June 2020

Tax Talk

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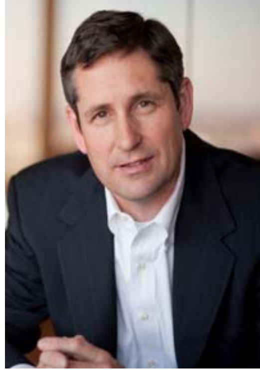
Inside this issue:

FFCRA, CARES Act, PPP Increase Act, and PPP Flexibility Act	1
An Update on Conservation Easements	2
The Paycheck Protection Program (PPP)	3
Quick Notes	4



Kent Bridges, Managing Partner

Dear Clients and Friends,

Each quarter, as I am drafting the current issue of this newsletter, I also think ahead as to what topics I might cover in the next quarter's issue. Back in February, when I was drafting the March issue of our newsletter, COVID-19 still felt like a distant thing, unlikely to impact the content of the June issue of our newsletter, and I had thought that for the June issue I might just update and recycle some of our old articles. Within just a few weeks, however, we had shut down much of our economy, and Congress was passing massive stimulus legislation to pump trillions of dollars into our economy to try and avoid its collapse. So, instead of updating some old articles, this issue of our newsletter will be devoted primarily to covering the massive stimulus legislation enacted over the past few months. Some of this has been covered in emails we sent to our distribution list, and more of it was covered in emails sent only to our business entity clients that we knew to likely be directly impacted by it, but we will try to summarize it all for you here in one place. The past three months have been quite a roller coaster ride.

In addition to discussing the economic stimulus legislation, we will provide an update on conservation easements and summarize various tax -related extensions associated with the COVID-19 crisis.

We hope that you will enjoy this issue and gain from it some useful information.

Sincerely,

Kent Bridges

FFCRA, CARES Act, PPP Increase Act, and PPP Flexibility Act

In March, as much of the U.S. (and global) economy began to shut down, Congress went to work passing massive stimulus legislation to try keep the economy going. Federal legislation enacted from March to June 2020 included the *Families First Coronavirus Response Act* (FFCRA), the *Coronavirus Aid, Relief and Economic Security Act* (CARES Act), the *Paycheck Protection Program Increase Act* (PPPIA), and the *Paycheck Protection Program Flexibility Act* (PPPFA). Collectively, this legislation represents trillions of dollars. Also, the US House passed the *Health and Economic Recovery Omnibus Emergency Solutions Act* (HEROES Act), but this legislation has not made it through the Senate. We will provide here a high-level summary of this collective legislation.

Paycheck Protection Program – The legislation which has almost certainly received the greatest amount of press, and has likely had the greatest benefit to smaller businesses, is the Paycheck Protection Program (PPP), which was a part of the CARES Act. Given the significance and complexity of the PPP, we discuss it in greater detail in a separate article in this issue. However, from a very high level, the PPP provides forgivable loans of up to $10,000,000 to virtually all businesses with 500 employees or less (and in some industries more), and certain nonprofits and tribal concerns. The loan amount is basically 2 ½ months of 2019 payroll, and it will be forgiven so long as used during the 8-week period following its receipt (or up to 24 weeks if elected) for qualifying costs (basically payroll, rent, utilities and mortgage interest, with some limitations).

Paid sick and family leave – The FFCRA requires employers with fewer than 500 employees to provide emergency paid sick leave and family and medical leave to employees who are unable to work or telework due to specified-virus related reasons or in order to care for a child whose school or daycare has been closed as a result of the Coronavirus shutdown. In order to reimburse employers for the cost of this mandated paid leave, the Act provides that the employer can claim a refundable payroll tax credit for the amounts paid. For a self-employed person who is unable to work due to a specified-virus reason or the need to care for another, there is a similar credit which can be claimed as an income tax credit.

***Employee retention credit* (ERC)** – Any employer whose business is partially or fully suspended by orders from a governmental authority due to the Coronavirus (or who has substantial decline in revenue due to Coronavirus) can claim a refundable payroll tax credit of up to 50% of qualified wages (which includes health insurance premiums) paid after March 12. For employers with 100 or fewer full-time employees (based on 2019 average), qualified wages include up to $10,000 per employee (regardless of whether they were able to work). For employers with more than 100 full-time employees, the amount is limited to $10,000 per employee and is only with respect to those employees who were unable to work due to the shutdown. You can claim both the ERC and the FFCRA credit, but you cannot double dip (i.e. cannot take the same wages into account in computing both credits). Also, you cannot claim these credits if accepting PPP funds. Since the PPP is generally more advantageous, most smaller companies are taking advantage of the PPP and foregoing the ERC and FFCRA credits.

