CHIEF INVESTMENT OFFICE

Tax Alert 2020-05

March 27 Legislation: Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act")

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AUTHORED BY:

National Wealth Strategies, Chief Investment Office

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OVERVIEW

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). This is the 3rd piece of legislation aimed at the coronavirus (COVID-19) pandemic and is sometimes referred to as "Phase 3." ("Phase 1" was the $8.3 billion spending bill enacted March 6. "Phase 2" was the Families First Coronavirus Response Act enacted March 18.) The CARES Act is a massive stimulus bill which includes lending facilities to large and small businesses (including targeted distressed businesses), expanded unemployment benefits and individual and business tax changes. Supplemental funding for small business lending was authorized on April 24, 2020, under the Paycheck Protection Program (PPP) and Health Care Enhancement Act. The projected cost of the CARES Act and the supplemental funding act is over $2.5 trillion, of which about $500 billion is allocated to tax changes.

In this Alert we summarize selected individual and business tax provisions. We also summarize the Act's small business lending program: the Paycheck Protection Program.

PROVISIONS AFFECTING INDIVIDUALS

Rebates for individuals

Rebates are a significant centerpiece of the stimulus bill. Eligible taxpayers will receive up to $1,200 ($2,400 for married filing jointly), plus $500 for each qualifying child. This applies whether or not the taxpayer has any income. Nonresident aliens and individuals that can be claimed as a dependent on another person's tax return are not eligible for this rebate. In addition, each individual and qualifying child must have a Social Security number. (For a qualifying child who is adopted or placed for adoption, the child's adoption taxpayer identification number will suffice.)

Payments will generally be made by direct deposit to a taxpayer's bank account if that information is on file with the Internal Revenue Service (IRS), otherwise by check. In either case, rebates are expected to be made as "rapidly as possible" and possibly as early as April 6 for electronic payments and two weeks later for paper checks. Either way, the IRS will notify taxpayers within 15 days of payments. A full rebate will be available only for individuals whose income is below certain thresholds. The amount of rebate begins to phase-out at adjusted gross income (AGI) of $75,000 ($150,000 for married filing jointly). Above those amounts, the rebate is reduced by $5 for each $100 over these limits. The rebate is fully phased out when AGI reaches $99,000 ($198,000 for married filing jointly).

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This rebate is a 2020 benefit to be based on 2020 income. However, to have this benefit distributed soon, there is an advance funding mechanism. The IRS will make an initial calculation of your rebate based on your 2019 federal tax return. If that return has not yet been filed, the initial calculation will be based on your 2018 federal tax return. If there is no 2018 return, the IRS can use information from 2019 social security benefit statements. Based on this information, the IRS will calculate and distribute the rebate without any action required by the recipients.

If this advance funding mechanism results in the maximum rebate, then that will be the result. For example, if your 2018 tax return is the proper reference (because you haven't yet filed your 2019 return), and if your income levels during 2018 were low enough to merit a full rebate but 2019 income levels were not, you would receive the full rebate and would not have to pay any excess back. For those who have not yet filed 2019 tax returns (the due date for which has been extended to July 15), this might be a reason to delay that filing. The opposite could also be true. That is, if 2018 income was high enough to reduce a full rebate but 2019 income would indeed result in a full rebate, that could be a reason to file your 2019 return soon so that 2019 is the reference year when the IRS calculates the advance funding rebate.

If you receive less than the full rebate based on these initial calculations by the IRS, you will be able to use the difference as a refundable credit on your 2020 return, assuming you qualify for tax year 2020 under the rules described above.

Tax-Favored Withdrawals from Retirement Plans (coronavirus-related distributions)

Withdrawals up to $100,000 (in the aggregate) from qualified plans, including IRAs, during 2020 for coronavirus-related purposes receive several favorable tax treatments.

First, those under age 59½ can withdraw from qualified plans and IRAs during 2020 without a 10% early withdrawal penalty, if the withdrawal is for coronavirus-related purposes (and subject to the $100,000 limit).

