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FINANCIAL OUTLOOK

WINTER 2021

REBATE PAYMENTS AND ENHANCED UNEMPLOYMENT BENEFITS

While the new Act contains many provisions to help small businesses, individuals also get relief in the form of another round of rebate payments and enhanced unemployment benefits. Here are the details:

REBATE PAYMENTS

In an effort to help stimulate the economy, the Act provides an additional 2020 refundable credit of $600 for single taxpayers, $1,200 for married filing joint taxpayers, plus a $600 credit for each qualifying dependent child under the age of 17. The rebates are subject to phase-out thresholds based on 2019 income beginning at $150,000 of adjusted gross income (AGI) for joint filers and surviving spouses, $112,500 of AGI for heads of household, and $75,000 of AGI for single taxpayers. The credit is phased out at $5 for each $100 of income over these threshold amounts.

The rebates are a 2020 refundable credit, paid as soon as possible based on income reported on 2019 income tax returns. If a taxpayer's 2019 income is high enough to phase out the rebate, but his/her actual 2020 income is lower, the difference will be added as a credit when the taxpayer files his/her 2020 tax return. However, taxpayers whose 2019 income was low enough to qualify for a rebate, but whose 2020 income would have resulted in a phase out, will not have to repay the difference.

The Treasury Secretary made the refunds via direct deposit, with payments made by January 15, 2021.

ENHANCED UNEMPLOYMENT BENEFITS

The Act provides $286 billion for enhanced unemployment benefits:

- Enhanced federal unemployment insurance is reinstated, providing an additional $300 per week (down from the $600 subsidy that expired in July 2020) for 11 weeks, through March 14, 2021.
- The Pandemic Unemployment Assistance (PUA) program is extended through March 14, 2021, which provides unemployment assistance to the self-employed, independent contractors, gig workers, low-wage individuals, and individuals with a limited work history.
- The Pandemic Emergency Unemployment Compensation (PEUC) program is extended through March 14, 2021, providing 11 additional weeks of federally funded unemployment benefits to individuals who exhaust their regular state benefits.
- The maximum number of weeks an individual can claim benefits through state unemployment plus emergency federal programs was increased to a total of 50

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RETURN OF THE PAYCHECK PROTECTION PROGRAM

The Act reopens the Paycheck Protection Program (PPP) with meaningful revisions and clarifications. Businesses that have not yet received a PPP loan will be able to apply for round one financing. Businesses that have already received a loan but need additional capital may be able to obtain a second loan if they meet the new qualification requirements. Here are the basics:

EXPENSES PAID WITH FORGIVEN PPP LOAN FUNDS ARE DEDUCTIBLE — If the PPP loan is forgiven, the loan is not considered taxable income for the business. However, the Internal Revenue Service had maintained that

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Rebate Payments

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weeks.

❍ Workers who have not exhausted the time for PUA/PEUC benefits on March 14, 2021 are entitled to a transition period for an additional three weeks of benefits, through April 5, 2021.

❍ The Act also confirms that shared work plans qualify as unemployment benefits for purposes of the $300 subsidy payment. ❍❍❍

Other Income Tax Provisions

The Act contains numerous changes to personal income taxes. Some of the more substantive changes include:

❍ **Payment of deferred payroll taxes extended to December 31, 2021** — Through executive order, employees were allowed to defer their share of Social Security taxes incurred from September 1 to December 31, 2020. Payment of these deferred taxes was supposed to happen between January 1 and April 20, 2021. As part of this Act, repayments can now be repaid from January 1 to December 31, 2021. Employers had the option to offer deferment of payroll taxes to employees, but many did not do so.

❍ **Permanent reduction in hurdle for medical expense deductions** — Medical expenses can now be deducted on tax returns when medical expenses exceed 7.5% of adjusted gross income (AGI), down from 10%. This change is permanent.

❍ **Deductions for college expenses** — 2020 is the last year that the above-the-line deduction for tuition and related expenses can be claimed. However, this Act replaced the above-the-line deduction by increasing the phase out ranges for the current Lifetime Learning Credit. Starting in 2021, the Lifetime Learning Credit phase out ranges will be aligned with the American Opportunity Tax Credit, phasing out from $80,000 to $90,000 for single taxpayers (up from $59,000 to $69,000) and from $160,000 to $180,000 for joint taxpayers (up from $118,000 to $138,000).

❍ **Charitable contribution deductions** — The CARES Act created an above-the-line deduction for cash contributions made to charitable organizations for individuals who do not itemize deductions. The deduction was for 2020 only with a maximum cap of $300 for both single and joint taxpayers. This benefit has been extended through 2021, and in 2021, joint taxpayers can claim a maximum of $600. The ability to deduct up to 100% (up from 60%) of an individual's AGI as a qualified charitable contribution when making an all cash contribution has also been extended through the end of 2021.

