

Income Tax-Related Provisions of Emergency Relief Legislation

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Overview

In recent days, the Congress has enacted and the President has signed into law various pieces of legislation to provide economic relief to individuals and businesses as a result of the economic devastation as a result of government's reaction to a novel viral strain of influenza originating in China that spread to the United States. On March 27, the President signed H.R. 748 into law. That bill, known as the Coronavirus Aid, Relief and Economic Security Act (CARES Act), contains multiple parts. Last week I addressed the bankruptcy and loan/grant provisions of the law. Earlier this week I covered the retirement related provisions. Today's discussion focusses on the provisions related to income tax.

Separately, the IRS provided broad filing-related relief on April 9 via Notice 2020-23 that applies to all taxpayers that have a filing or payment deadline falling on or after April 1, 2020, and before July 15, 2020, including individuals, trusts, estates, corporations, and other noncorporate tax filers. The IRS also stated that it will disregard this timeframe in calculating any interest, penalty, or addition to tax for failure to file the forms specified in the Notice. Notice 2020-23 grants automatic relief to affected taxpayers which means that there is no need to file extensions or send documents to the IRS to obtain relief. The relief applies to Forms and their related schedules and attachments and applies to time-sensitive acts listed in Treas. Reg. §§301.7508A-1(c)(1)(iv) through (vi) and Rev. Proc. 2018-58. However, the Notice does not grant filing or payment relief for federal estate tax returns (Form 706) while it does offer relief for federal gift taxes and the generation skipping transfer tax.

The Notice also postpones the June 15, 2020 deadline for estimated tax payments to July 15.

Via Notice 2020-23, the IRS allows partnerships subject to the centralized audit provisions in the Bipartisan Budget Act of 2015 (BBA), to file an amended partnership return for 2018 or 2019 to take advantage of beneficial tax provisions in the CARES Act.

Income tax provisions of CARES Act – it's the topic of today's post.

Miscellaneous Provisions

Credits for leave. Under prior emergency legislation enacted on March 18 (the Families First Coronavirus Response Act – P.L. 116-127), an employer with 500 or fewer employees whose employees receive paid sick leave or family leave required by that law are entitled to credits. The CARES Act provides that those credits can be advance refunded (including any refundable portion). *CARES Act*, §3606(a)-(b). Any penalty triggered under I.R.C. §6656 for failure to deposit tax imposed by I.R.C. §§3111(a) or 3221(a) is waived if the penalty was triggered because the taxpayer anticipated the allowed credit. *CARES Act*, §§3606(a)(3); 3606(c). The provision is effective for qualified sick leave or family leave wages paid for a period beginning on or before April 2, 2020 (at IRS discretion) through 2020.



Medical expenses. I.R.C. §223(d)(2) “qualified medical expenses” that can be paid from a health savings account on a tax-favored basis. Payment for medicine or drugs that are not prescribed do not meet the definition. Likewise, I.R.C. §106(f) specifies that reimbursement for qualified medical expenses from a taxpayer’s HSA doesn’t include medicine or drugs that are not prescribed. The CARES Act eliminates the requirement of a prescription and also specifies that qualified medical expenses include menstrual care products (defined as a tampon, pad, liner, cup, sponge or similar product used by women with respect to menstruation or other genital-tract secretions. In addition, expenses for such products are treated as incurred for medical care purposes under I.R.C. §106. *CARES Act, §§3702(a)(1)-(2); 3702(a)(1)-(2); (b) and (c), effective for expenses incurred after 2019.*

Individual Income Tax Provisions

Economic impact payment. The legislation provides a rebate (Economic Impact Payment) of advance refunds via check or direct deposit up to \$1,200 for single persons and heads of households and up to \$2,400 for married couples that have filed a joint return. The rebate is paid based on a taxpayer’s filed 2019 return (or 2018, if 2019 has not yet been filed). If a return has not been filed for either 2018 or 2019, then the IRS “may” use information from Form SSA-1099 (Social Security Benefit Statement), or Form RRB-1099 (the equivalent for railroad workers). Non-filers must file a return to claim a payment. Also provided is \$500 for each qualifying child of the taxpayer that is also the taxpayer’s dependent (as defined by the Child Tax Credit rules).