Second, the withdrawn amounts may be repaid (to the plan or to an IRA) in one or more payments at any time during the 3-year period beginning on the day after the distribution was received, and those repayments will be treated as a tax-free rollover, without regard to any contribution cap.

Third, for distributions not repaid with the 3-year period, those would be taxable income, but the amount can be included in income and taxed ratably over 3 years.

Your withdrawal is considered for coronavirus purposes if you, your spouse or dependent is diagnosed with COVID-19 (or SARS-CoV-2) or experiences certain adverse financial consequences as a result of (i) being quarantined, furloughed or laid off or having to work reduced hours because of the virus, (ii) being unable to work due to lack of child care because of the virus, (iii) closing or reducing hours of a business owned or operated by you due to the virus, or (iv) other factors as determined by the Treasury.

If you withdraw from your own IRA under this provision, you need to be sure the withdrawal is coronavirus-related. If you want to withdraw from a company-sponsored retirement plan under this provision, the plan must adopt this change within the time period specified by the Treasury and the administrator may rely on an employee's certification that a withdrawal is coronavirus-related.

Loans from Qualified Retirement Plans

Currently the limit for loans from a qualified plan is $50,000. Loans up to $100,000 (but no more than the plan balance) from qualified plans to a "qualified individual" will be permitted during the 180-day period beginning on the date of enactment, which is March 27. For purposes of this new loan provision, a "qualified individual" is defined in the same way as someone who would qualify for a "coronavirus-related distribution," which was discussed in the preceding section.

In addition, for any loans from qualified retirement plans that are outstanding on or after March 27 and which have a payment due in 2020, the due date for the payment will be delayed for 1 year.

Waiver of Required Minimum Distributions

Required minimum distributions ("RMDs") for certain defined contribution plans (e.g., 401(k)s) and IRAs) are waived for calendar year 2020. This applies to both of the following:

1. Those who have been taking annual RMDs. You do not have to withdraw an RMD for 2020.
2. Those who turned 70½ in 2019 but deferred the first RMD to April 1, 2020. You do not have to withdraw the delayed 2019 RMD in 2020. In addition, you do not have to withdraw an RMD for 2020.

For those who have already taken an RMD in 2020, it's now *not* considered to be an RMD, which means it can be rolled over within 60 days of withdrawal, assuming you otherwise qualify for rollover treatment (beneficiaries of inherited IRAs do not qualify for 60-day rollover treatment).

For those for whom the 60 days has already passed, it's possible the IRS could provide relief in the future. In 2008 Congress passed a similar law, waiving the RMD requirement for 2009. At that time, the IRS also issued a formal Notice stating that the 60-day rollover deadline would be satisfied if done by a certain date later in the year. It's possible the IRS could issue similar guidance in the future, which might allow someone who withdrew an RMD in 2020 more than 60 days ago to roll it over. However, the CARES Act does not change the rule that limits rollovers to once every 12 months.

In a related provision, if a retirement plan owner died and the beneficiaries who inherit the plan are required to satisfy the 5-year rule for distributions, that 5-year deadline can ignore 2020, which effectively makes it a 6-year rule.

Charitable Contribution Deductions

Taxpayers who do not itemize deductions may now deduct up to $300 for contributions made to qualifying charities. Contributions must be made in cash and cannot be made to a donor advised fund, certain supporting organizations or certain private foundations. Although the legislation is not entirely clear, many commentators feel that this amount is per taxpayer ($600 for a married couple). This is sometimes referred to as the "Universal Charitable Deduction." Again, the legislation is not entirely clear, but most commentators feel that this is a permanent change and applies for 2020 and subsequent years. Hopefully, the Internal Revenue Service will provide further guidance.

For those who do itemize, the deduction limitation for certain charitable contributions can be increased to 100% of AGI at the election of the taxpayer. Again, not all contributions are eligible. Contributions must be made in cash and cannot be made to a donor advised fund, certain supporting organizations or certain private foundations. Partners of partnerships and shareholders of S-corporations could also qualify for this treatment if they individually elect to do so. This provision is limited to charitable contributions made in 2020.