Rebate checks to individuals – Subject to income limitations (phaseout begins at $75,000 for individuals and $150,000 for couples), persons who cannot be claimed as a dependent on

(Continued on page 2)

FFCRA, CARES Act, PPP Increase Act, and PPP Flexibility Act — continued

(Continued from page 1)

someone else's income tax return have received or should receive $1,200 ($2,400 for couples filing a joint return) plus $500 for each child. While the rebate is technically a 2020 tax credit, the IRS has been sending out the checks and basing eligibility on your 2019 income tax return (or 2018, if 2019 has not been filed, or Form SSA-1099 if no 2018 or 2019 return has been filed). If the advance check is less than you should have received, then you can claim the shortfall when you file your 2020 return. Alternatively, if the advance amount you receive is more than you should have received, no repayment is required. Under the income phaseout rules, singles with income above $99,000 and couples with income above $198,000 are not eligible.

No 10% penalty on early retirement plan distributions and 3 years to repay or pay tax – Normally, if you take a distribution from a qualified retirement plan prior to age 59 ½, you pay the tax on the distribution plus a 10% penalty. Under the CARES Act, however, an individual who is diagnosed with COVID-19, whose spouse or dependent is so diagnosed, or who experiences adverse financial consequences as a result of being quarantined, furloughed, or lack of childcare due to the virus can take up to $100,000 of distributions from qualified retirement plans during 2020, not incur the 10% penalty, have up to 3 years to put the money back in the qualified retirement plan, or, alternatively, include the distribution in income ratably over three tax years.

RMD requirement waived for 2020 – Normally, those age 70 ½ (72 following legislation enacted in late 2019), must take a certain minimum amount of distributions (based on life expectancy) from their IRAs each year, or otherwise incur a 50% penalty on any shortfall. The CARES Act provides that the RMD requirements do not apply for 2020.

Charitable contribution limitations temporarily relaxed – For 2020, individuals who do not itemize will be able to deduct up to $300 of charitable contributions. Also, the 60% of AGI limitation which normally applies to cash donations will be suspended for 2020 for cash contributions (except for donations to private foundations, donor advised funds, and supporting organizations).

Deferral of payroll taxes – 50% of the employer 6.2% social security tax for 2020 can be deferred to December 31, 2021, and the other 50% can be deferred to December 31, 2022. A similar rule applies for self-employment tax.

Federal pandemic unemployment compensation – In addition to the amount of unemployment benefits they would normally receive from the state (typically about 62% of prior compensation, but not to exceed $330 per week), unemployed persons will receive an additional $600 per week provided by the Federal government. For many workers, the combination of these amounts will exceed what they were making from working. Also, in some states (e.g. up to $300 in Georgia), you can now receive some amount of compensation for part-time work without diminishing your unemployment benefits. The supplemental $600 per week from the Federal government is set to expire July 31, unless Congress acts to extend it.

TCJA rules pertaining to NOLs, excess business losses, and business interest expense relaxed – In order to help pay for tax rate reductions, the *Tax Cuts and Jobs Act* (TCJA) legislation enacted in late 2017 imposed new limitations on net operating loss carrybacks and carryforwards, business losses from flow through entities, and business interest expense. Under TCJA, net operating losses (NOLs) could no longer be carried back, and could offset no more than 80% of taxable income in a carryforward year. CARES Act permits NOLs from 2018 – 2020 to be carried back 5 years, and the 80% limitation in carryforward year is relaxed. Under TCJA, the amount of business loss an individual could use as an offset against other sources of income was limited to $250,000 for singles and $500,000 for married filing joint return. CARES Act effectively delays the application of this rule until tax year 2021. TCJA generally limited business interest expense deductions to 30% of EBITDA (with exceptions). The CARES Act increases this to 50% for 2019 and 2020 (with a special rule essentially deferring this benefit to 2020 for partnerships), and provides that in computing the limitation for 2020 you can elect to use 2019 EBITDA.

