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MAY 2020

INCOME TAX CHANGES – CARES ACT

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law on March 27, 2020. By now, the economic provisions of the CARES Act, with a cost of $2.2. trillion, have been well reported by the news media. Some of the major tax provisions of the CARES Act are discussed below.

Rebates for Individuals. The CARES Act provided for automatic checks to individual taxpayers in the amount of $1,200 ($2,400 for joint filing taxpayers) with an additional amount of $500 for each child. The rebates are not available to high income taxpayers and phase out for adjusted gross incomes above $75,000 for singles, $112,500 for heads of household, and $150,000 for joint return taxpayers. The rebates are not taxable income.

Suspension of Required Minimum Distributions from Retirement Plans. Generally, a required minimum distribution (RMD) must be taken each year from tax-deferred retirement accounts by owners over 72 years of age. The CARES Act suspends the RMD for 2020 and applies to qualified plans (401(k), 403(b), etc.) and individual retirement accounts (IRAs). Taxpayers who had already taken a 2020 distribution but were still within 60 days of the date of distribution may be able to return the distribution as a rollover to an IRA within 60 days of receipt. If the RMD was paid between February 1, 2020 and May 15, 2020, the IRS issued guidance on April 9, 2020 stating that the funds could be returned without adverse consequences if returned by July 15, 2020.

The suspension also applies to beneficiaries of inherited accounts who have not taken their RMD for 2020.

Cash Charitable Contribution Limitation Changes. The CARES Act temporarily changes the cash charitable contribution limitation for individuals from a maximum of 60 percent to 100 percent of adjusted gross income (AGI). Amounts in excess of the 100 percent of AGI limitation can be carried forward for deduction in the following five tax years. For corporations, the CARES Act changes the cash charitable contribution deduction limitation from 10 percent to 25 percent of taxable income (corporations are allowed a five-year carryforward for cash contributions in excess of the 25 percent limitation).

Charitable Contribution Deduction without Itemized Deductions. Individuals who do not itemize their deductions may take a limited deduction for a charitable contribution, not as an itemized deduction but for computing their adjusted gross income. The deduction is limited to $300. The taxpayer is still allowed the full amount of the applicable standard deduction for 2020 of $12,400 for a single taxpayer, $24,800 for those married and filing jointly, or $18,650 for a head of household.

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Limitation on Deduction of Business Losses for Non-Corporate Taxpayers. Prior to the CARES Act, non-corporate taxpayers (individuals, trusts, estates) were limited in their ability to deduct net business losses against nonbusiness income. Generally, net business losses deductible for a non-corporate taxpayer from all trades or businesses were limited to $250,000 per year ($500,000 for a married couple filing jointly), but losses above the limit could be carried forward and deducted in future years as part of a net operating loss deduction. This prior law limitation was effective for the years 2018 through 2026. The CARES Act retroactively delays the application of this limitation until 2021. In other words, non-corporate taxpayers are not subject to the loss limitation for 2018, 2019, and 2020. Taxpayers with losses that were not allowable on returns previously filed may now file for refunds.

Changes of Limitation on Business Interest. The Tax Cuts and Jobs Act of 2017 generally limited the amount of business interest allowed as a deduction to 30 percent of adjusted taxable income. The CARES Act increases the limitation on deductibility of interest expense retroactively and temporarily from 30 percent to 50 percent for tax years beginning in 2019 and 2020. A taxpayer may, for 2020, also elect to apply the limitation based on the taxpayer's taxable income for 2019 instead of taxable income for 2020 (which might be greatly reduced as a result of the disruption of Covid-19). The deduction of additional interest expense allowed by the increase in the limitation caps may generate or increase a net operating loss, which is subject to fewer limitations as discussed below.

Changes in Net Operating Loss Carryovers. Prior to the CARES Act, the amount of a net operating loss deduction was limited to the lesser of the aggregate of the net operating loss carryovers to a year and the net operating loss carrybacks to such year or 80 percent of the taxable income for the year computed without regard to the net operating loss deduction. The Act temporarily removes the taxable income limitation and allows a net operating loss to fully offset taxable incomes for 2018, 2019, and 2020. For 2021, the CARES Act change will end and taxpayers will again be precluded from carrying back net operating losses, and the deduction of post-2017 net operating losses will again be limited to 80 percent of taxable income. In summary, the CARES Act makes the old net operating loss rules, which were more favorable, applicable to 2018, 2019, and 2020 and returns to the new "80 percent of taxable income" rules for 2021. The CARES Act generally allows taxpayers to carry back net operating losses generated in 2018, 2019, and 2020 for up to five years. The potential impact is significant because taxpayers can carry back losses to years before 2018 when the maximum corporate rate was 35 percent rather than carrying forward these losses to years where the maximum rate is 21 percent.