Temporary Relief for Federal Student Loan Borrowers

All federal student loan payments (principal and associated interest) are suspended for 6 months, through September 30, 2020, without penalty. This applies only for federally owned loans, which covers 95% of all student loan borrowers.

Employers can pay employees' student loans

In general, an employee's gross income does not include up to $5,250 per year of employer payments for the employee's education, as long as that is done under an educational assistance program. The CARES Act adds to the types of payments that can be made under this provision, adding student loan repayments made after the date of enactment (March 27) and before January 1, 2021. Such payments can be made to the student or the lender and will still be subject to the overall $5,250 limitation for all educational payments.

PROVISIONS AFFECTING BUSINESSES

Employee Retention Tax Credit

Certain employers are eligible for a tax credit against their employment tax equal to 50% of qualified wages (up to $10,000) paid to each employee.

For employers with more than 100 full-time employees, qualified wages are wages paid to employees when they are not working due to COVID-19-related circumstances. For businesses with 100 or fewer employees, all employee wages qualify for the credit, whether the employer is open for business or subject to a shut-down order. The credit is provided for the first $10,000 of compensation, including health benefits, paid to an eligible employee. The credit is provided for wages paid or incurred from March 13, 2020 through December 31, 2020.

An employer is eligible for this credit only if they were carrying on a trade or business in 2020 and (i) the operation of that business is fully or partially suspended (for specified reasons) by the government (Federal, state or local) due to COVID-19, or (2) the business has seen a significant decline in gross revenue (50% less than in the calendar quarter of the prior year) and for so long until the business recovers to 80% of the prior year's revenue. A business can elect not to have this provision apply. If the business receives a loan under the new Paycheck Protection Program (described below), the business is not eligible for an Employee Retention Tax Credit.

Delay of Payment of Payroll Taxes

Employers (for profit and not-for-profit) and self-employed individuals can defer the employer portion of payroll taxes with respect to their employees. This is the 6.2% portion of Social Security taxes. This applies to payroll taxes for the period from enactment of the CARES Act (March 27) to December 31, 2020. 50% of the deferred payroll taxes will be payable on December 31, 2021; the remaining 50% will be payable on December 31, 2022. If the business receives a loan forgiveness under the new Paycheck Protection Program, the business is not eligible to defer payment of payroll taxes from and after the date the lender issues a decision to forgive the loan.

Net Operating Losses Modification

The CARES Act relaxes the limitations on a company's use of losses. Losses from 2018, 2019 and 2020 can be carried back for 5 years, without regard to a taxable income limitation, and so the losses can fully offset income. It is expected that many companies could suffer losses in 2020 due to mandatory closure and other economic hardships. Those losses may not be known until the company files its 2020 taxes in early 2021. Once determined, those losses could be carried back to offset income (and thus lower taxes) from profitable years. Some of those losses would be carried back to tax years when the business was subject to a 35% tax rate (the current corporate rate is 21%). This will provide relief, but not immediate relief, to struggling businesses.

Increase in Limit on Business Interest Expense

For 2019 and 2020, businesses can deduct business interest up to a limit of 50% of taxable income, an increase from the usual limit of 30%. Special rules apply to pass-through businesses.

Charitable Deduction Limitation Increased

The deduction limitation for corporations for certain charitable cash contributions made in 2020 is increased to 25% of taxable income (up from 10% of income under prior rules) as long as the contribution is made to a public charity. Corporations can also deduct charitable contributions of food inventory made during 2020 to public charities up to 25% of taxable income (up from 15% prior to the change).

Other: Technical Correction of Tax Reform 2017

This allows a deduction (write off) of certain costs associated with improving facilities. This is a long sought technical fix arising from the 2017 tax legislation, which has prevented retailers and restaurants from writing-off the cost of certain improvements. The change is retroactive back to the original legislation, and therefore businesses could amend their returns to seek the benefit of this change.

