

Tax Provisions in H.R. 748, the CARES Act

Key Tax Provision Highlights of H.R. 748 for Individuals and Businesses

- An advance rebate/credit for 2020 is to be issued to eligible US taxpayers equal to the sum of \$1,200 (\$2,400 MFJ) plus \$500 for each qualifying child of the taxpayer(s). The credit/rebate is phased out by 5% times the amount of AGI in excess of \$75,000 (\$150,000 MFJ).
- For 2020 and beyond, a \$300 above-the-line deduction is allowed for taxpayers who elect not to itemize and who make cash contributions to public charities other than donor advised funds and supporting organizations.
- Qualifying cash contributions made by individuals in the year 2020 to public charities (other than donor advised funds and supporting organizations) are deductible up to 100% of AGI, reduced by the amount of contributions otherwise deductible under normal AGI limitation rules.
- Required minimum distributions (including 2019 RMD that an individual was eligible to defer until April 1, 2020) are waived for 2020 for certain retirement plans and for IRAs. Distributions already taken in 2020 to satisfy the RMD can be rolled over to an eligible retirement plan as long as it is done within 60 days of the distribution.
- The 10% early withdrawal penalty for up to \$100,000 of distributions from certain retirement plans and IRAs is waived for qualifying coronavirus-related distributions made during 2020.
- Qualifying coronavirus-related loan distributions from certain retirement plans allowed for 180 days up to lesser of the account balance or \$100,000.
- Employers will be allowed to treat reimbursements of student loan principal and interest as being paid on a pre-tax basis.
- HSA rules are modified to allow the use of telehealth services without meeting deductible limits.
- Previous TCJA NOL rules are relaxed to allow carryback of NOLs arising in 2018 through 2020 to the 5 prior tax years.
- The TCJA \$250,000 limitation on deducting business losses is delayed until 2021 and is not applicable for years 2018 through 2020.
- The TCJA limitation on deducting business interest is modified to allow consideration of 50% of adjusted taxable income as opposed to only 30%, applicable to 2019 and 2020 years.
- The so-called “retail glitch” for bonus depreciation for leasehold improvements under TCJA has been fixed to allow “qualified improvement property” placed in service after 2017 to qualify for 100% bonus depreciation.
- Employers can receive a refundable payroll tax credit for 50% of wages paid by eligible employers to certain employees during the Covid-19 crisis that are paid or incurred from 3/13/2020 through 12/31/2020.
- Employers can defer the employer’s 6.2% portion of the Social Security payroll tax, effective for wages paid between the date of enactment and 12/31/2020.

Explanation of Provisions

The Senate version of H.R. 748, the *Coronavirus Aid, Relief, and Economic Security Act* (or “CARES Act” or “the Act” below) was passed by the House on Friday, March 27, 2020 and signed into law by the President on the same day. What follows is an explanation of some of the highlights of the generally applicable tax provisions addressing individual and business taxpayers.

Advance Rebate

The Act provides for a refundable credit for the 2020 tax year for US taxpayers other than nonresident aliens, trusts, estates and those claimed as dependents on another taxpayer’s return for the 2020 tax year. Although the credit is for the 2020 tax year, there is a coordinating provision which provides for an advance rebate payment based on 2019 tax year criteria as to eligibility and AGI levels. The amount of the advance rebate is equal to the sum of \$1,200 (\$2,400 MFJ) plus \$500 for each qualifying child (same definition used for the child tax credit), but this amount is reduced by 5% of the amount of the taxpayer’s AGI which exceeds \$75,000 (\$150,000 MFJ, \$112,000 HOH). For example, a married couple with 3 qualifying children would be eligible for an advance rebate payment of \$3,900, but this amount would be totally phased out at \$228,000 based on the 2019 AGI levels. If the taxpayer has not filed a 2019 return at the time of determination, the IRS will use 2018 return data, and if there is no 2018 data, it will look to 2019 Social Security benefit information. The IRS is authorized to make delivery, as rapidly as possible, of any rebate electronically to any account to which the payee authorized, on or after 1/1/2018, the delivery of a refund of taxes or a federal payment.

