Tax Impact

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The CARES Act offers tax relief for businesses

When it was signed into law in late March, the Coronavirus Aid, Relief and Economic Security (CARES) Act was the largest stimulus package in U.S. history. The law contains numerous provisions designed to help mitigate the economic impact of the novel coronavirus (COVID-19) pandemic, including welcome tax relief for businesses that is potentially relevant for all of 2020 and, in some cases, for past or future years, too.

A win on losses

The CARES Act temporarily eases restrictions on net operating loss (NOL) carrybacks, allowing eligible businesses to claim an immediate refund of taxes paid in previous years. At one time, businesses could carry back NOLs up to two years and forward up to 20 years to offset taxable income in those years. But the Tax Cuts and Jobs Act (TCJA) eliminated NOL carrybacks and permitted NOLs to be carried forward indefinitely. It also limited NOL deductions to 80% of taxable income in a given year.

The CARES Act allows businesses with NOLs arising in 2018, 2019 or 2020 to carry back those losses up to five years. It also temporarily removes the 80% cap on deductions, enabling businesses with sufficient losses to fully offset taxable income in a carryback year. The cap generally will be reinstated for tax years beginning in 2021.

The ability to carry back NOLs is particularly valuable in light of the TCJA's reduction of corporate and individual income tax rates. Under the CARES Act, it's possible to use an NOL from a year with a lower tax rate to offset taxable income from a previous year that was taxed at a higher rate.

For example, a C corporation that incurs a $1 million NOL in 2020 could use the loss to offset up to $1 million in taxable income in 2015 that was originally taxed at a 35% rate, even though the same income would have been subject to only a 21% rate beginning in 2018.

A rise in interest deductions

The CARES Act relaxes limits on business interest deductions, enabling many businesses to reduce their tax bills. The TCJA imposed a cap on deductions of business interest (for example, interest on business-related loans, lines of credit or mortgages) generally equal to 30% of a taxpayer's adjusted taxable income (ATI). Small businesses — generally, those with average annual gross receipts of $25 million or less for the preceding three years — are exempt from the limit.

Under the CARES Act, businesses subject to the limit may deduct interest up to 50% of ATI for the 2019 and 2020 tax years (subject to special partnership rules for 2019). In addition, businesses may elect to use their 2019 ATI to calculate the 2020 limit, which will increase interest deductions for many businesses whose income declines this year.

Are you eligible for payroll tax relief?

The Coronavirus Aid, Relief and Economic Security (CARES) Act provides tax benefits to employers that retain their employees during the COVID-19 crisis. If you haven't already taken advantage of this relief, be sure to check whether you're eligible:

Payroll tax deferral. You can defer the employer's share of the 6.2% Social Security tax on wages paid from March 27, 2020, through the end of this year. The tax is then due in two installments: 50% on December 31, 2021, and 50% on December 31, 2022. Similar benefits are available to partners and sole proprietors for the "employer's half" of self-employment tax.

Employee retention credit. You can claim a refundable payroll tax credit equal to 50% of up to $10,000 in compensation (including health care benefits) paid to eligible employees from March 13, 2020, through the end of 2020. To qualify, your business must have experienced either 1) full or partial suspension of operations due to a COVID-19-related shutdown order, or 2) a decline in gross receipts by more than 50% compared to the same quarter in the previous year.

If you have more than 100 employees, the credit is available only for compensation paid to employees who aren't working or have had their hours reduced for one of the reasons listed above. If you have 100 or fewer employees, the credit is available even for compensation paid to employees who continue to work.

Additional rules and limits apply, so check with your tax advisor for more details.

A retroactive fix for qualified improvement property

Before the TCJA took effect, certain interior improvements to retail, restaurant and leased buildings generally were depreciable over 15 years and entitled to 50% bonus depreciation in Year 1. The TCJA consolidated these properties into a single, comprehensive category of qualified improvement property (QIP).

Congress's intent was for QIP, which encompasses most improvements to nonresidential buildings after they were first placed in service, to be depreciable over 15 years and to be eligible for 100% bonus depreciation. However, because of a drafting error, QIP was classified as 39-year property *ineligible* for bonus depreciation.