❍ **Full deduction for business meal expenses** — For 2021 and 2022, business meal expenses incurred for food or beverages provided by a restaurant can be fully deducted (up from a 50% deduction).

❍ **Earned income and child tax credits** — Since many individuals were out of work for a good portion of 2020, they may not have enough earned income to qualify for the full earned income or child tax credits. This Act allows individuals to use their 2019 earned income to calculate the amount they will receive for either credit for 2020.

❍ **Employer payments of student loans** — Originally authorized by the CARES Act for 2020 only, employers can provide up to $5,250 of annual tax-free education assistance to pay the principal or interest on an employee's qualified student loan debt through 2025. Neither the employer nor the employee is liable for employment taxes on this amount.

❍ **Discharge of qualified principal residence debt** — The Act extends the period of time that forgiven debt for a primary residence may be excluded from income through 2025. Beginning in 2021, the maximum amount of debt that can be discharged is reduced from $2 million to $750,000 for joint filers and from $1 million to $375,000 for single filers.

❍ **Carryforward of flexible spending account funds** — Typically, funds remaining in an individual's dependent care or health flexible spending accounts at the end of the year are forfeited, with employers able to provide some limited relief. This Act allows employers to let employees roll forward any unused 2020 balances to 2021 and any unused 2021 balance to 2022. Employers are not required to do this. Also, employees can modify future contributions for 2021 only. Individuals who cease participation in the plan during 2020 and 2021 can receive reimbursements through the end of the plan year that participation ceased.

❍ **Educator expenses include COVID-19 related supplies** — The above-the-line deduction of $250 per educator includes expenses for personal-protective equipment, disinfectant, and other supplies used for the prevention of the spread of COVID-19 incurred after March 13, 2020.

❍ **Mortgage insurance premiums** — The deduction for mortgage insurance premiums has been extended through 2021, subject to phase out limits. ❍❍❍

Paycheck Protection

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any expenses paid with those funds could not be deducted on the business' tax return. This Act explicitly authorizes that expenses paid by PPP proceeds can be deducted on tax returns.

Additional expenses that can be paid with PPP funds — Four new categories of expenses can be paid with unused original PPP funds and second PPP loan proceeds:

- Covered operations expenditures, including payment for any software, cloud computing, and other human resources and accounting needs.
- Covered property damage costs, including expenses related to property damage and vandalism or looting due to public disturbances that occurred during 2020 not covered by insurance or other compensation.
- Covered supplier costs, including expenditures pursuant to a contract for goods in effect prior to the PPP loan and essential to the current operations of the entity.
- Covered worker protection expenditures, including expenditures for personal protective and other equipment needed to help a borrower comply with federal health and safety guidelines related to the COVID-19 pandemic.

Payroll expenditures must still comprise 60% of used PPP loan funds and 40% can be used for non-payroll expenses, including the four categories above, mortgage, rent, and utility payments.

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Expansion of payroll expenses — Group life insurance, group disability, vision, and/or group dental insurance all count toward payroll expenses.

Economic Injury Disaster Loan (EIDL) advances — The $10,000 EIDL advance will no longer reduce the amount of PPP loan forgiveness.

Selection of PPP covered period — The covered period for the PPP loan is used in calculating how much of the PPP loan is forgivable. Initially, the covered period was eight weeks, but was extended to 24 weeks for loans funded on or after June 5, 2020. All PPP borrowers will now have the option of choosing a covered period ranging from eight to 24 weeks, but the period must end by September 30, 2021.

Simplified forgiveness application — PPP borrowers of up to $150,000 seeking forgiveness of their loan simply have to fill out a one-page forgiveness certification with minimal information, including number of employees retained due to the PPP loan, estimated amount of PPP funds spent on payroll expenses, and total loan value. While borrowers have to follow all applicable PPP rules, they do not have to submit any proof. Relevant records must be retained for four years for employment records and three years for all other records.

Expansion of eligible businesses — Organizations that now qualify for PPP loans include nonprofit trade associations, veterans' organizations, tribal businesses, farmers, ranchers, destination marketing organizations, and media organizations such as newspapers, television, and radio stations previously ineligible due to their affiliation with other stations. Certain organizations are not eligible, such as publicly traded businesses, new organizations not in operation on February 15, 2020, certain financial services industries and foreign organizations, and entities that receive grants under the live venues grant program.

