

President Trump signs the Consolidated Appropriations Act, 2021 that includes \$900 Billion for COVID-19 Relief, including Tax and Paycheck Protection Program Provisions

PRACTICE AREAS

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INDUSTRIES

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Nonprofit Organizations

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Professional Services Firms

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On December 21, 2020, Congress passed, with large bipartisan majorities, the Consolidated Appropriations Act, 2021 (CAA), an approximately \$2.3T omnibus appropriations bill to fund the government through September of 2021 that includes \$900B of COVID-19 relief intended to help businesses and individuals. President Trump, even though dissatisfied with the additional \$600 individual payment amounts (he preferred \$2,000) and certain other aspects, signed into law the CAA on December 27, 2020.

I. Certain Tax and Related Provisions Relevant to Businesses

A. Employee Retention Tax Credit

The CAA extends, increases, and amends the CARES Act's Employee Retention Tax Credit (ERTC). Under the CARES Act, the employee retention credit allowed certain employers carrying on a trade or business to claim a tax credit computed on a calendar quarter basis as a percentage (50%) of the 6.2 percent Social Security payroll tax. A precondition to claiming the credit was that either (1) the employer's business was either fully or partially suspended by a government order or (2) that the employer sustained a significant decline in gross receipts (very generally at least a greater than 50% decline in gross receipts for a quarter in 2020 as compared to the same quarter during 2019).

The CARES Act limited the credit to 50% of “qualified wages” paid to each employee (generally up to \$10,000 per employee per year). What constitutes qualified wages varied depending on whether the employer’s average number of employees during 2019 was more or less than 100. The changes made to the ERTC can be separated between prospective and retroactive changes.

For employers with more than 100 employees, the original CARES Act allowed an ERTC but only with respect to a portion of wages.

As originally drafted, the ERTC did not apply to any governmental employer.

1. Prospective Changes

The most significant change made by CAA to the ERTC is to extend the ERTC for qualified wages paid through June 30, 2021 (from December 31 2020 in the CARES Act) and increases the credit base to 70% of such wages (from 50% in the CARES Act). The CAA also increases the ERTC base to \$10,000 of qualified wages per employee per calendar quarter (from \$10,000 per employee in the aggregate under the CARES Act). Eligible employers may seek advance payment of the ERTC for any calendar quarter. Advance payments are generally estimated based on average quarterly wages from 2019.

The CAA expands eligibility for the ERTC in a number of ways. The CAA raises the threshold for treatment as a “large employer” from 100 employees to 500 employees. This change greatly expands the credit amount for employers with more than 100 employees. The CAA also lowers the required reduction in quarterly gross receipts that may trigger ERTC eligibility to 20% (from 50% under the CARES Act). An employer’s reduction in gross receipts is generally measured against the same calendar quarter from 2019, but the CAA provides for electing employers and employers not in existence in 2019 to use the preceding calendar quarter to calculate their reduction in gross receipts. The CAA also makes the credit available to certain governmental employers and provides rules to allow new employers with little or no 2019 history to claim the credit.

2. Retroactive Changes

The CAA includes several clarifications and technical corrections with respect to the ERTC. The CAA addresses the interaction between the ERTC and the PPP loan program. The statute makes clear that the ERTC may be claimed on otherwise qualifying wages paid from PPP loan proceeds but only to the extent that the covered loan under the PPP loan program is not forgiven. Apparently, this language means that any employer that either applies for less than 100% of a PPP loan to be forgiven or is denied forgiveness for any portion of a PPP loan may apply for and obtain an ERTC for that portion of the PPP loan proceeds that are not forgiven. Moreover, an employer should qualify for an ERTC to the extent that a PPP loan amount is less than the employer’s payroll costs during the covered period. This raises a number of issues, including to which covered costs (payroll, rent, utilities, mortgage, etc. (“covered costs”)) the PPP loan proceeds are deemed to fund or to which covered cost the unforgiven portion of the PPP loan proceeds are deemed to fund. We hope the Secretary of the Treasury will

provide an ordering rule. Also, while we believe our reading of the statutory language is correct, we await guidance from the Secretary of the Treasury to clarify congressional intent.

For tax-exempt organizations, the CAA clarifies that “gross receipts” for purposes of determining ERTC eligibility shall have the same meaning as in IRC Section 6033, used to determine return filing requirements.

With respect to employer health plan expenses, consistent with previous IRS guidance, the CAA confirms that amounts paid by an eligible employer to provide and maintain a group health plan constitute qualified wages to the extent excluded from the income of the employee under IRC Section 106. The CAA expands the ability to elect out of the ERTC by permitting employers to elect out for a portion of the employer’s qualified wages, rather than the all-or-nothing ability to elect out under the CARES Act.

3. Clarification

Finally, the CAA makes clear that employers may not obtain a “double benefit” by treating wages used to claim the ERTC as wages for purposes of the credits available under IRC Sections 41, 45S, 51, or 1396.