The CARES Act corrects this error by reducing the cost recovery period for QIP from 39 to 15 years, making it eligible for bonus depreciation. The law also clarifies that, to be eligible for these tax advantages, the improvements must have been made by the taxpayer. These changes are retroactive to the beginning of 2018, as if they'd been part of the TCJA when it was enacted.

Eligible businesses that have made qualified improvements since that time may now file amended returns or applications for a change in accounting method to capture the bonus depreciation or other depreciation deductions they missed.

Stay tuned

Don't be surprised if Congress passes additional tax legislation to help businesses affected by COVID-19. Some may even have been passed by the time you're reading this article. Your tax advisor can help you make the most of the tax relief available to your business. ■

A silver lining

Current conditions are favorable for cost-effective wealth transfers

The ongoing novel coronavirus (COVID-19) pandemic has taken a terrible toll on the economy. But the current low-interest-rate environment coupled with depressed asset values means that now may be a good time to transfer wealth to your children and grandchildren.

Consider making gifts

For 2020, the federal gift and estate tax exemption is an inflation-adjusted $11.58 million ($23.16 million for married couples), the highest it's ever been. The exemption is scheduled to drop to its pre-2018 level of $5 million (indexed for inflation) on January 1, 2026.

This window of opportunity could close sooner, however, depending on the results of this fall's election. So if you have a large estate, it's a good time to consider making substantial tax-exempt gifts to your loved ones as a hedge against future reductions to the exemption amount.

Gifting is a particularly good strategy during an economic downturn, because the values of many assets are temporarily depressed.

Gifting is a particularly good strategy during an economic downturn, because the values of many assets, such as stocks and real estate, are temporarily depressed. In addition, low interest rates make certain estate planning techniques, such as grantor retained annuity trusts (GRATs), even more powerful.

Why GRATs are great now

A GRAT is an irrevocable trust that pays you an annuity during the trust term and then distributes any remaining assets to your children or other beneficiaries. Your contributions to the trust are treated as taxable gifts to your beneficiaries, but the value of the gift is limited to the present value of the remainder interest.

To calculate the gift tax value, the present value of the annuity payments is subtracted from the value of the assets you contribute to the GRAT. Present value is based on a conservative, assumed rate of return commonly known as the Section 7520 rate. At the time of this writing, that rate, which is published monthly by the IRS, was under 1%.

If you set the annuity payments high enough or the trust term long enough, you can minimize the value of the gift for gift tax purposes or even reduce it to zero. And so long as the trust assets outperform the Sec. 7520 rate (and you survive the trust term), your beneficiaries will receive a substantial amount of wealth at the end of the term, free of gift and estate taxes.

GRATs are an attractive option when interest rates are low because it's easier to outperform the Sec. 7520 rate, maximizing the amount of wealth you can transfer tax free. And if you fund a GRAT with assets whose values are depressed and are expected to appreciate significantly in the future, the benefits a GRAT provides are that much greater.

Prioritize what's important

During times like these, your family's health is your first priority. But it's also important to take into account their future financial security. That means taking advantage of current low interest rates and depressed asset values to cost effectively transfer wealth. Contact your estate planning advisor for additional details on the best strategies to transfer wealth to your heirs during this difficult time. ■

How does the CARES Act affect your retirement accounts?

As individuals continue to deal with the impact of the novel coronavirus (COVID-19) pandemic, the Coronavirus Aid, Relief and Economic Security (CARES) Act contains some retirement-related provisions to help ease the financial pain.

RMDs waived in 2020

If you're in the fortunate financial position that you don't need to access retirement account funds this year, you might benefit from the CARES Act's required minimum distribution (RMD) relief: If you were scheduled to take an RMD this year, the CARES Act allows you to skip it.

People with traditional IRAs or 401(k) plan accounts generally must begin taking annual RMDs by April 1 of the year following the year in which they reach age 70½ (age 72 for those who didn't turn 70½ before January 1, 2020). RMDs are also generally required for inherited retirement accounts regardless of the heir's age (unless the heir is the original owner's spouse).

