



Eye on Washington

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Coronavirus Aid, Relief, and Economic Security (“CARES”) Act Establishes \$2.2 Trillion Financial Backstop to U.S. Economy in Time of Crisis

On March 27, 2020, the U.S. Congress passed, and the President signed into law, a massive and unprecedented economic rescue package to provide a capital infusion to individuals and businesses alike. This legislation follows on the heels of two recent bills aimed at providing emergency medical funding support as well as paid sick leave for many employees. As the saying goes, desperate times call for desperate measures, and the sudden and immediate shutdown of large swaths of the US (and global) economy as a result of the COVID-19 pandemic has resulted in a surge of unemployed workers as well as businesses facing existential concerns. The government mandated closures have triggered a needed government response that has been crafted to include direct cash payments to many, as well as government secured business loans that may be forgiven to the extent proceeds cover payroll costs and certain fixed business expenses. And to demonstrate the true thoroughness of the legislation, Congress saw fit to mercifully grant a temporary exception from excise taxes on alcohol to producers of hand sanitizer.

Key Stimulus Provisions of CARES Act

- Expedited Small Business Administration (SBA) loans, for businesses with fewer than 500 employees, up to \$10 million with loan principal forgivable up to the total cost of eight weeks’ worth of payroll, rent, mortgage interest and utilities of the business;
- Payments of \$1,200 per individual (\$2,400 for married couples), plus \$500 per child, for individuals with income below certain thresholds (\$75,000 single/\$150,000 married);
- Penalty-free access of up to \$100,000 from IRAs and qualified retirement plans for participants impacted by the coronavirus, plus increased loan capacity to such level;

- Waiver of required minimum distributions from IRAs and qualified plans for 2020;
- Deferral for payment of the employer portion of the FICA taxes payable in 2020;
- The ability to carry net operating losses incurred in 2018-2020 back to prior tax years in order to generate potential tax refunds this year and next; and
- Various other short-term tax rules changes, including additional incentives for charitable gifts.

Small Business Paycheck Protection Loan Program (PPP)

Perhaps the most significant and desperately needed program to be established under the law involves the ability for businesses with fewer than 500 employees to borrow up to \$10 million through SBA loans under the Paycheck Protection Program (PPP). Not only is an immediate infusion of capital being made available to possibly hundreds of thousands of small businesses across the country, but also a portion of the amount borrowed may be forgiven as an effective grant based on the costs of payroll and certain business expenses.

Which Business Are Eligible for PPP Loans?

- In addition to small businesses normally eligible for loans under the SBA's 7(a) program, the CARES Act broadly expands the scope of eligibility to "**any business concern, non-profit organization, veteran's organization or Tribal business concern.**" Such concerns must **generally have no more than 500 total employees**; however, the SBA may apply a larger standard for specific industries. Non-profits are specifically defined as 501(c)(3) organizations, so not all non-profit organizations are eligible.
- Notably, **for accommodation and food service businesses** (which includes most hotels, restaurants and bars under the NAICS 72 classification), the 500 employee rule is based on a per location basis. The applicable classification, however, excludes civic and social organizations, amusement and recreation parks, theaters, and other recreation or entertainment facilities. While employee figures generally include affiliates under applicable SBA rules, such affiliation rules are waived for hotel and food service industries, as well as franchises.
- The 500 employee threshold includes all employees, including individuals employed on a full-time, part-time or "other basis."
- **Sole proprietorships and independent contractors** are eligible for loans as well.
- Note that businesses that received an economic injury disaster loan (EIDL) after January 31, 2020, are still eligible for a PPP loan so long as the EIDL is used for separate purposes.
- Employers who obtain a PPP loan will not be eligible for the employee retention credit due to COVID related closure; however, such credits are limited to \$5,000 per employee per calendar quarter, and are further limited to employment taxes payable during such period. As a result, it is likely that the Paycheck Protection Program will be much more attractive in most cases.

How Do Business Owners Apply for the Loans?

- PPP loans can be obtained through commercial banks, credit unions and other lending institutions, with the SBA providing a 100% guarantee for the loan to the lender. In order to expedite the processing of such loans, many of the requirements for traditional SBA 7(a) loans are being waived (including posting collateral, offering a personal guarantee, or demonstrating an inability to obtain loans through other channels, etc.).
- Loans should start to become available in early April, and the SBA indicated it is hiring 1000 people to assist with the expected massive volume of applications. Under the law, borrowers will have until June 30, 2020, to apply for a loan.