Prior provisions — As a reminder, PPP loans are 100% forgivable if used in accordance with program rules. Repayment may be required if certain rules are not met, such as maintaining the number of employees, stable hours, and wage levels. Proportionate repayment may be required if the employer does not maintain the average number of full-time-equivalent employees or if compensation for any individual making less than $100,000 per year is reduced by more than 25%. However, if reductions in the number of employees or in compensation are restored by a safe-harbor date, reductions will not affect loan forgiveness. The safe-harbor date was changed from December 31, 2020 to September 30, 2021 for borrowers that have not already applied for forgiveness.

Second Draw PPP Loans

To obtain a second draw PPP loan, a business must have received and spent its first PPP loan. Businesses that did not obtain a first loan will be able to do so now. The second draw PPP loans operate very similar to the original PPP loans, but the eligibility criteria are different:

- Businesses must have no more than 300 employees (down from the original 500 employees), except for accommodation and food services businesses, which can still have up to 500 employees.
- The business must have experienced a drop in revenue of more than 25% in any quarter in 2020 compared to the same quarter in 2019. Special rules apply for businesses that were in operation by February 15, 2020 but did not exist for all or some portion of 2019.
- The loan amount is still equal to 2.5 times average monthly payroll with a second draw limit of $2 million (down from the original $10 million limit). Businesses in the accommodation and food services industries can receive second draw loans up to 3.5 times their average monthly payroll costs. ❍❍❍

Expanded Employee Retention Tax Credit

The CARES Act provided businesses with an employee retention tax credit for wages paid from March 12, 2020 to January 1, 2021. Businesses that received a PPP loan were not able to utilize the employee retention tax credit. This Act extends, expands, and modifies the employee retention tax credit. Some changes are effective retroactively to 2020 and some changes are only for 2021.

Changes Retroactive to 2020

The most significant retroactive change is that businesses that received a PPP loan can also take advantage of the employee retention credit. However, the same wages cannot be used to qualify for both the employee retention credit and forgiveness of a PPP loan. The Internal Revenue Service and Treasury Department must issue guidance on this provision before it can be put into effect.

The other significant retroactive change is that healthcare expenses are now eligible to be treated as wages, even if the employee was not receiving other wages (for example, if he/she was furloughed).

To summarize the original employee retention tax credit: Employers were eligible for the credit if they met one of two tests and did not receive a PPP loan: 1) Operations were fully or partially disrupted because of a government order limiting commerce and travel as a result of COVID-19. 2) Gross receipts for a quarter in 2020 were less than 50% of gross receipts for the same quarter in 2019, with eligibility ceasing following a quarter where gross receipts were greater than 80% of the previous year. Businesses with over 100 employees could only take the credit for wages paid to employees who were furloughed or faced reduced hours as a result of the coronavirus. Businesses with 100 or fewer employees could take the credit for all paid wages. The retention credit was calculated by taking 50% of qualified wages for each employee during the eligible period of March 12, 2020 to January 1, 2021. The maximum wage amount used for the credit is $10,000 for that period, meaning the credit cannot exceed $5,000 per employee. The credit was used against the employer's share of Social Security payroll taxes. If the credit for the quarter exceeded that amount, the excess was treated as a tax overpayment and was refunded to the employer.

Changes for 2021

The Act makes a number of substantial enhancements to the employee retention credit for 2021:

- The employee retention credit is extended through June 30, 2021.
- The amount of wages eligible for the credit are $10,000 per employee per quarter (compared to $10,000 for all of 2020).
- The credit percentage is increased from 50% of wages to 70% of wages. Thus, the maximum credit per employee is $7,000 per quarter or $14,000 for 2021. The maximum credit in 2020 was $5,000 per employee.
- A small employer is defined as one with up to 500 employees, up from 100 employees in 2020.
- To qualify for the credit, gross receipts must decline by more than 20% (down from 50%) when comparing either the calendar quarter or the prior quarter to the corresponding quarter in 2019 or the employer must be fully or partially shut down by government order. For example, an employer may be eligible for the first quarter of 2021 if either its gross receipts for the first quarter of 2021 fell by more than 20% when compared to the first quarter of 2019 or its gross receipts for the fourth quarter of 2020 fell by more than 20% when compared to the fourth quarter of 2019.
- Advance payment of this credit is allowed only in cases of small employers with fewer than 500 employees and only up to 70% of the average quarterly wages paid in 2019. ❍❍❍

Please Call

In addition to an appropriations bill for the federal government for the 2021 fiscal year, the Consolidated Appropriations Act of 2021 (the Act) provides another round of economic stimulus and relief for the COVID-19 pandemic. The bill was passed by the House of Representatives and the Senate on December 21, 2020 and signed into law by President Trump on December 27, 2020.

The articles in this newsletter cover major provisions in the Act that impact individuals and small businesses. Due to the large number of provisions in the bill, there are many more that may apply to individual circumstances. Please call if you would like to discuss this Act in more detail. ❍❍❍