preceding tax year.

Certain Charitable Contributions Deductible by Non-Itemizers. The provision provides that, in the case of any tax year beginning in 2021, if an individual does not elect to itemize deductions, the deduction under Code Sec. 170 for a charitable contribution equals the deduction, not in excess of $300 ($600 in the case of a joint return), which would be determined under Code Sec. 170 if the only charitable contributions taken into account in determining the deduction were contributions made in cash during the tax year to an organization described in Code Sec. 170(b)(1)(A) and not (1) to a Code Sec. 509(a)(3) supporting organization or (2) for the establishment of a new, or maintenance of an existing, donor advised fund (as defined in Code Sec. 4966(d)(2)). In addition, the penalty under Code Sec. 6662(a) for an underpayment attributable to an overstatement of the deduction for charitable contributions by non-itemizers is increased from 20% to 50% of the underpayment.

Modification of Limitations on Charitable Contributions. The increase of the limitation for the deduction for donations of food inventory in a tax year from 15% to 25% under Section 2205 of the CARES Act is extended through 2021. Under the CARES Act, the increased deduction limitation for food inventory donations is available only to taxpayers other than C corporations.

Temporary Special Rules for Health and Dependent Care Flexible Spending Arrangements. The provision provides that, for plan years ending in 2020 or 2021, a plan that includes a health flexible spending arrangement or dependent care flexible spending arrangement will not fail to be treated as a cafeteria plan under the Code merely because the plan or arrangement permits participants to carry over any unused benefits or contributions remaining in any such flexible spending arrangement from the 2020 or 2021 plan year to the next plan year. In addition, a plan that includes a health flexible spending arrangement or dependent care flexible spending arrangement will not fail to be treated as a cafeteria plan under the Code merely because the plan or arrangement extends the grace period for a plan year ending in 2020 or 2021 to 12 months after the end of such plan year, with respect to unused benefits or contributions remaining in a health flexible spending arrangement or a dependent care flexible spending arrangement. A plan that includes a health flexible spending arrangement will not fail to be treated as a cafeteria plan under the Code merely because the plan or arrangement allows an employee who ceases participation in the plan during calendar year 2020 or 2021 to continue to receive reimbursements from unused benefits or contributions through the end of the plan year in which such participation ceased (including any grace period).

DISASTER TAX RELIEF PROVISIONS

Disaster Tax Relief in General. Tax relief is provided for individuals and businesses in Presidentially declared disaster areas for major disasters declared on or after January 1, 2020, through 60 days after the date of enactment. The relief generally applies to incident periods beginning on or after December 28, 2019. It does not apply to areas for which a major disaster has been so declared only by reason of Covid-19.

Special Disaster Related Rules for Use of Retirement Funds. This provision provides an exception to the 10% early retirement plan withdrawal penalty for qualified disaster relief distributions (not to exceed $100,000 in qualified disaster distributions cumulatively). Amounts withdrawn are included in income ratably over 3 years or may be recontributed to a retirement plan to avoid taxable income and restore savings. It also allows for the re-contribution of retirement plan withdrawals for home purchases cancelled due to eligible disasters, and provides flexibility for loans from retirement plans for qualified disaster relief.

Employee Retention Credit for Employers Affected by Qualified Disasters. This provision provides a tax credit for 40% of wages (up to $6,000 per employee) paid by a disaster-affected employer to a qualified employee. The credit applies to wages paid without regard to whether services associated with those wages were performed. Certain tax-exempt entities are provided the option to claim the credit against payroll taxes.

Other Disaster Related Tax Relief Provisions. The provision temporarily suspends limitations on the deduction for charitable contributions associated with qualified disaster relief. With respect to uncompensated losses arising in the disaster area, the provision eliminates the current law requirements that personal casualty losses must exceed 10% of adjusted gross income to qualify for deduction. The provision also eliminates the current law requirement that taxpayers must itemize deductions to access this tax relief.

Low-Income Housing Tax Credit. This provision increases the 2021 and 2022 state ceilings for 9% low-income housing tax credit allocations for allocations to qualified disaster zones. The maximum increase across 2021 and 2022 is equal to $3.50 multiplied by the number of state residents in disaster zones and is capped at 65% of the state’s 2020 low-income housing tax credit ceiling. The provision also allows an additional year for properties provided disaster allocations to place buildings in service.

Treatment of Possessions. The Secretary of the Treasury is granted authority to make payments to the territories of the United States equal to the losses the territories would incur by reason of the application of the disaster relief provisions.

Future Stimulus?

The House of Representatives is currently voting on whether or not to increase the amount of advances under the second round of recovery rebates for up to $2,000 per qualifying adult, a vote supported by President Trump. It is uncertain at this time if the legislation will ultimately be passed and what additional stimulus measures are planned by President Elect Biden.

Don't hesitate to call us with questions or to discuss additional strategies. We'd be happy to assist you in any way that we can.

Very truly yours,

Butterfield + Co. CPAs, Inc.

Butterfield + Co. CPAS, Inc.