\$300 Charitable Deduction

Although the charitable industry was hoping for a greater amount, the Act allows taxpayers who elect not to itemize deductions to claim up to \$300 of deductions against gross income beginning on 2020 returns for cash amounts paid to qualifying charities. Only taxpayer who elect not to itemize are eligible. The payment must be in cash and be paid to a “50% public charity”, not including a donor advised fund or a supporting organization. Eligible amounts do not include charitable deduction carryovers from prior years. This deduction is not temporary and applies to 2020 and succeeding tax years.

2020 Suspension of 60%-of-AGI Limitation on Qualifying Cash Contributions

For individuals, cash contributions to public charities can currently qualify for a 60%-of-AGI limitation (for tax years 2018 through 2025, reverting to 50% thereafter) when made to public charities. Under the Act, qualifying cash contributions of individual taxpayers made in the year 2020 to public charities (other than donor advised funds and supporting organizations) are deductible up to 100% of the excess of the taxpayer’s adjusted gross income (computed without regard to any net operating loss carryback to the taxable year) over the amount of all other charitable contributions allowed and otherwise subject to the existing 50%, 30% and 20% AGI limitation rules. Any excess amount is added to the existing 60% contribution carryover amount for cash contributions to a public charity.

C corporations will be allowed a deduction for such qualifying cash distributions only to the extent that the aggregate of such contributions does not exceed the excess of 25% of taxable income over the amount of all other charitable contributions allowed.

The language provides that a “qualifying contribution” is one paid in cash during calendar year 2020 to a public charity other than a donor advised fund or a supporting organization, subject to the taxpayer electing to apply this section with respect to such contribution. In the case of partnerships and S corporations, each partner or shareholder must make the election separately. The IRS will have to provide guidance on how to make the election. A separate memo will discuss more details of the refundable credit/rebate.

Waiver of 2020 Required Minimum Distributions

A 2020 required minimum distribution (RMD) will not be required from any individual retirement account (including inherited IRAs and individual retirement annuities that have yet to be annuitized) and certain defined contribution plans (including a 401(k), 403(b) and governmental 457(b) plan). The waiver is not extended to defined benefit plans. The waiver also applies to a 2019 RMD that an individual was eligible to defer until April 1, 2020 and did not actually choose to withdraw in 2019.

As to distributions subject to the 5-year rule where the owner died before his/her required beginning date and did not have a designated beneficiary (e.g., left to an estate, charity, non-look through trust), 2020 will not count in the computation of the 5-year period, resulting in an added year to complete the plan distribution to beneficiaries. Distributions already taken in 2020 to satisfy the RMD can be rolled over to an eligible retirement plan as long as it is done within 60 days of the distribution. Whether the 60-day period will be extended, as it was in 2009 when there was a similar waiver, remains to be seen.

Penalty Free Withdrawal of Coronavirus Related 2020 Distributions

The 10% early withdrawal penalty is waived for Coronavirus-related retirement plan or IRA distributions between January 1, 2020 and December 31, 2020 for an amount not to exceed \$100,000 in the aggregate.

The waiver only applies to an individual --

- who is diagnosed with COVID-19,
- whose spouse or dependent is diagnosed with COVID-19, or
- who experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off or having work hours reduced due to such virus or disease, being unable to work due to lack of child care due to such virus or disease, closing or reducing hours of a business owned or operated by the individual due to such virus or disease.

As to employer plans, a distribution must otherwise be allowed by the plan sponsor (in-service and hardship withdrawal provision are at the plan sponsor's discretion). Employers are permitted to amend plans to provide for these distributions. It will be up to the individual (not the plan) to self-certify that he/she meets the requirement for waiver of the penalty. Distributions will not be subject to tax withholding.

The individual will recognize the income for federal tax purposes of such a distribution ratably over a 3-year period beginning with the year of distribution, instead of all in the year of distribution. The individual may opt out of this 3-year treatment and recognize the income all in the year of distribution. Amounts distributed can also be repaid (rolled over) to an eligible retirement plan at any time over the 3-year period commencing on the day after the distribution was received. There is no requirement that repayment be made at one-time, rather repayment can be spread out over the entire 3-year period through one or more contributions. It is not clear how such repayments will be treated where income was recognized on the distribution in an earlier year (further guidance will be needed).