Deferment of Payment of Employer Payroll Taxes. The CARES Act allows employers to defer paying the employer portion of Social Security taxes (6.2 percent) after March 26, 2020 through the end of 2020. In other words, the employer can defer paying the employer's portion, 6.2 percent of subject wages, for the period March 27, 2020 through December 31, 2020. One-half of the deferred amount must be paid by December 31, 2021 and one-half by December 31, 2022. Self-employed individuals may also defer 50 percent of their Social Security taxes (6.2 percent), which must be paid by December 31, 2021 and December 31, 2022. The deferral of the Social Security taxes is not available to a taxpayer after any indebtedness is forgiven under the Small Business Administration Paycheck Protection Program.

Immediate Expensing of Qualified Improvement Property. For years beginning after 2017, the Tax Cuts and Jobs Act expanded the bonus depreciation deduction from 50 percent to 100 percent of the cost of qualifying property, allowing the full cost of the property to be deducted in the year in which the property was placed in service. The rules required that property generally must have a 20-year or less

(Continued on page 3)

depreciation recovery period to qualify for this bonus depreciation. Congress intended to provide a general 15-year recovery period for "qualified improvement property." However, the text of the Tax Cuts and Jobs Act failed to properly include the 15-year recovery period. The CARES Act corrects this technical error by specifically designating qualified improvement property as 15-year property for depreciation purposes and making it eligible for bonus depreciation. This correction is effective for property placed in service beginning in 2018. Taxpayers who were unable to immediately expense qualified improvement property on 2018 and 2019 returns because of this technical error are now eligible to file for refunds.

CONGRESS EXEMPTS – IRS TAXES

The CARES Act, by Section 1106(i), specifically excludes from gross income the amount of the forgiveness of indebtedness under the Paycheck Protection Program (PPP). Ordinarily, forgiveness of debt is, under tax law, included in gross income. If the PPP loan forgiveness was not to be a tax-free benefit, there would have been no reason for Congress to include Section 1106(i) in the CARES Act as the forgiveness of indebtedness would have been, by the existing law, included in gross income. Accordingly, tax practitioners were stunned when on April 30, 2020 the Internal Revenue Service (IRS) released guidance (Notice 2020-32) that attempts to nullify a major benefit of the Paycheck Protection Program. The IRS notice disallows the income tax deductions for all expenses relating to the loan forgiveness. For example, assuming $100,000 of expense related to loan forgiveness (for example, payroll) by a 30 percent taxpayer, this IRS decision results in a $30,000 increase in income taxes and a decrease in the CARES Act benefits to the small business not intended by Congress.

A bipartisan group of congressional leaders (including Senator Charles Grassley (R-Iowa), Chairman of the Senate Finance Committee; Senator Ron Wyden (D-Oregon), the ranking Democrat on the Senate Finance Committee; and Representative Richard Neal (D-Maryland), Chairman of the House Ways and Means Committee) have stated that the IRS in Notice 2020-32 has taken a position contrary to congressional intent. These leaders wrote in a May 5th letter to Treasury Secretary Mnuchin, "*We believe the position taken in the Notice ignores the overarching intent of the PPP, as well as the specific intent of Congress to allow deductions in the case of PPP loan recipients. Had we intended to provide neutral tax treatment for loan forgiveness, Section 1106(i) would not have been necessary.*"

On May 6, Senator Grassley along with several other Senate leaders introduced the Small Business Expense Protection Act to clarify that expenses paid with proceeds from forgiven PPP loans remain tax-deductible. Representative Lizzie Fletcher (D-Texas) announced that she plans to introduce similar legislation in the House of Representatives. Whether by additional law or by cancellation of Notice 2020-32, restoring with certainty the tax-free status of PPP loan forgiveness will be very significant to small businesses.

