TAX IMPACT

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Businesses provided a lifeline

CAA enhances PPP loans and extends Employee Retention Credit

The Consolidated Appropriations Act (CAA), passed late last year, provides much needed stimulus and tax relief for businesses hard hit by the COVID-19 pandemic. Two of the provisions that business owners likely are most interested in are the $284 billion in funding for forgivable loans through the Paycheck Protection Program (PPP), for both first-time and so called "second-draw" borrowers, and the extension of the Employee Retention Credit.

Deduction for PPP expenses

The CARES Act created the Paycheck Protection Program (PPP), which made forgivable loans available to eligible small businesses that suffered losses as a result of the pandemic. The CAA expands the allowable uses for PPP funds, provides a simplified forgiveness process for smaller loans, and clarifies the proper tax treatment of loan proceeds and forgiven amounts. Businesses can make new loans through March 31, 2021, or until the funding is exhausted.

The CAA confirms that PPP loan recipients will enjoy two tax benefits: 1) tax-free loan forgiveness, and 2) tax deductions for expenses funded by those loans.

The law clarifies that the forgiven portion of a PPP loan won't be included in a borrower's gross income for tax purposes. The CARES Act didn't address whether expenses paid with the proceeds of forgiven loans would be tax deductible. But the IRS, in Notice 2020-32, announced that such deductions would be disallowed.

However, the CAA overrules Notice 2020-32 retroactively. It confirms that PPP loan recipients will enjoy two tax benefits: 1) tax-free loan forgiveness, and 2) tax deductions for expenses funded by those loans.

Employee Retention Credit extended

The CARES Act established an employee retention tax credit to encourage businesses to keep employees on their payrolls despite the financial impact of the pandemic. The CAA extends the credit through the middle of 2021 and enhances many of its benefits.

Under the CARES Act, the fully refundable payroll tax credit was equal to 50% of up to $10,000 per employee in qualified wages paid after March 12, 2020, and before January 1, 2021. The credit was available for wages paid while a business's operations were fully or partially suspended by a COVID-19 governmental order or during a period that the business suffered a significant decline in gross receipts. Generally, a "significant decline" meant that gross receipts in a 2020 calendar quarter were less than 50% of gross receipts in the same calendar quarter in 2019. The significant decline was deemed to continue until gross receipts in a quarter reached 80% of gross receipts in the same quarter in 2019.

Although the credit was available to businesses of all sizes, those with 100 or fewer employees had an advantage: They could claim the credit for wages paid to all eligible employees, regardless of whether they continued working. Businesses with more than 100 employees could claim the credit only for wages paid to employees who were not working. The credit wasn't available to businesses that received PPP loans.

The CAA extends the credit to include qualified wages paid before July 1, 2021. It also provides several enhancements for the first two quarters of 2021:

- The credit increases from 50% to 70% of up to $10,000 in wages per quarter (previously, per year). In other words, the maximum credit in the first half of 2021 is $7,000 per quarter (compared to $5,000 per year) for each eligible employee.
- The threshold for a "significant decline" in gross receipts decreases from 50% to 20%.
- The number-of-employees threshold increases from 100 to 500. Thus, businesses with 500 or fewer employees may claim the credit for wages paid to all eligible employees, regardless of whether they continue working.

The CAA also makes several changes to the credit that applies retroactively to March 13, 2020. For example, PPP loan recipients may now claim the credit for qualified wages paid after March 12, 2020, so long as the credit isn't claimed for wages paid with the proceeds of a forgiven loan. In other words, a business may claim the credit if it pays qualified wages in excess of forgiven PPP loan proceeds used for payroll.

Review your situation

All businesses should review their tax situations carefully to be sure they're receiving all the tax benefits they deserve. Businesses that wish to apply for PPP loan forgiveness, the Employee Retention Credit, or both, should also ensure that they have the necessary records to document wages and other expenses and the source of funds used to pay them. ■

Other business tax benefits

The Consolidated Appropriations Act's (CAA's) significant changes involve PPP loans and the Employee Retention Credit, but it also makes several other important changes that benefit businesses. For example, the act:

- Allows businesses to deduct the full cost of otherwise deductible restaurant business meals in 2021 and 2022. Previously, business meals were only 50% deductible.
- Makes the Section 179D "Commercial Buildings Energy-Efficiency Tax Deduction" permanent.
- Extends the time for repaying employee payroll taxes for the period September 1, 2020, through December 31, 2020, that were deferred according to the president's executive order. Previously, to avoid penalties and interest, these taxes had to be repaid by April 30, 2021. The CAA extends the repayment period through December 31, 2021, allowing businesses to withhold and remit those taxes ratably over the course of the year.
- Extends the Work Opportunity Tax Credit and empowerment zone credits through 2025.