More Favorable Qualified Plan Loan Rules

Normally, the maximum amount that a plan can permit as a loan is the *lesser of* (1) \$50,000 or (2) the greater of \$10,000 or half the vested account balance. An individual that meets the qualifications for a Coronavirus penalty free withdrawal (as described above) is also eligible for favorable loan benefits. For a 180-day period beginning with the date of enactment of this legislation, the dollar amount that an eligible individual can take as a loan from a qualified plan is increased from \$50,000 to \$100,000. Additionally, the percentage test limit is also increased from half the present value of the individual's vested balance to the full value of the individual's vested balance. The net effect is an allowable loan of the *lesser of* the full account balance or \$100,000.

A qualified plan is allowed, but not required, to offer plan loans. A 1-year extension is provided for an eligible individual that has a loan repayment due between the date of enactment of this legislation and December 31, 2020. The loan repayment can be made one year from the date the original repayment was required. Remaining payments plus applicable interest must be re-amortized to reflect the delay in payment. It is not clear if eligible individuals will be able to opt-out of this delay. The 5-year limit on loan repayments will disregard the 1-year delay for 2020.

Student Loan Benefits

For an employer that sponsors an educational assistance program, benefits provided by the employer to the employee can currently be excluded from income up to \$5,250 per year. Under the Act, the definition of amounts that can be reimbursed on a pre-tax basis will be expanded to include the payment of principal and interest on student debt. This change will apply to payments made by the employer (whether directly to the lender or to reimburse the employee for such an expense) before January 1, 2021. Additionally, principal and interest payments on any student loans owned by the federal government can be deferred through September 30, 2020 without any penalty to the borrower. Interest will not accrue on the balance during this period.

Health Savings Accounts and Qualified Medical Expenses

Telehealth services will be added to the list of services that can be provided by a qualifying high deductible health plan without requiring the covered individual to first meet the deductible for plan years beginning on or before December 31, 2021. The offering of such services by the plan before the deductible is met will not disqualify the individual from being able to contribute to a health savings account during this period. It should be noted that this law does not codify recent guidance issued by the IRS in Notice 2020-15 that included a similar addition for plans that cover testing for and treatment of COVID-19 before the deductible is met. Feminine hygiene products purchased after December 31, 2019 are added to the list of qualifying medical expenses as to distributions from a health savings account, health flexible spending account and health reimbursement arrangement.

Most notably, the requirement from the Affordable Care Act that all such qualifying medical expenses (other than insulin) had to be prescribed no longer applies. This means that over-the-counter medications can now be considered qualified medical expenses as to distributions from a health savings account, health flexible spending account and health reimbursement arrangement.

Modification of Net Operating Losses (NOLs)

The *2017 Tax Cuts and Jobs Act* (TCJA) eliminated the ability to carry net operating losses (NOLs) back to prior taxable years and limited the deduction for NOL carryovers to 80% of taxable income. The Act relaxes these rules and allows taxpayers to carry back net operating losses arising in 2018, 2019, and 2020 to the five prior tax years. NOLs incurred in these years can fully offset prior year taxable income. The Act also allows C corporations to elect to file for an accelerated refund to claim the carryback benefit. Taxpayers who incurred NOLs in 2018, now have the option of carrying this loss back to their 2013 and subsequent years' returns. However, when assessing this option, you must consider the impact of the alternative minimum tax (AMT). The deduction for an AMT NOL carryback continues to be limited to 90% of AMT taxable income. Looking ahead, NOL's arising in 2021 and after can only be carried forward and will be limited to 80% of taxable income.