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Tax & Business Alert

MAY 2020

ROLLING OVER CAPITAL GAINS INTO A QUALIFIED OPPORTUNITY FUND

If you're selling a business interest, real estate or other highly appreciated property, you could get hit with a substantial capital gains tax bill. One way to soften the blow — if you're willing to tie up the funds long term — is to "roll over" the gain into a qualified opportunity fund (QOF).

WHAT IS A QOF?

A QOF is an investment fund, organized as a corporation or partnership, designed to invest in one or more Qualified Opportunity Zones (QOZs). A QOZ is a distressed area that meets certain low-income criteria, as designated by the U.S. Treasury Department.

Currently, there are more than 9,000 QOZs in the United States and its territories. QOFs can be structured as multi-investor funds or as single-investor funds established by an individual or business. To qualify for tax benefits, at least 90% of a QOF's funds must be "QOZ property," which includes:

QOZ business property. This is tangible property that's used by a trade or business within a QOZ and that meets certain other requirements.

QOZ stock or partnership interests. These are equity interests in corporations or partnerships, with substantially all their assets in QOZ property.

Note: Final regulations define "substantially all" to mean at least 70%.

WHAT ARE THE BENEFITS?

If you recognize capital gain by selling or exchanging property, and reinvest an amount up to the amount of gain in a QOF within 180 days, you'll enjoy several tax benefits.

Taxes will be deferred on the reinvested gain until the earlier of December 31, 2026, or the date you dispose of your QOF investment. There will be a permanent reduction of the taxability of your gain by 10% if you hold the QOF investment for at least five years, and an additional 5% if you hold it for at least seven years. If you hold it for at least 10 years, you'll incur tax-free capital gains attributable to appreciation of the QOF investment itself.

The only way to obtain these benefits is to first sell or exchange a capital asset in a transaction that results in

IRS ADDRESSES QOFS IN 2020 GUIDANCE

In February 2020, the IRS issued guidance on reporting gains from qualified opportunity funds (QOFs). It gives instructions on how to report the deferral of eligible gains from Section 1231 property and the inclusion of those gains when the QOF investment is sold or exchanged.

Taxpayers who defer eligible gains from such property, including gains from installment sales and like-kind exchanges, by investing in a QOF must report the deferral election on Form 8949, "Sales and Other Dispositions of Capital Assets," in the deferral tax year. And taxpayers selling or exchanging a QOF investment must report the inclusion of the eligible gain on the form.

gain recognition. You then would reinvest some or all of the gain in a QOF. You can't simply invest cash.

You or your heirs will eventually be liable for taxes on some or all of the original gain. Consider ways to avoid those taxes, such as holding the original property for life or doing a tax-free exchange.

WHO CAN HELP?

The rules surrounding these QOFs are complex. We can help you further explore the idea. ■

HEED THE LESSONS OF YOUR TAX RETURN AND CHECK YOUR WITHHOLDING

Every year's tax return provides valuable lessons on the optimal amount that taxpayers should have withheld from their paychecks. Heeding these lessons is especially important if you end up owing a substantial amount of money.

Of course, even if you got a nice tax refund, that shouldn't necessarily be your goal. It essentially means you're giving the government an interest-free loan. Here's a primer on why and how to review your withholding and change it, if necessary.

THE TCJA'S IMPACT

Following the passage of the Tax Cuts and Jobs Act (TCJA), the IRS updated the withholding tables that indicate how much employers should hold back from their employees' paychecks. In general, the amount withheld was reduced. This was done to reflect changes under the TCJA — including the increase in the standard deduction, suspension of personal exemptions and changes in tax rates.

The new tables provided a reasonable amount of tax withholding for some individuals, but they caused other taxpayers to not have enough money withheld to pay their ultimate tax liabilities. Although many people have since adjusted to the TCJA's impact, the IRS urges taxpayers to review their tax situations annually and adjust their withholding as appropriate.

The agency provides a withholding calculator to assist you. The calculator reflects tax law changes in areas such as available itemized deductions, the increased child credit, the dependent credit and the repeal of dependent exemptions. You can access the IRS calculator at https://bit.ly/2aLxK0A.