The payment phases out at a five percent rate above adjusted gross income (AGI) of \$75,000 (single); \$122,500 (HoH); and \$150,000 (MFJ). Thus, the payment is phased out if AGI exceeds \$99,000 (single) or \$198,000 (MFJ) for taxpayer’s without dependent children. There is no income floor or phase in. Tax filers must provide their Social Security number for each family member claiming a rebate other than active duty military. The rebates are also available to residents of U.S. Territories. *CARES Act, §2201.*

Note: On March 30, 2020, the IRS issued IR 2020-61 in which it set forth the rules for the Economic Impact Payment. Under the rules, the IRS stated that all older clients on Social Security who did not file a tax return for either 2018 or 2019 due to income limits may be required to file some type of simple tax return with the IRS to receive payment. However, the IRS reversed course two days later. On April 1, 2020, the IRS indicated that it would simply rely on Social Security numbers to make payments to individuals that otherwise do not have an income tax filing obligation.

Charitable contributions. The new law makes two modifications to existing law impacting charitable contributions. The CARES Act provides for a \$300 above-the-line deduction for cash contributions to public charities during 2020. The legislation also increases the 60 percent limitation on charitable deductions to 100 percent of modified adjusted gross income for cash contributions to public charities during 2020. Thus, 100 percent of cash contributions to charity can be deducted against MAGI for 2020. Corporations, for 2020, will be able to deduct charitable donations up to 25 percent of MAGI rather than being limited to 10 percent. In addition, the legislation increases the limitation on food inventory contributed by a corporation to charity from 15 percent to 25 percent for 2020. *CARES Act, §2205.*

Student Loans. Present law allows an employer to exclude up to \$5,250 from income for an employer-sponsored educational assistance program. The CARES Act includes in the definition of qualified expenses for this purpose an employer’s payment of student loan debt. *CARES Act, §2206, effective for student loan payments made after March 27, 2020 before January 1, 2021.*

Business Provisions

Payroll tax credit. Through 2020, the CARES Act provides a refundable payroll tax credit for 50 percent of wages paid by an employer (including non-profit organizations) that has had operations fully or partially suspended due to governmental actions as a result of the virus. The credit is in lieu of participation in the payroll protection loan program. The credit also is available to an employer that has suffered a decline in quarterly revenues by more than 50 percent compared to the same quarter a year earlier.

Note: Farming and ranching businesses are deemed “essential” and, thus, can only qualify if quarterly revenues decline by more than 50 percent compared to the same quarter last year. Revenues could be shown to decline by the necessary amount, for example, by a farmer taking out a CCC loan on a crop (or crops) and then selling the grain under loan after the end of the second quarter (June 30, 2020). Alternatively, a deferred payment contract could be entered into that defers payment after June 30, 2020.

For employers with more than 100 employees, wages of employees that have been furloughed or had work hours reduced are also eligible. All employee wages of employers with an average number of full-time employees in 2019 of 100 or fewer full-time employees are eligible. The credit applies to the first \$10,000 in wages and compensation (including health benefits) the employer pays to an eligible employee. Disqualified wages are those taken into account for purposes of payroll credits and for required sick or family leave. Also disqualified are wages taken into account for the employer credit for paid family and medical leave, as well as wages taken into account for the I.R.C. §45S employer credit for paid family and medical leave. The credit is not available to employers receiving Small Business Interruption Loans under CARES Act §1102 - I.R.C. §2301(c)(2). *CARES Act, §2301, effective for wages paid after March 12, 2020 and before January 1, 2021.*

Note: The eligibility requirement of having revenues decline by more than 50 percent from the same quarter a year earlier does not allow the deferment of payment of the employer share of FICA tax to the end of 2021 and 2022.