Skipping a 2020 RMD can be advantageous because the funds can continue growing on a tax-advantaged basis. Plus, if the values of investments in your account have declined, taking a distribution means selling shares at depressed prices — not an ideal strategy.

In addition, your RMD for 2020 is calculated based on the account's value as of December 31, 2019. If that value has declined, the RMD will represent a larger percentage of the account's total value than you originally anticipated. Skipping your 2020 RMD can be a great strategy for preserving the account's value to the extent possible.

Tax relief for withdrawals

If the COVID-19 pandemic has left you in need of cash to pay expenses, the CARES Act also provides relief. It allows you to withdraw up to $100,000 on or after January 1, 2020, and before December 31, 2020, from IRAs, 401(k) plans or certain other retirement plans (if the plan allows it) on a tax-advantaged basis, even if you're under age 59½.

The law waives the 10% penalty for early withdrawals and allows you to avoid tax altogether by recontributing the withdrawn amount within three years (without regard to annual contribution

limits in those years). To the extent this amount is not repaid within that time period, it's taxable, but the tax may be prorated over three years.

Skipping a 2020 RMD can be advantageous because the funds can continue growing on a tax-advantaged basis.

To qualify for this tax treatment, you must meet one of the following conditions:

1. You were diagnosed with COVID-19,
2. Your spouse or a dependent was diagnosed with COVID-19, or
3. You experienced adverse financial consequences as a result of the pandemic because you were quarantined, furloughed, laid off, had your work hours reduced, were unable to work due to lack of child care, or were forced to close or reduce the hours of a business you own.

Check with your tax advisor on whether any IRS guidance on these conditions has been released that might affect your eligibility.

Increased limit on retirement plan loans

The CARES Act increases the amount you're permitted to borrow from certain qualified retirement plans from the lesser of $50,000 or 50% of your vested account balance to the lesser of $100,000 or 100% of your vested account balance. The higher limit is available for loans taken within 180 days after the March 27, 2020, enactment date.

In addition, if you had any plan loans outstanding on that date, you may delay any repayments otherwise due in 2020 for one year.

Keep in mind that retirement plans aren't required to allow loans. So check with your employer on whether your plan permits them.

Strike a balance

In challenging economic times, it's important to strike a balance between meeting immediate financial needs and preserving assets for retirement. The CARES Act provisions discussed above make it easier to achieve this objective. ■

Feeling charitable? Now's the time to give

In an economic downturn, charitable donations typically decline. So, if you're in a position to donate, charitable organizations need your help now more than ever. Fortunately, the Coronavirus Aid, Relief and Economic Security (CARES) Act offers some tax incentives to support your favorite charity.

For cash gifts made to public charities in 2020, the law increases the deduction limit from 60% of adjusted gross income (AGI) to 100% of AGI. If you're considering donating appreciated stock or other assets, generally a good strategy, this year it may be preferable to sell the assets and donate the cash.

The act also creates a new "above-the-line" deduction for cash donations up to $300 by nonitemizers. ■

Tax break for employer student loan repayments

The Coronavirus Aid, Relief and Economic Security (CARES) Act allows employees to exclude from income up to $5,250 in student loan repayments made by their employers between March 27 and December 31, 2020. It appears that there's no need to show a connection between the loan repayment and the novel coronavirus (COVID-19) pandemic.

The law also permits most borrowers to suspend monthly loan payments through September 30, 2020, without penalty. ■

Employers: Should you reimburse employees' remote work expenses?

One byproduct of the novel coronavirus (COVID-19) pandemic is that more employees are working remotely than ever before. As a result, these employees may incur a variety of expenses for such items as:

- Phone and internet services,
- Computers, monitors, tablets, printers, teleconferencing equipment, fax machines, software and other technology,
- Desks, chairs and other office furniture,
- Paper and other office supplies, and
- Electricity and other utilities.

Generally, employees cannot deduct these expenses. But their employers may be able to deduct them as business expenses if they reimburse employees. And, if reimbursement is made according to an "accountable plan," employees need not include these amounts in their income. Be aware that under some states' laws, employers may be *required* to reimburse these expenses. ■