Technical correction for qualified improvement property – Because of an unintended technical glitch in the *Tax Cuts and Jobs Act* enacted in late 2017, "qualified improvement property" (certain leasehold improvements, restaurant property, and retail property improvements) did not qualify for 100% bonus depreciation. The CARES Act fixes that.

An Update on Conservation Easements

As mentioned in previous issues of this newsletter, Georgia is the epicenter of the syndicated conservation easements industry, which has been in the IRS' crosshairs for quite some time. Accordingly, we continue to provide regular updates on the topic of conservation easements.

In *Oakbrook Land Holdings* (opinion released May 12, 2020), the IRS prevailed on the technical foot fault it is using to win most of these cases, which is that the deed did not comply with the proportionality rule in the event of judicial extinguishment of the easement. The primary importance of this case is that the full court (with a couple of dissenters) upheld the validity of the IRS regulation dealing with how the deed must provide for extinguishment proceeds to be shared. Judge Holmes probably summarized the syndicated conservation easement situation best in his dissenting opinion; one excerpt from which includes: "*I fear that our efforts to clear cut and brush hog our way out of the volume of conservation-easement cases we have to deal with has left us a field far stumpier than when we began.*" The *Woodland Property Holding* (May) and *Hewitt* (June) cases were subsequently added to the list of cases in which the IRS has prevailed before Tax Court judges based on failure to adhere to the proportionality rule.

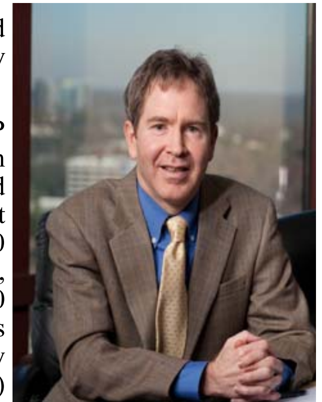
The taxpayers got a rare win in *Champions Retreat* (released May 13, 2020) when the 11th Circuit ruled that the Tax Court erred in disallowing a conservation easement deduction solely because the property was a golf course. The 11th Circuit found that even though 80% of the land was a golf course, the natural areas of the property still provided a habitat for protected plant and animal species and provided scenic views for the public canoeing and kayaking on the adjacent rivers. The 11th Circuit remanded the case to the Tax Court for the Tax Court to determine the appropriate amount of the deduction.

The Paycheck Protection Program (PPP)

In mid-March, as efforts began to “flatten the curve” of the spread of COVID-19, businesses began to furlough employees by the millions, and the fear was that many small businesses would not survive. In an effort to preserve jobs and businesses, Congress included in the CARES Act the “Paycheck Protection Program” (PPP). From a very high level, the PPP provides forgivable loans of up to $10,000,000 to virtually all businesses with 500 employees or less (and in some industries more), and certain nonprofits and tribal concerns. The loan amount is basically 2 ½ months of 2019 payroll costs, and it will be forgiven so long as used during the 8-week period following its receipt (or up to 24 weeks if elected) for qualifying costs (basically payroll, rent, utilities and mortgage interest, with some limitations).

The stampede – Congress initially appropriated $349 billion for the PPP. It was widely believed that this would not be a sufficient amount to satisfy the need, and, other than a “Sense of the Senate” as to what types of businesses should receive priority (which the SBA appears to have ignored), the legislation provided no guidance as to how the funds would be allocated if oversubscribed. The SBA announced that the limited funds would be allocated on a first-come-first-served basis, which caused a mad dash to apply as soon as the application process opened. It was as if President Trump had announced he was flying over the country in Air Force One dropping hundred-dollar bills. When the $349B was gone, and it was learned that publicly-traded companies and other high-profile organizations had received millions in funding while many “Main Street” businesses got left out, the widely-held perception was that the banks (through which the application process was run) had favored their best customers over the small businesses that most needed the funding. Basically, if you were a large customer of a small bank you got funded, whereas if you were a small customer of a large bank you probably did not.