Deferral of payroll taxes. The legislation allows a taxpayer to defer payment of the employer portion of some payroll taxes (employer portion of FICA and the employer and employee representative portion of Railroad Retirement taxes that are attributable to the employer FICA rate, and one-half of SECA tax liability) through 2020. Then, deferred amounts will be due in two equal installments – at the end of 2021 and the end of 2022. Deferral is unavailable if the employer has obtained a Small Business Administration 7(a) loan designated for payroll under §1106 of the CARES Act. *CARES Act, §2302, establishing a payroll tax deferral period beginning March 27, 2020 and continuing through 2020.*

Net operating losses. The legislation provides for a carryback of any NOL arising in a tax year beginning after Dec. 31, 2017, and before Jan. 1, 2021, to each of the five tax years preceding the tax year in which the loss arises. For tax years beginning before 2021 and after 2017, a five-year carryback of NOLs is allowed for all taxpayers, farm and non-farm. This has the result of delaying the 80 percent taxable income limitation of present law until 2021. C corporations can elect to file for an accelerated refund to claim the carryback benefit. -For tax years beginning after 2021, a taxpayer is eligible for full NOL deduction attributable to tax years before 2018, and an 80 percent of modified taxable income for NOLs arising in tax years after 2017. *CARES Act, §2303(b).*

Note: In Rev. Proc. 2020-24 issued on April 9, 2020, the IRS provided guidance on the treatment of NOLs under the provision, and extended the deadline for filing an application for a tentative carryback adjustment under I.R.C. §6411 to carryback an NOL that arose in any tax year that began

during calendar year 2018 and that ended on or before June 30, 2019. Under the guidance, an election to waive the I.R.C. §172(b)(3) carryback for NOLs arising in tax years beginning in 2018 or 2019 must be made no later than the due date, including extensions, for filing the taxpayer's federal income tax return for the first tax year ending after March 27, 2020. A taxpayer makes the election by attaching to its federal income tax return filed for the first tax year ending after March 27, 2020, a separate statement for each of the tax years 2018 or 2019 for which the taxpayer intends to make the election. The election statement must state that the taxpayer is electing to apply I.R.C. §172(b)(3) under Rev. Proc. 2020-24 and the tax year for which the statement applies. The election for an NOL arising in a tax year beginning in 2018 or 2019 must be made no later than the due date, including extensions, for filing the taxpayer's federal income tax return for the first tax year ending after March 27, 2020. For an NOL arising in a tax year beginning after Dec. 31, 2019, and before Jan. 1, 2021, an election must be made by no later than the due date, including extensions, for filing the taxpayer's federal income tax return for the tax year in which the NOL arises. The election is made by attaching a statement to the return.

Also, in Notice 2020-26, the IRS extended the deadline for filing an application for a tentative carryback adjustment under I.R.C. §6411 to carry back an NOL that arose in a tax year beginning during 2018 and ending on or before June 30, 2019. The legislation did not provide additional time to file tentative carryback adjustment applications for NOLs arising in a tax year beginning on or after Jan. 1, 2018 and ending before March 27, 2019. Taxpayers with losses during this timeframe can carry them back to an earlier tax year by filing amended returns. Also, the IRS granted affected taxpayers a six-month extension of time to file Form 1045 or Form 1139 (if the NOL arose in a tax year beginning in 2018 and ending on or before June 30, 2019). The time extension is only for requesting a tentative refund to carry back an NOL. It does not extend the time to carry back any other item. To use the extension, a taxpayer must file the form no later than 18 months after the close of the tax year in which the NOL arose (i.e., no later than June 30, 2020, for a tax year ending Dec. 31, 2018); and include on the top of the form "Notice 2020-26, Extension of Time to File Application for Tentative Carryback Adjustment."