Congress declined to extend mandatory paid sick and family leave under the Families First Coronavirus Response Act, which expired December 31, 2020. But the CAA makes tax credits available to businesses with fewer than 500 employees if they voluntarily offer paid leave according to the FFCRA framework through March 31, 2021.

A second marriage requires an estate plan review

Many people view a second marriage as a fresh start and a new chance at happiness. If you're planning to take another walk down the aisle, it's critical to take the time to review and, if necessary, revise your estate plan.

Will your current plan become outdated?

Most likely the answer is yes if you had drafted your plan while still in your first marriage. Given your current circumstances, you'll probably want to consider whether you've adequately provided for your new spouse and not inadvertently benefited your former spouse. And if you have children, juggling their interests with those of your current and, if appropriate, former spouse can be a challenge.

Thus, it's critical to review your will, trusts, health care directives, powers of attorney and other estate planning documents to ensure that your wishes are carried out.

Should you consider a prenuptial agreement?

If you have children from your previous marriage, you may wish to leave the bulk of your estate to them, particularly if your new spouse is financially independent. The laws in most states, however, make it difficult to "disinherit" your spouse.

For example, many states provide a surviving spouse with an "elective share" — typically between one-third and one-half — of the other spouse's estate, regardless of the terms of his or her will or living trust.

You can use a prenuptial agreement to waive your respective rights to each other's property. These agreements can also be used to serve a variety of other purposes, including retaining control of a business and defining premarital assets and debt.

Are your beneficiary designations up to date?

Determine whether your former spouse is still named as beneficiary of any life insurance policies,

annuities or retirement plans and, if appropriate, update the beneficiary designations. Also, keep in mind that, if you've named any minor children from your previous marriage as beneficiaries, and you unexpectedly die, your former spouse will likely become their legal guardian and gain control over their property. If this scenario is unacceptable, consider designating a trust as beneficiary for your child's benefit.

Have you established any irrevocable trusts that name your former spouse as a beneficiary? If so, do the trusts provide that his or her rights terminate automatically in the event of divorce?

Also, find out whether your divorce decree grants your former spouse any rights with respect to life insurance, retirement plans or other assets. If the answer is yes, your ability to update certain beneficiary designations may be limited.

As you name new beneficiaries, be aware that your new spouse may have mandatory rights to certain assets, such as qualified retirement plans. If you wish to name someone else as beneficiary — a child from your previous marriage, for example — you'll have to ask your new spouse to waive these rights in writing.

> ***Determine whether your former spouse is still named as beneficiary of any life insurance policies, annuities or retirement plans.***

Avoiding unintended outcomes

If you're planning your second trip down the aisle, or have already taken that trip, now is the time to reexamine your estate plan. As currently written, your plan may not represent your new circumstances. Your estate planning advisor can help you avoid any unintended outcomes. ■

Tips for avoiding IRS penalties

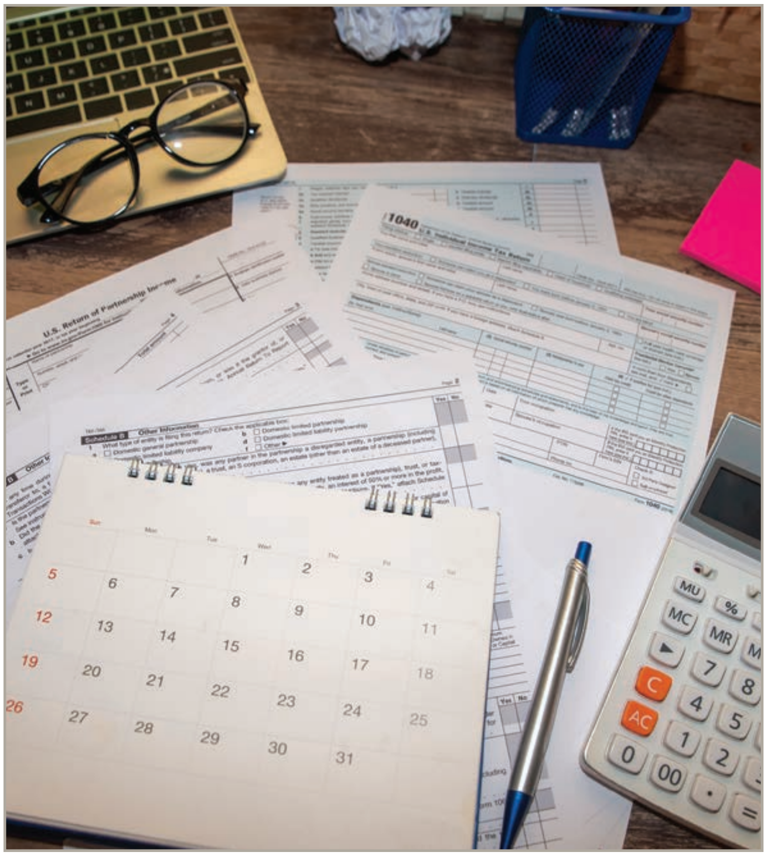
If your job or business has been affected by the COVID-19 pandemic, you may be concerned about your ability to pay taxes on time or to pay a delinquent tax debt. Fortunately, it may be possible to obtain relief from harsh IRS penalties and other consequences of the tax collection process, provided you take action soon. Here are some tips for doing so.