- For independent contractors, sole proprietors, and self-employed individuals, lenders are being instructed to verify eligibility through certain documents, including payroll tax filings, Forms 1099-MISC, and income and expenses from the sole proprietorship.
- Note that recently obtained SBA loans (after January 31, 2020) but prior to the enactment of the CARES Act, may be refinanced as a covered loan under PPP loan program.

How Much Can Be Obtained Through a PPP Loan?

- The **maximum amount that can be borrowed** is 2.5 times the borrower's average monthly payroll costs, **up to a maximum of \$10 million**. Average monthly payroll costs are based on an employer's total 1-year payroll costs (as described below) prior to the date the loan is made.
 - *Example: A business applies for an SBA PPP loan on May 1, 2020. For the period of May 1, 2019, until April 30, 2020, the total payroll costs of the business were \$2 million, for an average monthly cost of \$166,667. The maximum loan available would therefore be **\$416,667**.*
- For "seasonal employers" (to be determined by the SBA), the average monthly payroll is based on the 12-week period beginning on February 15, 2019 (or at the election of the borrower, the average based on March 1 to June 30, 2019).
- For new employers who may not have been in business prior to June 30, 2019, the average monthly payroll cost may be determined based on the period from January 1, 2020, through February 29, 2020.

What Are the Loan Repayment and Forgiveness Terms?

- The basic terms of the loan require a maximum 4% interest rate and 10-year maximum duration. Loan repayment on interest and principal is deferred for a minimum period of 6 months, and up to 1 year. All loans made under this program are furthermore free of any pre-payment penalties that may otherwise apply.
- The primary and obviously most attractive feature of these small business loans is the ability to not only obtain desperately needed capital in a time when revenues may have dried up, but also to have some or all of the principal repayment obligation forgiven. The **amount that may be forgiven** is based on expenditures **incurred during the eight-week period beginning on the date of origination of the loan** as to:
 - Payroll costs;
 - Interest payments on mortgages (incurred before February 15, 2020) on real or personal property of the business (not including any prepayments);
 - Rent payments under a leasing agreement (in force before February 15, 2020); and
 - Utility payments of the business including electricity, gas, water, transportation, telephone or internet access for which service began prior to February 15, 2020.
- Note that the total amount forgiven cannot exceed the amount borrowed. More importantly, however, the amount of forgiveness is based on the extent employees are maintained on the payroll of the business. Since the purpose of the program is to enable businesses to continue paying employees where it is otherwise unprofitable or impossible to do so, the amount forgiven is reduced proportionally based on any work force reduction during the first 8 weeks after obtaining the loan.

To make such determination, the average monthly number of full time employees during the forgiveness period is compared to the average monthly full time employees of the business during the period of February 15, 2019, to June

30, 2019, or (alternately at the election of the lender), the average employees employed during January 1, 2020-February 29, 2020.

- *Example: Assume total forgivable loan based on eight weeks of qualifying costs is \$100,000, for loan beginning on May 1, 2020. Full time equivalent (FTE) employees as follows:*

January 2020	February 2020	Average Monthly	May 2020	June 2020	Average Monthly
24 FTE	20 FTE	22 FTE	18 FTE	14 FTE	16 FTE

- *The average proportion of employees retained is **72.73%**. Therefore, the **total amount forgivable is reduced to \$72,730.***
- The amount of loan forgiveness may also be reduced if the **salary or wages of employees** earning less than \$100,000 annually **is reduced by more than 25%** during the eight-week period after the loan is obtained. The amount of forgiveness reduction is based on the amount of total wage reduction in excess of such 25% level, as determined by reference to the most recent quarter of earnings prior to the loan.
- While many employees may have already been furloughed or laid off as result of the forced closure of the business, the principal forgiveness reduction will not apply to businesses that re-hire such workers by June 30th. Any reduction in employment or pay occurring between February 15, 2020, and April 26, 2020 (30 days post enactment of the CARES Act), will not be included in any assessment of the forgivable principal amount if corrected.
 - *Example: A restaurant employing 25 individuals lays off the entire workforce as a result of the shutdown on April 1st. A PPP loan is obtained on May 1st. Assuming the entire workforce is rehired (or returns to a total of 25 employees) by June 30th, the average monthly full time employees in May and June will not otherwise trigger a reduction in the forgivable amount of loan principal.*
- Note that borrowers must request forgiveness from their lender by submitting documentation verifying the number of full-time equivalent employees, as well as their payroll costs, mortgage payments, rent payments and utilities payments.