B. 100% Deduction for Business Meals and Expenses

The CAA allows a 100% deduction for business meals and beverages provided by a restaurant incurred after December 31, 2020, and before January 1, 2023. Before this change, IRC Section 274(n) generally limits the amount allowed as a deduction for any expense for food or beverages to 50% of the expense that otherwise would be allowed. This deduction does not include expenses associated with entertainment.

C. Extenders

The CAA makes permanent or temporarily extends various existing provisions otherwise set to expire. Several of these provisions were included as temporary provisions in the Tax Cuts and Jobs Act (“TCJA”).

1. Permanent Extensions

Included in the CAA’s permanent extension of already existing provisions are the reduction of excise taxes and simplification of recordkeeping requirements related to the taxation of beer, wine, and distilled spirits and the 7.5% medical expense deduction (applicable to all taxpayers). In addition, the CAA makes permanent a 40% credit for short-line railroads and certain energy-efficient commercial building deductions.

2. Provisions Extended to 2025

The CAA extends to 2025 a number of provisions, including the look-through rule, which provides that dividends, interest, rents and royalties received or accrued by a controlled foreign corporation

from a related controlled foreign corporation are not per se subpart F income. Additional provisions that are extended to 2025 include the work opportunity tax credit, the paid family and medical leave credit, the new market tax credit, an exclusion from income for certain employer's payment of student loans, benefits for empowerment zones, and depreciation associated with motorsports.

3. Provisions Extended Through 2021

The CAA provides a 1-year extension for provisions including the alternative fuels/mixture credit, the second generation biofuels credit, the fuel cell motor vehicle credit, the renewable electricity credit and certain credits applicable to coal credits, and employment credits.

In addition, the CARES Act provided for an increase from 10% to 25% for qualified cash contributions and from 15% to 25% for contributions of food inventory made by corporations in 2020. CAA provides a 1-year extension of these provisions through 2021.

II. Certain Tax and Related Provisions Relevant to Individuals

A. "Recovery Rebate" Payments

The CAA provides for additional recovery rebates of up to \$600 for most individual U.S. residents. Married individuals who file a joint return are eligible for a rebate of up to \$1,200. The rebate amounts increase by \$600 for each child under age 17. No rebate will be made to anyone who is claimed as a dependent on another taxpayer's federal income tax return. The rebate, which will be delivered via direct deposit when possible, is not taxable income.

The rebate amounts are reduced for higher-income taxpayers and begin phasing-out for taxpayers once adjusted gross income exceeds \$75,000 (the phase-out threshold is \$112,500 for heads of households and \$150,000 for joint filers). For these higher-income taxpayers, the rebate amount is reduced by \$5 for each \$100 that a taxpayer's adjusted gross income exceeds the phase-out threshold, and it will be completely phased-out when adjusted gross income exceeds \$87,000 for single filers (with no children), \$124,500 for heads of households with one child and \$162,000 for joint filers with no children.

B. Charitable Contribution Provisions

Allowance of Partial Above-the-Line Deduction. To encourage Americans to contribute to charitable organizations in 2021, individuals who claim the standard deduction will be permitted to deduct up to \$300 (\$600 for married couples filing a joint return) of cash charitable contributions "above the line" on their 2021 federal income tax returns.

Increased Limitations for 2021. The CARES Act increased the deduction limitation on 2020 cash charitable contributions to public charities by individuals who itemize their deductions to 100% of

adjusted gross income. The CAA extends this benefit to 2021. However, cash contributions are still limited to the excess of adjusted gross income over the amount of all other charitable contributions, with any excess cash contributions carried forward to subsequent tax years.

The above provisions will not apply to contributions to supporting organizations or donor advised funds.

III. Paycheck Protection Program Provisions for Small Businesses

The CAA clarifies, expands, and revises the Paycheck Protection Program (“PPP”) as follows:

A. Clarification of Tax Deductibility

In order to obtain forgiveness of PPP loans under the original PPP program, borrowers were required to utilize the loan proceeds on payroll costs, rent payments, utility payments, interest on real property mortgages, and interest on secured tangible personal property. The Treasury Department previously issued guidance stating PPP borrowers would not be able to deduct any expenses to the extent they were covered by PPP loan amounts expected to be forgiven. The CAA changes applicable law to allow PPP borrowers to deduct all qualifying expenses, including those expected to be covered by forgiven PPP loan amounts. The CAA further clarifies that forgiven PPP loan proceeds are not taxable income and that the use of PPP loan proceeds for forgivable expenses will not reduce any tax attribute or deny any basis increases.

B. Expansion of PPP Program

The CAA provides a second round of funding for PPP loans that is substantially different than the first round of PPP funding. This new round of PPP loans expands permitted use of the funds but limits both types of eligible businesses and the maximum loan amount. This round of PPP will be funded with \$284B and will be available until no later than March 31, 2021.