File on time

Even if you won't be able to pay your full tax liability, be sure to file your return on time and pay as much as you can afford. Failure-to-file penalties accrue at a rate of 5% of your tax liability per month (up to a 25% maximum). Failure-to-pay penalties, on the other hand, accrue at only 0.5% per month (also up to a 25% maximum).

Request an undue hardship extension

It may be possible to obtain an extension if you're able to show that paying the tax on time would cause undue hardship. Inconvenience isn't enough; you must demonstrate that paying the tax when due would result in a substantial financial loss, such as selling property at a "sacrifice price." And mere inability to pay is insufficient to avoid penalties. You must also show that you exercised ordinary business care and prudence in providing for payment of the tax liability but were prevented from doing so by unanticipated events.



Apply for a payment plan

Depending on your circumstances, you may avoid penalties (but not interest) if you qualify for a short-term payment plan (payment in 120 days or less) or an installment agreement (payment in more than 120 days). Generally, you're eligible for a short-term payment plan if you owe less than $100,000 in combined tax, penalties and interest. An installment agreement is an option if you owe $50,000 or less in combined tax, penalties and interest, and have filed all required returns.

Seek an offer-in-compromise

An offer-in-compromise is essentially a settlement of your tax debt for less than the full amount you owe, which may be paid in a lump sum or installments. Qualifying for an offer-in-compromise isn't easy, however. You'll need to demonstrate to the IRS that, based on your assets and expected future income and expenses, it will be virtually impossible for the IRS to collect the full amount of your tax debt within a reasonable period of time.

Check out the Taxpayer Relief Initiative

This initiative provides additional options for people affected by the pandemic, including:

- Short-term payment plans may be extended from 120 days to 180 days,
- The IRS will automatically add certain new tax balances to existing installment agreements — ordinarily grounds for default,
- Some taxpayers who owe less than $250,000 will be able to obtain installment agreements without providing financial statements or substantiation and without the need for a federal tax lien on their property or income, and
- Taxpayers with existing direct debit installment agreements may request lower monthly payments or altered payment schedules online.

In addition, taxpayers who are unable to pay may request that the IRS temporarily delay the collection process until their financial condition improves.

Take care of your taxes

If you will have trouble paying your taxes on time, relief is available, but only if you're proactive about asking for it. Ignoring the IRS won't make it go away. Talk to your tax advisor for additional information. ■

Using qualified small business stock to attract investors

For businesses in need of funding, qualified small business stock (QSBS) can be a powerful tool for attracting investment capital. It entices investors with the prospect of tax-free gains on the sale of the stock (subject to certain limitations), provided they hold it for more than five years. Generally, to qualify, stock must be issued by a domestic C corporation that has aggregate gross assets of $50 million or less, must not be involved in certain types of business (for example, professional services, banking, insurance, farming, oil and gas, or hospitality), and must meet several other requirements. Among other things, the stock must be acquired by investors as part of an original issuance rather than from other shareholders. ■

Pass the SALT

Since 2018, individuals have been subject to a $10,000 limit on itemized deductions of state and local taxes (SALT). Until recently, however, it was uncertain whether that limit applies to entity-level taxes incurred by pass-through entities — such as S corporations, partnerships and limited liability companies — and passed through to their individual owners. Recently, the IRS announced its intent to issue regulations confirming that these taxes *aren't* subject to their owners' $10,000 SALT deduction limit. Although it's not yet clear how the final regulations will work, the announcement appears to endorse a workaround to the $10,000 limit, adopted in some states. These states have imposed entity-level taxes on pass-through businesses, with the business owners receiving a corresponding tax credit or exemption. ■

Reducing taxes with net gifts

A "net gift" can be an effective tool for reducing gift taxes. It's simply an agreement by the donee, as a condition of receiving the gift, to pay any resulting gift tax. This liability reduces the value of the gift, thereby reducing the tax. A "net, net gift" can reduce the tax even further. Here's how it works: In addition to agreeing to pay the gift tax, the donee also assumes liability for any estate tax that might arise if the donor dies within three years of making the gift. (Under the "three-year rule," gifts made within three years of death are included in the donor's estate.) The actuarial value of this potential liability reduces the value of the gift. ■

Want to save taxes? Hire your kids

For business owners, hiring your children can be a great tax-saving strategy. By shifting income to family members in lower tax brackets, you can reduce your family's overall tax bill. Plus, if your kids are under 18, they're exempt from Social Security and Medicare taxes if the business is either a sole proprietorship or a partnership in which you and your spouse are the only partners. ■