What Items Are Included in “Payroll Costs?”

- Payroll costs are very broadly defined to include salary, wages, commissions, cash tips, as well as payments for leave (including vacation, parental, family, medical or sick leave), payments for group health care benefits (including insurance premiums), and payments for retirement benefits. Note that payroll costs do not include payments made to independent contractors hired by the business (as such individuals are expected to apply for their own loans).
- Payroll costs additionally **include income and net earnings from self-employment** of a sole proprietor or independent contractor.
- In all events, the maximum annual compensation of any employee or self-employed individual considered for purposes of forgivable loans is \$100,000 (equating to \$1,923 per week maximum, or \$15,384 total per employee for eight weeks). Additionally, compensation for these purposes is limited to employees with their principal place of residence inside the United States.
- Payroll costs furthermore exclude any costs for qualified sick and family leave for which a tax credit is allowed under the recent Families First Coronavirus Response Act.

What About Businesses That Don't Necessarily Need the Funds to Operate?

- The law is intended to assist companies that are in need of funds to keep employees on the payroll in light of the sudden economic shutdown. As such, borrowers are required to certify with their loan applications that:
 - The uncertainty of current economic conditions makes necessary the loan request to support ongoing operations;
 - Funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments; and
 - No duplicate loan applications are pending or duplicative amounts have been received.
- The lending institutions themselves are being delegated authority to verify the purposes and suitability of the loans. It is likely that additional guidance will be forthcoming from the SBA, but the immediate intention is to make loans available to largest swath of businesses possible. For the time being, it does not appear that immediate and specific financial distress must be demonstrated.
- While loans do not require personal guarantees, they are considered non-recourse to the business owner except to the extent that loan proceeds are used for a purpose not otherwise authorized.

Are Forgiven Amounts of Principal Taxable to the Business?

- While PPP loan principal that is forgiven is considered canceled indebtedness, the CARES Act specifically excludes such debt forgiveness from gross income for federal income tax purposes.
- While forgiven loans are therefore effectively tax-free grants to a business owner to help fund operations, it appears that a **deduction for business expenses funded via the loans should still be available** to offset taxable income as earned, a potentially significant tax benefit for businesses that maintain operations.

Individual Income Tax Items

The economic rescue package contains significant individual income tax provisions aimed at providing direct cash payments to millions of Americans and the ability to access retirement plan balances on a preferential basis as well. The most significant of such items includes the 2020 individual recovery rebate – an “advanced tax credit” that will be direct deposited in many individual’s accounts in the coming weeks or otherwise mailed as a check.

2020 Individual Recovery Rebates

- Taxpayers with adjusted gross income (AGI) below certain thresholds are eligible for payments of \$1,200 per individual (\$2,400 for a married couple), plus an additional \$500 for any dependents under the age of 17. Eligible recipients must be U.S. citizens or U.S. resident aliens, may not be claimed as a dependent on another tax return, and must have a valid ID number (generally, a Social Security number). AGI thresholds are as follows:
 - **\$75,000** individual;
 - **\$112,500** head of household;
 - **\$150,000** married filing jointly.
- The rebate is phased out by 5% of income above such thresholds, (complete phaseout above \$99,000 individual, and \$198,000 married), and the phaseouts apply to rebates for children as well.
 - *Example: Married couple with 2 children and combined AGI of \$180,000. Total rebate amount is \$2,400 (couple), plus \$1,000 for the children, or \$3,400. AGI exceeds threshold by \$30,000. 5% of \$30,000 is \$1,500 reduction in rebate to \$1,900.*

- The determination of AGI is by reference to the taxpayer's 2019 tax return (if filed), otherwise the 2018 tax return. Notably, the rebate is being treated as an "advanced tax credit" reported on the 2020 tax return.
 - For taxpayers who will not be eligible based on ultimately reported 2020 taxable income, but who are eligible for and receive the credit based on 2019 or 2018 income, it is not considered likely at this point that any portion of the tax credit will need to be refunded, or will otherwise increase the taxpayer's tax liability when 2020 taxes are computed.
 - For taxpayers who are not eligible based on 2019 or 2018 income, but are eligible based on 2020 income, it is anticipated that such credit should be available to reduce the taxpayer's tax liability when the 2020 return is filed.
 - Taxpayers who are not eligible for the rebate based on 2019 income and have not yet filed their return, but would be eligible based on 2018 income, may consider waiting to file their 2019 return (with current due date extended to July 15, 2020).
- Note as well that the credit is considered "refundable," meaning that a taxpayer does not need taxable income in order to be eligible. As a result, retirees who receive only Social Security and/or tax-free income will be eligible for such payments.