The “necessity of the loan” requirement – One of the requirements for receiving a PPP loan is that the applicant “make a good faith certification that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient”. This is perhaps the most vague and subjective standard ever included in legislation, and initially the consensus seemed to be that Congress basically intended to fund 2 ½ months of payroll for all small companies and qualifying nonprofits. However, after it became known that publicly-traded companies like Ruth’s Chris Steakhouse and Shake Shack had gotten PPP money, members of Congress and the Administration began to publicly question whether some companies which had applied met the “necessity of the loan” requirement. Treasury Secretary Steven Mnuchin went on CNBC and suggested possible criminal charges for those who had applied and shouldn’t have, and the SBA issued FAQ 31 suggesting that some borrowers should return their PPP funds and providing an amnesty date (originally May 7; later extended to May 14) by which they could return the money and avoid the risk of criminal charges. Many companies immediately returned their PPP funds. However, when it became clear that many of the businesses intended to benefit from the program were fearful of utilizing the money because of the risk of criminal prosecution under a totally subjective standard, the SBA walked back the tough talk and issued FAQ 46 which says that any applicant which received a PPP loan of less than $2,000,000 is deemed to have met the necessity of the loan requirement, and if a recipient of PPP loan in excess of $2M is found not to meet the requirement then they simply have to repay it.



Philip R. Poovey, CPA
Partner in Charge of
Accounting and Attestation

Qualification for the PPP – The PPP is available to most businesses with fewer than 500 employees (as tested on an affiliation basis), restaurant businesses with fewer than 500 employees at any one location, businesses with more than 500 employees where the company is considered small by its industry standards, and 501(c)(3) organizations, 501(c)(19) veterans’ organizations, and tribal concerns with fewer than 500 employees.

Maximum amount of PPP loan - $10,000,000; which, mathematically, would be about the most a business with fewer than 500 employees could qualify for anyway, based on 2.5 months of payroll limited to $20,833 for any one employee.

Computation of eligible amount – Basically, you take your 2019 W-2 wages paid, back out amounts paid to any one individual(s) in excess of $100,000, add in health insurance premiums and retirement plan contributions paid by the employer, divide by 12, and multiply by 2.5 (i.e. roughly 2 ½ months of payroll). This is an oversimplification of the process, and there are exceptions for seasonal employers and start-ups, but, for most companies, this will get you pretty close to the eligible amount.

Independent contractors – Based on the language in the statute, it was originally thought that companies might be able to include in the computation of eligible amount the amounts they paid to 1099-MISC contractors. However, subsequent guidance from the SBA provided that you cannot count amounts paid on 1099-MISC. The independent contractor can instead apply for their own PPP, based on their “income replacement amount” (which is basically 20.83% of their 2019 Schedule C profit, not to exceed $20,833).

Partner compensation – Under tax rules, partners receive neither W-2 nor 1099-MISC. Instead, their compensation for services rendered is reported on their Schedule K-1. The PPP legislation was silent with respect to partner compensation. Initially, the SBA appeared unsure how to handle, but eventually came out with guidance permitting 20.83% of partner self-employment income (not to exceed $20,833) to count, and permitting partnerships which had applied prior to the guidance (and excluded partner compensation) to apply for an additional PPP amount which included partner compensation.

The application process – To apply for a PPP forgivable loan, you submit a Form 2483 to your bank along with supporting documentation. Once the bank has approved, it submits to SBA for approval, and after the SBA approves, the bank provides the loan.

Forgiveness – What makes the PPP attractive is that the loan will be forgiven, so long as you spend the proceeds on qualifying costs within the “covered period”. Qualifying costs are payroll (which includes health insurance and retirement plan contributions), rent, utilities and mortgage interest. Qualifying

(Continued on page 4)

The Paycheck Protection Program (PPP) — continued

(Continued from page 3)

salary cannot exceed the equivalent of $100,000 annually for any one individual, as prorated over the covered period (i.e. $15,385 per person under the original 8-week period, or $46,154 per person if electing the 24-week period). For owner-employees, the amount cannot exceed the annualized equivalent received in 2019. Under initial SBA guidance, at least 75% of the PPP had to be spent on payroll costs. However, subsequent legislation reduced this to 60%. There were concerns (based on the language of the statute), that the 60% was a cliff (i.e. no forgiveness if you spent less than 60% of PPP amount on payroll), but SBA has now said you will receive forgiveness, but with the amount of such limited to the payroll costs divided by 60%. To apply for forgiveness, once you have gotten through the 8-week covered period (or longer period if elected), you submit a Form 3508 to the bank which made the loan.