Relaxation of Limitation on Deducting Business Losses

For tax years 2018-2025, the TCJA imposed a limitation on the deduction of business losses. For individuals and other noncorporate taxpayers, the deduction of current year net business losses is limited to \$250,000 (\$500,000 for joint filers) adjusted annually for inflation. The Act relaxes this rule by delaying application of the business loss limitation until 2021. Therefore, net business losses will be deductible without limitation for tax

years 2018-2020. Clients who had their deduction for business losses limited on their 2018 returns can file amended returns claiming the full amount of the loss. If this results in an NOL, the loss can be carried back to 2013 or subsequent years' returns as discussed above.

Looking forward, when the business loss limitation becomes applicable in 2021, business losses will not be deductible against wages and other income received for services rendered as an employee. This is a clarification of an area that was uncertain after the passage of TCJA.

Modification of Limitation on Deducting Business Interest

The TCJA generally limits the amount of business interest allowed as a deduction to business income plus 30% of adjusted taxable income (ATI), which for taxable years through 2021 is generally taxable income computed without depreciation and certain other deductions. The Act provides that for 2019 and 2020, the percentage of ATI threshold would be increased from 30 percent to 50 percent. The Act would also allow businesses to use their adjusted taxable income from 2019 in tax year 2020 (rather than their 2020 adjusted taxable income) for purposes of applying the 50 percent limitation. This will allow businesses that experience a decline in profit in 2020 to increase the amount of deductible interest expense for that year. Special rules apply to partnerships, one of which may allow a partner to accelerate a deduction into 2020 for a portion of its share of partnership interest expense that was not deducted in 2019 due to the interest expense limitation.

Bonus depreciation for qualified leasehold improvements

The Act corrects a drafting error in the TCJA that precluded 100% bonus depreciation for the cost of many interior improvements to commercial property. Since the enactment of the TCJA, the retail and restaurant industries have been urging Congress to correct what became known as the "retail glitch." Accordingly, retroactive to 2018, the cost of "qualified improvement property" placed in service after 2017 will qualify for 100% bonus depreciation. Clients who made interior improvements to commercial property (i.e. fit up of a restaurant or retail store) should review these expenditures to determine if they qualify for bonus depreciation. In certain instances, filing an amended 2018 return may be in order.

Employee Retention Credit for Employers

The Act provides a refundable payroll tax credit for 50% of wages paid by eligible employers to certain employees during the COVID-19 crisis that are paid or incurred during the period March 13, 2020 through December 31, 2020. The credit is available to employers, including non-profits, whose operations have been fully or partially suspended as a result of a government order limiting commerce, travel or group meetings. The credit is also provided to employers who have experienced a greater than 50 percent reduction in quarterly receipts, measured on a year-over-year basis. Employers who receive Small Business Interruption Loans under §1102 of the Act are not eligible for the credit. Eligible employers may elect out of this credit provision.

Wages of employees who are furloughed or face reduced hours as a result of their employers' closure or economic hardship are eligible for the credit. For employers with 100 or fewer full-time employees, all employee wages are eligible, regardless of whether an employee is furloughed. The credit is provided for wages and compensation, including health benefits, and is provided for the first \$10,000 in wages and compensation paid by the employer to an eligible employee. Thus, the maximum credit per employee is \$5,000. The credit is computed on a calendar-quarterly basis and is claimed against the 6.2% employer-side Social Security payroll tax and corollary Railroad Retirement Tax Act (RRTA) taxes, respectively. Eligible wages do not include amounts taken into account for purposes of employer payroll credits for required paid sick leave or required paid family leave that were enacted as part of Families First Coronavirus Response Act. Further, any wages taken into account for purposes of the retention credit cannot be taken into account for the IRC §45S employer credit for paid family and medical leave. In spite of the name assigned to this credit, it does not appear that credit eligibility is conditioned on retaining workers for any prescribed time period.

Delay of Employer Payroll Tax Payments

The Act allows employers (and self-employed individuals) to defer payment of the 6.2% employer-side Social Security payroll tax, effective for wages paid between the date of enactment and December 31, 2020. Similar relief is available for Railroad Retirement Tax Act (RRTA) taxes. Deferred payments are due in two equal installments, on December 31, 2021 and December 31, 2022, respectively. Employers who have indebtedness forgiven under certain provisions of the Act are not eligible for this payroll tax payment deferral.

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