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CERTIFIED PUBLIC ACCOUNTANTS

Dear Friends and Valued Clients:

On December 21, Congress passed the Consolidated Appropriations Act of 2021 (CAA), which provides pandemic relief, as well as other tax and health-related provisions. The massive 5,500-plus page bill is expected to be signed into law by President Trump soon. It also contains other laws within it, including the COVID-Related Tax Relief Act of 2020 (COVIDTRA).

Highlights of the bill include:

**Direct payments to certain individuals.** The CARES Act, passed earlier this year, provided for direct payments to certain people that the government called Economic Impact Payments (EIPs).

The COVIDTRA contains a new program, which it refers to as "additional 2020 recovery rebates" to people under certain income thresholds.

The provision provides a refundable tax credit to eligible individuals in the amount of $600 per eligible family member. The credit is $600 per taxpayer ($1,200 for married couples filing jointly), in addition to $600 per qualifying child. It "phases out" starting at $75,000 of modified adjusted gross income for individuals ($150,000 for married couples filing jointly and $112,500 for heads of household) at a rate of $5 per $100 of additional income.

The credit is available on taxpayers' 2020 returns. However, the CAA provides for the U.S. Treasury Department to issue advance payments based on the information provided to the IRS.

**Change to the business meal deduction rules.** Under the CAA, a business can deduct 100% of business meals for the next two years, provided the food is purchased from a restaurant. In general, taxpayers can deduct the ordinary and necessary food and beverage expenses associated with operating a trade or business, including meals consumed by employees on work travel.

Currently, the deduction is generally limited to 50% of the otherwise allowable amount (although there are some exceptions). Under the CAA, the 50% limit won't apply to expenses for food or beverages provided by restaurants that are paid or incurred after December 31, 2020, and before January 1, 2023.

**Extended tax break for charitable donations made by non-itemizers.** This break was created under the CARES Act, and the CAA extends it for another year. For 2020, individuals who don't itemize deductions may take up to a $300 above-the-line deduction for cash contributions to qualified charitable organizations. (The deduction limit of $300 also applies to married filers.) The CAA extends this rule through 2021, allowing individual cash contributions of up to $300 ($600 for married joint filers) to be deducted above-the-line to qualified charitable organizations.

**More Paycheck Protection Program (PPP) loan funds.** In addition to providing more funding for these loans, there's an expansion of PPP eligible expenses and changes to the eligibility for certain types of businesses. The CAA also clarifies the tax treatment of PPP loans as well as certain aspects of loan forgiveness.

As background, the CARES Act provides that a PPP loan recipient may use the loan proceeds to pay:

- Payroll costs,
- Certain employee benefits relating to healthcare,
- Interest on mortgage obligations,
- Rent,
- Utilities, and
- Interest on any other existing debt obligations.

If a PPP loan recipient uses its PPP loan to pay those costs, the business can have its loan forgiven in an amount equal to those costs. PPP loan forgiveness doesn't give rise to taxable income, and the tax code generally doesn't allow a taxpayer to deduct expenses that are paid with tax-exempt income.

The COVIDTRA clarifies that taxpayers whose PPP loans are forgiven are allowed deductions for otherwise deductible expenses paid with the proceeds of a PPP loan, and that the tax basis and other attributes of the borrower's assets won't be reduced as a result of the loan forgiveness.

**Various tax "extender" breaks.** The CAA extends certain tax law provisions that were scheduled to expire at the end of 2020, including the Work Opportunity Tax Credit (WOTC). As background, the tax code contains dozens of temporary tax provisions with fixed termination dates. Often, these expiring provisions are temporarily extended for a short period of time (for example, one or two years).

In terms of the WOTC, an elective general business credit is available under the tax code to employers hiring individuals who are members of one or more of ten targeted groups. It's based on qualified first-year wages paid to the individual hired. Under prior tax law, the credit applied to hires made before January 1, 2021. The CAA extends the credit through 2025 and applies to individuals who begin work for the employer after December 31, 2020.

**Temporary special rules for flexible spending arrangements (FSAs).** A cafeteria plan may permit the carryover of unused amounts remaining in a health FSA as of the end of a plan year to pay or reimburse a participant for medical care expenses incurred during the following plan year, subject to a carryover limit (currently $550). The CAA expands the carryover period for 2020 and 2021. The provision also allows employers to extend the grace period for plan years ending in 2020 and 2021 to 12 months after the end of such plan year for unused benefits and contributions to health and dependent care FSAs.

In addition, an employer may allow an employee who stops participating in the plan during calendar year 2020 or 2021 to continue to receive reimbursements from unused benefits or contributions through the end of the plan year in which the employee's participation ceased, including any extended grace period. The CAA also provides a special carry-forward rule for dependent care flexible spending arrangements where the dependent aged out during the pandemic.

**Larger tax credits for some parents.** Under the tax code, to the extent the child tax credit (CTC) exceeds a taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15% of as much of the taxpayer's taxable earned income for the tax year as exceeds $2,500. In addition, the earned income tax credit (EITC) for lower-income taxpayers equals a percentage of their earned income.

For both purposes, earned income means wages, salaries, tips and other employee compensation, if includible in gross income for the tax year. Earned income also includes self-employment income, computed without the deduction for one-half of self-employment tax.

Under the CAA, in determining the refundable CTC and the EITC for 2020, taxpayers may elect to substitute the earned income for the preceding tax year if it's greater than the taxpayer's earned income for 2020. These changes apply beginning in 2020.

**A special break for teachers who buy personal protective equipment (PPE).** Currently, eligible educators are allowed a $250 above-the-line deduction for certain otherwise allowable trade or business expenses paid by them. The COVIDTRA provides that, not later than February 28, 2021, the IRS must, by regulation or other guidance, clarify that PPE, disinfectant and other supplies used for the prevention of the spread of COVID-19 are covered under the $250 tax break for teachers.

**Much More**

These are only some of the provisions contained in the new law. There are many other key provisions including:

- An extra $300 per week to people who are unemployed and receiving state aid,
- Changes to disaster-related distributions from retirement plans, and
- An extension of the refundable tax credits available to employers who provide paid sick and family leave related to the COVID-19 pandemic.

We recognize that these are difficult times and we remain committed to supporting you. If you have other questions or concerns, please contact your LLME advisor at (858) 455-1200 or by email.

Thank you for your continued trust and confidence in our firm. We hope that you and your loved ones will continue to be safe and healthy in the new year.

Lavine, Lofgren, Morris & Engelberg, LLP

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