Is it taxable? – Under general principles of tax law, if you take out a loan, use the proceeds to pay business expenses, and then later have the loan forgiven, the expenses are still tax deductible, but you have taxable income for the cancellation of indebtedness (COD income). In the PPP legislation, Congress specifically provided that the PPP forgiveness would be considered COD income, but that such income would be excluded from taxable income. Accordingly, Congress made clear its intent that the PPP amount would be nontaxable. The above notwithstanding, the IRS issued a notice (2020-32) that it intends to disallow the deduction of the expenses paid with PPP funds. Members of Congress on both sides of the aisle, in both the House and the Senate, have indicated this is contrary to Congressional intent, and so it appears that Congress may override the IRS on this. Otherwise, a court challenge would appear likely.

The PPP Increase Act – As noted previously, the initial $349B appropriated for the PPP was insufficient to satisfy demand. Accordingly, Congress subsequently appropriated an additional $310B, bringing the total to $659B. This increase, combined with amounts returned by some companies, appears sufficient to have covered all who have applied.

The PPP Flexibility Act – The initial legislation provided that the "covered period," during which you could utilize amounts and have such count in the forgiveness computation, was the 8-weeks following approval for the PPP. Many businesses (and especially those that were subject to government-ordered closures) found that 8 weeks was not a sufficient time period to expend the funds on qualifying costs. Further, some businesses could not meet the requirement that 75% be spent on payroll. Recognizing these challenges, Congress passed legislation permitting the "covered period" to extend up to 24 weeks and requiring that only 60% of the forgivable amount be spent on payroll-related costs.

Where are we today? - After a wild roller-coaster ride over the past 3 months, with Congress making several substantial changes to the initial legislation and the SBA and IRS issuing frequent, and at times inconsistent, guidance, we still have many unanswered questions. PPP funds remain available (until June 30) for any eligible business or self-employed person who has not yet applied. Those who applied and received a loan of less than $2M appear to be in a position to be comfortable that they will not be challenged as to whether the loan was necessary. Those who received a loan in excess of $2M appear to now be freed from the risk of criminal prosecution if SBA determines they did not really need the loan. Those businesses which were struggling to effectively utilize the PPP proceeds on qualifying costs within an 8-week period have additional time to do so. Overall, while the PPP got off to a rocky start and has been a roller-coaster ride, it appears that most eligible companies have received funding and are benefitting substantially from it.

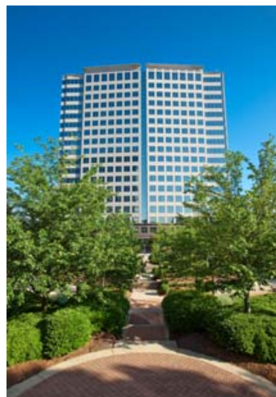
Quick Notes

- Because of the COVID-19 shutdown, the IRS extended to July 15 the due date for most income-tax-related filings and payments otherwise due between April 15 and June 30, 2020. The usual September 15 (partnerships and S-corps), September 30 (trusts), and October 15 (individuals and calendar year C-corps) extended due dates are still available.

- Similarly, in Notice 2020-39, the IRS announced relief for Qualified Opportunity Funds and their investors, including (1) an extension of the 180-day period for reinvestment of QOF investor gain (to 12/31/20 if the 180-day period would otherwise fall between 4/1/20 and 12/31/20), (2) relaxing the 90% investment standard for the period 4/1/20 – 12/31/20, (3) disregarding the period 4/1/20 – 12/31/20 for purposes of the 30-month substantial improvement period, (4) extending the working capital safe harbor another 24 months for assets otherwise intended to be converted to QOZ property by 12/31/20, and (5) extending the QOF 12-month reinvestment period another 12 months if the original 12-month period included 1/20/20.

- Some have referred to the COVID-19 crisis as a "war against an invisible enemy". If the "war" analogy holds up, then that is bad news for marginal income tax rates. The income tax first appeared during the Civil War, and the top rate hit 77% during WWI and 94% during WWII.

400 Galleria Parkway, Suite 1050
Atlanta, GA 30339
Phone: 770-563-8888
Fax: 770-563-8885
www.bridgesdunnrankin.com



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