CIRCUMSTANCES THAT TRIGGER CHANGE

There are a variety of specific circumstances that should trigger you to check your withholding. For example, if you adjusted your withholding in

2019 — especially in the middle or later part of the year — give it another look. Also, as mentioned, if you got hit by a bigger tax bill than you expected, or received a sizable refund, you may want to make an adjustment.

Certain life changes typically warrant adjusting withholding as well. These include getting married or divorced, having a child or adopting one, buying a home, or incurring notable changes in income.

You can modify your withholding at any time during the year, or even multiple times within a year. To do so, simply submit a new Form W-4 to your employer. Changes typically go into effect several weeks after a new Form W-4 is submitted. (For estimated tax payments, you can make adjustments each time quarterly estimated payments are due. The next payment is due on Monday, June 15.)

WE CAN HELP

Contact us to discuss your situation and what you can do to remedy any shortfalls to minimize taxes due, as well as any penalties and interest. We can help you sort out whether to adjust your withholding. ■

BENEFIT WITH A TWIST: THE ROTH 401(K)

Most everyone has heard of a 401(k) plan, and a sizable number of adults likely have at least a passing familiarity with the Roth IRA. What remains less well known among job candidates and employees is the Roth 401(k) plan. This retirement benefit with a twist might be worth offering to your staff, so long as you and they understand how it works.

HYBRID PLAN

As the name implies, Roth 401(k)s are hybrid plans that take some characteristics from employer-sponsored 401(k)s and others from Roth IRAs. Any employer with an existing 401(k), 403(b) or governmental 457(b) plan can offer designated Roth 401(k) accounts.

From there, eligible employees can elect to defer part of their salaries to Roth 401(k)s, subject to annual limits. The employer may choose to provide matching contributions. For 2020, a participating employee can contribute up to $19,500 ($26,000 if he or she is age 50 or older) to a Roth 401(k). The most you can contribute to a Roth IRA for 2020 is $6,000 ($7,000 for those age 50 or older).

Note: The ability to contribute to a Roth IRA is phased out for upper-income taxpayers, but there's no such restriction for a Roth 401(k).

PROS AND CONS

Unlike with traditional 401(k)s, contributions to employees' accounts are made with after-tax dollars, instead of pretax dollars. Therefore, employees forfeit a key 401(k) tax benefit. On the plus side, after an initial period of five years, "qualified distributions" are 100% exempt from federal income tax, just like qualified distributions from a Roth IRA. In contrast, regular 401(k) distributions are taxed at ordinary-income rates, which are currently up to 37%.

Generally, qualified distributions are those made after a participant reaches age 59½ or because of a death or disability. Therefore, you can take qualified Roth 401(k) distributions in retirement after age 59½ and pay no tax, as opposed to the hefty tax bill that may be due from traditional 401(k) payouts. Roth 401(k)s follow the same required minimum distribution rules as traditional 401(k)s, but employees can avoid mandated withdrawals by converting a Roth 401(k) to a Roth IRA.

NOT FOR EVERYONE

A Roth 401(k) is more beneficial than a traditional 401(k) for some participants, but not all. For example, it may be valuable for employees who expect to be in higher federal and state tax brackets in retirement than in their working years. Contact us if you have questions about adding a Roth 401(k) to your benefits lineup. ■

A LARGE UNPAID TAX BILL COULD PUT YOUR PASSPORT AT RISK

Most Americans aren't using their passports right now. But it's still important to remember that, if the IRS certifies that you have a seriously delinquent tax debt (SDTD), your passport application could be denied, or your current passport could be limited or revoked.

You have an SDTD if 1) you owe more than $53,000 (as indexed for inflation) in back taxes, penalties and interest, 2) the IRS has filed a Notice of Federal Tax Lien, *and* 3) the period to challenge the lien has expired or the IRS has issued a levy.

Should you find yourself in this situation, there are several steps to take to avoid losing your passport. First, obviously, you can pay your tax debt in full immediately. If that's not possible, you may be able to pay your debt on a timely basis according to an approved installment agreement, accepted offer in compromise or settlement agreement with the Justice Department.

Requesting a collection due process hearing regarding a levy, or having collection suspended through a request for innocent spouse relief, may also enable you to retain your passport. More important, the IRS won't likely notify the U.S. State Department of an SDTD during a federally declared disaster, such as the one we've experienced this year, or in the case of bankruptcy, identity theft or other hardships. Contact us for more info. ■