Paycheck Protection Program (Small Business Loans)

To help small businesses with near-term liquidity concerns and to encourage the retention of employees, the CARES Act includes a complicated set of rules for government guaranteed loans and grants to eligible businesses, without personal guaranties or collateral. To then shift the burden and cost to the federal government, those businesses may be eligible to have all or a portion of the loan forgiven.

Loans to Small Businesses. $659 billion is allocated for helping small businesses through a Paycheck Protection Program loan: $349 billon under the CARES Act and an additional $310 billion under the supplemental funding act. The supplemental funding act specifically sets aside at least $30 billion for loans from small banks and credit unions and at least another $30 billion from very small banks, credit unions and community financial institutions.

Small businesses are generally those with 500 or fewer employees, whether they are for profit or non-profit. Individual sole-proprietors, independent contractors and other self-employed individuals are eligible for loans. The primary forms of assistance are loans fully guaranteed by the government and grants facilitated by the U.S. Small Business Administration (the "SBA"), although additional lenders can be authorized by the Department of the Treasury.

PPP loans cannot have a maturity beyond 10 years and an interest rate above 4%. In an "interim final" rule issued by the SBA on April 2, 2020, it was determined that all PPP loans will have identical terms: a 2 year maturity and an interest rate of 1%. These loans will have a 100% government guarantee if made between February 15, 2020 and June 30, 2020. Principal and interest payments will be deferred, not waived, for six months.

Loan Amount. Loans can be made up to a maximum of $10 million, but the amount of the loan is generally a formula tied to payroll of the business during the one-year period before the loan (or during calendar year 2019, according to SBA rules), which could result in a lower loan amount. More specifically, the loan amount is generally the lesser of:

- The average monthly payroll (over the past 12 months before the loan is made) x 2.5, plus the outstanding amount of any economic injury disaster loan (EIDL) from the SBA from January 31, 2020 to the time the loan is refinanced into a PPP loan,[1] or
- $10,000,000

Loan Proceeds. Loan proceeds can be used for payroll (salaries, sick leave, medical leave, insurance premiums) and certain administration expenses (mortgage interest, rent and utility payments), in addition to existing allowable uses under SBA rules.[2] However, according to SBA rules, "at least 75% of loans proceeds must be used for payroll costs." According to the SBA rule, this will effectuate the core purpose of the program and ensure finite program resources are devoted to keeping workers paid and employed. A borrower must make a good faith certification as to the necessity of the loan and that the borrower will use the loan for appropriate purposes.

Loan Forgiveness. A PPP borrower may be eligible to apply for loan forgiveness equal to an amount spent during an 8-week period after the loan origination date (capped at the loan amount) for:

- payroll costs (excluding compensation above $100,000),
- interest payments on any mortgage incurred prior to February 15, 2020,
- rental lease payments (in force before February 15, 2020), and
- utility payments (for services which began before February 15, 2020).

Non-payroll costs are capped at 25% of the loan forgiveness amount according to the SBA.

There are further complicated rules reducing the amount that could be forgiven based on a reduction of the businesses' employees and the reduction of the employees' wages compared with the prior year. Businesses that have already reduced their payrolls can become eligible for loan forgiveness if they restore their payrolls after obtaining the loan.

Any amount of the loan that is forgiven will not be considered taxable income to the business.

[1] For businesses that were not in business during the period from Feb. 15, 2019 to June 30, 2019, the formula can instead use the average monthly payroll from Jan. 1, 2020 to Feb. 29, 2020, multiplied by 2.5, plus the outstanding amount of any economic injury disaster loan (EIDL) from the SBA from Jan. 31, 2020 to the time the loan is refinanced into a PPP loan.

[2] For sole proprietors and independent contractors (so-called Form 1040, Schedule C filers), eligible expenses must have been claimed or entitled to be claimed as a deduction on such person's 2019 Form 1040 Schedule C for them to be a permissible use during the eight-week period following the first disbursement of the loan (the "covered period"). For example, if the sole proprietor did not claim or is not entitled to claim utilities expenses on their 2019 Form 1040 Schedule C, that person cannot use the proceeds for utilities during the covered period.

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