Preferential Access to IRAs and Qualified Retirement Plans

- Individuals who have been adversely impacted by COVID-19 have the ability (during 2020) to take a penalty-free distribution of up to \$100,000 from qualified defined contribution retirement plans and IRAs. A 10% penalty normally applies to distributions from such plans for participants who are under age 59½. Of course, for those who continue to be employed, in-service distributions from employer sponsored plans may not be permitted under the plan document. In such instances, a plan loan under expanded terms (as discussed below) may be considered in the alternative.
- To be considered a "coronavirus-related distribution," the participant or account owner must:
 - Be diagnosed with SARS-CoV-2 or COVID-19;
 - Have a spouse or dependent diagnosed with such virus; or
 - Experience adverse financial consequences as a result of quarantine, furlough, being laid off, a reduction in work hours, or an inability to work due to lack of child care, business closing or reduced hours.
- Such **distribution may be included in income over a three-year period**. Conversely, the distribution may be re-contributed over a three-year period, in which case it is treated as an eligible rollover contribution.
 - As a result, an individual may elect to pay income taxes on the distribution over the next three years, or repay over the same period as essentially an interest-free loan.
 - Tax withholding obligations on such distributions will not apply to plan administrators.
 - While it appears possible to effect complete repayment in the third year, it is unclear what the impact of income recognition ratably over the prior two years would be. Additional guidance on this and several other questions will likely be required.
- Lastly, the CARES Act includes a provision permitting participants of qualified plans who have likewise been impacted by COVID-19 (as described above) to take **up to \$100,000 in loans** (or up to 100% of the fully vested balance) from such plans, for a period of up to 180 days from March 27, 2020, the date of enactment. This is an increase from the normal loan limit of \$50,000 or half of the vested account balance.

- Additionally, repayment on plan loans for such qualified participants are delayed for one year, with interest accruing on the loans during such period.

RMD Waiver for 2020

As was provided in 2009 during the last recession amid the financial crisis, **required minimum distributions (RMDs)** for qualified plans and IRAs (though not defined benefit plans) **are waived for 2020**. A waiver is helpful for many retirees whose plan balances have been battered by the severe correction in financial markets, where they would otherwise be required to take a taxable distribution at potentially depressed values. Any rebound in markets could then accrue to the participant on a tax-deferred basis.

Charitable Income Tax Deduction Preferences

- Charitable deduction rules for individual taxpayers have been modified as well, to encourage those able to consider charitable giving during this tumultuous period, as well as to enable donors to benefit from increased generosity. Specifically:
 - The AGI limit to deduct cash contributions to public charities has increased from 60% under current law to 100% for 2020.
 - For taxpayers who do not itemize deductions (where charitable contributions are otherwise claimed), a \$300 above the line deduction will be available for cash contributions to most public charities (though not private foundations or donor advised funds). As a result, relatively small charitable gifts will effectively increase the amount of the available standard deduction. This provision is effective in 2020, but continues indefinitely.

Student Loan Relief Provisions

- The CARES Act expands the existing exclusion for up to \$5,250 of employer educational assistance (which currently applies to expenses such as tuition, fees and books), to include employer repayments of student loans. Employees may exclude employer student loan repayments made between the date of enactment and Dec. 31, 2020.
- Lastly, certain student loan repayment obligations under the Federal Family Education Loan (FFEL) Program and Ford Federal Direct Loan (Direct Loan) Program have been suspended until September 30, 2020, with no accrual of interest required.

Conclusion

The current situation related to the COVID pandemic has witnessed one of the most rapidly deteriorating economic environments in modern history. In spite of the extremely partisan divisions in Washington, the federal government has been able to enact a series of increasingly bold programs, most recently placing an enormous wager on the long-term prospects of the U.S. economy. Many observers are rightly concerned about the level of debt necessary to finance the multi-trillion dollar CARES package, on top of already high levels. While the near zero interest rate environment will help, the only way to ever ultimately repay the stimulus outlays is for a vibrant U.S. economy to flourish and lead the world as it has for many decades. The short-term infusion of capital to keep American businesses open and workers and their families housed and fed should provide much needed stability during unprecedented times and, hopefully, a swift recovery when the crisis abates. Morning in America cannot arrive soon enough.

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