Excess business loss limitation. The excess business loss limitation of \$250,000 (single) and \$500,000 (MFJ) is eliminated for tax years 2018-2025. Thus, a taxpayer may deduct business losses without limit for 2018-2025 and carry the losses back for up to five years. In addition, the provision specifies that excess business losses do not include any deduction under I.R.C. §172 or I.R.C. §199A, or any deductions related to performing services as an employee. Also, capital loss deductions are not taken into account in computing the I.R.C. §461(l) limitation, and the amount of capital gain taken into account in calculating the I.R.C. §461(l) limitation cannot exceed the lesser of capital gain net income from a trade or business or capital gain net income. *CARES Act, §2304, effective for tax years beginning after 2017.*

Note: Effective for tax years beginning after 2020, business income cannot be offset by wage income, include wages paid from the business. This could present enhanced audit activity concerning reasonable compensation in the S corporation context.

Corporate AMT. The legislation allows corporations to claim 100 percent of AMT credits in 2019 as fully refundable and provides an election to accelerate claims to 2018, with eligibility for accelerated refunds. *CARES Act, §2305, effective for tax years after 2017.*

Business interest.

The legislation allows a business with gross receipts over \$26 million to elect to increase the limitation on the deduction of interest from 30 percent of adjusted taxable income to 50 percent of adjusted taxable income for tax years beginning in 2019 and 2020. A business may elect to use

2019 adjusted taxable income (ATI) in calculating the 2020 limitation. If an election is made to compute the limitation using 2019 ATI for a tax year that is a short tax year, the ATI for the taxpayer's last tax year beginning in 2019 which is substituted under the election will be equal to the amount which bears the same ratio to the ATI as the number of months in the short taxable year bears to 12. A taxpayer may elect out of the increase for any tax year beginning in 2019 or 2020. It is an irrevocable election unless IRS consents to a revocation.

Note: In Rev. Proc. 2020-22, issued on April 10, 2020, the IRS set forth the rules for making a late election or withdrawing an election for real property trades or businesses and farming businesses. The IRS, in the Rev. Proc, also provided guidance concerning the time and manner for electing out of the 50 percent ATI limitation for tax years beginning in 2019 and 2020; using the taxpayer's ATI for the last tax year beginning in 2019 to calculate the taxpayer's limitation for tax year 2020; and electing out of deducting 50 percent of excess business interest expense for tax years beginning in 2020 without limitation.

The 50 percent ATI limitation does not apply to partnerships for taxable years beginning in 2019. Rather, a partner treats 50 percent of the partner's allocable share of the partnership's excess business interest expense for 2019 as an interest deduction in the partner's first taxable year beginning in 2020 without limitation. The remaining 50 percent of excess business interest from 2019 is subject to the ATI limitation as it is carried forward at the partner level. A partner may elect out of the 50 percent limitation. *CARES Act, §2306, effective for tax years beginning after 2018.*

Note: Businesses entitled to use cash accounting (i.e., those with average revenue not exceeding \$26 million for 2020) are not subject to the limitation on deducting business interest. I.R.C. §163(j)(5) defines the term "business interest" as any interest expense properly allocable to a trade or business. "Trade or business" for this purpose does not include an "electing farming business."

Qualified improvement property. The legislation makes a technical correction to the Tax Cuts and Jobs Act to allow qualified improvements to business real estate (i.e., interior improvements of buildings) to be classified as 15-year MACRS property rather than 39-year property. The 15-year classification allows such property to be immediately expensed via 100 percent first-year bonus depreciation or, in the alternative, depreciated over 20 years (in the case of a real property trade or business). *CARES Act, §2307, effective for property placed in service after 2017.*

Note: An affected taxpayer may find it worthwhile to amend the 2018 return or file Form 3115 for the 2019 return. Doing so could also create an NOL that could be carried back five years.

Conclusion

The CARES Act is massive economic aid legislation as an attempt to provide relief to individuals and businesses harmed by the governmental reaction to a virus that has spread to various degrees throughout the U.S. Many tax provisions are included for individuals and businesses primarily on a temporary basis.

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