1. Eligible Businesses

To qualify for this new round of PPP funding, eligible business entities must: (a) have 300 or fewer employees; and (b) have gross receipts during the first, second, or third quarter of 2020 that are 25% or more less during the same calendar quarter of 2019. An applicant business must meet the comparison receipt test for only one calendar quarter. Accordingly, a business with gross receipts of \$1M in the second quarter of 2019 and gross receipts of \$750,000 in the second quarter of 2020 would qualify regardless of the gross receipts’ comparison for any other calendar quarter.

Applicants submitting after January 1, 2021, may use fourth quarter gross receipts. Non-profit entities, churches, and religious organizations are eligible businesses and may apply. Similar to the original PPP program, entities reporting under NAICS Code 72 (generally hotels/restaurants) are subject to special qualification rules.

Entities applying under NAICS Code 72 with more than 300 employees are eligible so long as they employ 300 or fewer individuals at each location. Additionally, the SBA affiliation rules for NAICS Code 72 businesses are excluded. The CAA also contains special qualification provisions for news organizations, farmers, and ranchers.

2. Loan Terms and Amounts

Similar to the original PPP program, a borrower may elect an 8 week or 24 week loan term, which is referred to as its covered period. The CAA provides further flexibility to borrowers by allowing them to select the end of their covered period, which will begin on loan origination and end on a date unilaterally selected by the borrower that is more than 8 weeks after loan origination, but less than 24 weeks after loan origination. The maximum amount that a PPP borrower may obtain is the lesser of: (a) its average monthly payroll cost during calendar year 2019 or the 12 months immediately preceding loan origination multiplied by 2.5; or (b) \$2M. The CAA contains special rules allowing new eligible businesses, i.e., those not in existence on February 15, 2020, to qualify for loans. Similar to the original PPP legislation, there are special rules for calculating payroll costs for seasonal employees, and a NAICS Code 72 eligible business is eligible to receive a loan amount equal to the lesser of: (a) its average monthly payroll cost during calendar year 2019 or the 12 months immediately preceding loan origination multiplied by 3.5; or (b) \$2M.

3. Permitted Uses and Forgiveness

PPP borrowers must use loan proceeds on so-called covered expenses to obtain forgiveness. These covered expenses include all of the permitted expenses set forth in the original PPP program, which included: (a) payroll costs; (b) interest on real property mortgage obligations, excluding prepayments; (c) interest on personal property security obligations, excluding prepayments; (d) rent; and (e) utilities. The CAA expands the list of covered expenses that qualify for forgiveness to also include: (w) covered operations expenditures; (x) covered property damage costs; (y) covered supplier costs; and (z) covered worker protection expenditures. A covered operations expenditure is any payment for business software or cloud computing that facilitates business operations in any manner, including, among other things, internal HR procedures, payroll processing, or accounting. A covered property damage cost is any damage related to vandalism or looting as a result of public disturbances that were not covered by insurance. A covered supplier cost means any cost for the supply of goods that are essential to the operations of the entity incurred by contract or purchase order prior to the loan period. Purchase of perishable goods during a borrower's loan term will qualify as a covered supplier cost. A covered worker protection expenditure means any operating or capital expenditure incurred by an eligible business to comply or adapt to guidance issued by HHS, CDC, OSHA, or any state or local government since March 1, 2020. Covered worker protection expenditures would include redesigning a business to increase social distancing, constructing barriers to ensure social distancing, PPE equipment, and air filtration systems.

The CAA requires PPP borrowers to spend at least 60% of the loan proceeds on payroll costs to achieve full forgiveness regardless of how much they spend on other covered expenses. Borrowers spending less than 60% on payroll costs will have a portion of their loan not forgiven. Unforgiven loan amounts will bear interest at 1% and have a 5 year maturity date. Borrowers will also be subject to the employee reduction forgiveness and salary reduction tests set forth in the original PPP program. California has not conformed to federal treatment of expenditures related to loan forgiveness. Please contact our State and Local tax professionals to discuss other state treatment of the expenditures related to PPP loan forgiveness.

C. Revisions to Original PPP Program

To obtain maximum forgiveness under the original PPP program, borrowers were required to spend loan proceeds on: (a) payroll costs; (b) interest on real property mortgage obligations, excluding prepayments; (c) interest on personal property security obligations, excluding prepayments; (d) rent; and (e) utilities. The CAA revises the original PPP program to allow borrowers to spend loan proceeds on (w) covered operations expenditures; (x) covered property damage cost; (y) covered supplier cost, and (z) covered worker protection expenditure. Borrowers who used loan proceeds outside of the original text of the PPP program can now have such amounts forgiven so long as the loan proceeds were spent on the expanded uses set forth above. The CAA allows borrowers under the original PPP program to unilaterally select the end of their covered period, which will begin on loan origination and end on a date unilaterally selected by the borrower that is more than 8 weeks after loan origination, but less than 24 weeks after loan origination. The CAA eliminates the requirement that PPP borrowers reduce their PPP loans by any Economic Injury Disaster Loan advance received.

The CAA will provide relief to many businesses, families, and individuals. Please contact your HCVT professional to answer any questions you may have about CAA.