Chapter 1: New Developments

Please note. Corrections were made to this workbook through January of 2021. No subsequent modifications were made.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

About the Author

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Throughout the 2020 *University of Illinois Federal Tax Workbook,* there are topics affected by recent major legislation, notably the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020, and the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019. For the reader's convenience in locating these issues, there are icons in the left margin highlighting areas of impact and their source.

CARES Act

SECURE Act

FAMILIES FIRST CORONAVIRUS RESPONSE ACT

On March 18, 2020, President Trump signed into law the Families First Coronavirus Response Act (FFCRA).[1] The FFCRA responds to the COVID-19 (i.e., coronavirus disease) pandemic by providing paid sick leave, free COVID-19 testing, expanded food assistance and unemployment benefits, and increased Medicaid funding.[2]

In addition, the FFCRA gives eligible employers (defined as **businesses with fewer than 500 employees)** funds to provide employees with paid sick and family and medical leave in connection with COVID-19. Workers can receive up to 10 days (80 hours) of paid sick leave either for their own health needs or to care for the employee's family members. Employees can also receive up to 10 weeks of paid family leave to care for a child whose school or place of care or childcare provider is closed or unavailable because of COVID-19 precautions. The FFCRA provides **refundable tax credits** to the business to cover the costs of this paid leave. Certain self-employed individuals are also entitled to similar credits.[3]

The material in this section provides information on the following tax-related provisions.

- Payroll credit for required paid sick leave
- Payroll credit for required paid family leave
- Credit for sick leave for certain self-employed individuals
- Credit for family leave for certain self-employed individuals

OLD LAW[4]

Federal employment taxes are imposed on wages paid to employees. The taxes imposed include the following.

- Federal Insurance Contributions Act (FICA), which is comprised of the following components
  - Social security (also called old-age, survivors, and disability insurance (OASDI))
  - Medicare
- Federal Unemployment Tax Act (FUTA)
- Federal income tax

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1. PL 116-127.
2. *H.R. 6201—Families First Coronavirus Response Act.* Congress.gov. [www.congress.gov/bill/116th-congress/house-bill/6201] Accessed on Apr. 7, 2020.
3. *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Apr. 28, 2020. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Jul. 27, 2020.
4. *Technical Explanation of Division G, "Tax Credits for Paid Sick and Paid Family and Medical Leave," of H.R. 6201, the "Families First Coronavirus Response Act"* (JCX-10-20). Mar. 17, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=fileinfo&id=5251] Accessed on Apr. 14, 2020.

The applicable rate for social security tax is 12.4%, with half of that imposed on the employee and the other half imposed on the employer. The tax is imposed on covered wages up to the social security wage base, which is $137,700 in 2020.[5]

The applicable rate for Medicare taxes is 2.9%. Half of that is imposed on the employee and the other half is imposed on the employer. There is no earnings limit on the amount of covered wages that are subject to the Medicare tax.[6]

Wages is defined in IRC §3121(a) for social security purposes as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any form other than cash, with certain exceptions. Such wages include salaries, vacation pay, bonuses, deferred compensation, commissions, and fringe benefits.

The Self-Employment Contributions Act (SECA) imposes tax on the self-employment (SE) income of an individual. SECA taxes consist of:

- Social security tax (12.4% of SE income), and
- Medicare tax (2.9% of SE income).

SE income subject to SECA tax is the individual's net earnings from self-employment during the tax year, subject to certain exceptions.

In addition, Tier 1 of the Railroad Retirement Tax Act (RRTA) imposes a tax on compensation paid to railroad employees and representatives.[7] The railroad retirement system is separate from and parallel to the Social Security Administration (SSA). However, the SSA collects taxes to fund the program.

NEW LAW: GENERAL INFORMATION ON FFCRA CREDITS[8]

The information provided below generally pertains to all the FFCRA credits discussed in this section.

Eligible Employers

An eligible employer for purposes of the credits available under the FFCRA is defined as businesses and tax-exempt organizations with fewer than 500 employees that are required to provide paid sick leave and paid family leave.

Generally, a business with fewer than 500 employees is a covered employer that must provide paid sick leave and family leave. However, certain employers with **fewer than 50** employees may be exempt from the FFCRA's requirements to provide paid sick leave due to school or place of care closures or the unavailability of childcare providers due to COVID-19 when doing so would jeopardize the company's viability as a going concern.[9]

> **Note.** For information about claiming the small business exemption available to certain employers with fewer than 50 employees, see the U.S. Department of Labor (DOL) guidance at **uofi.tax/20a1x1** [www.dol.gov/agencies/whd/pandemic/ffcra-questions#58].

5. *Contribution and Benefit Base.* Social Security Administration. [www.ssa.gov/OACT/COLA/cbb.html] Accessed on Apr. 20, 2020.
6. Ibid.
7. IRC §3221.
8. *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Mar. 31, 2020. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Apr. 21, 2020.
9. *Families First Coronavirus Response Act: Questions and Answers.* U.S. Department of Labor. [www.dol.gov/agencies/whd/pandemic/ffcra-questions#4] Accessed on Apr. 21, 2020.

A business is considered to have fewer than 500 employees if the business employs fewer than 500 full-and part-time employees within the United States, the District of Columbia, or any territory or possession of the United States. The determination of whether the business has fewer than 500 employees is made at the time an employee's leave is to be taken.

> **Note.** DOL guidance provides more detail about which workers must be taken into account for purposes of determining the 500-employee limit. DOL guidance also explains when business entities should be treated as separate employers and when they should be aggregated as a single employer when determining their total number of employees. The guidance is available at **uofi.tax/20a1x2** [www.dol.gov/agencies/whd/pandemic/ffcra-questions].

Allocable Qualified Health Plan Expenses

Qualified health plan expenses are amounts paid or incurred by the employer to provide and maintain a group health plan but only to the extent such amounts are excluded from the employees' income under an accident or health plan.[10] An eligible employer can use any reasonable method to determine and allocate the plan expenses.

Qualified health plan expenses allocable to qualified leave wages increase the amount of the tax credits for qualified sick leave wages and qualified family leave wages. The amount of qualified health plan expenses taken into account for purposes of determining the credits generally includes the portion of the cost paid by the eligible employer as well as the portion of the cost paid by the employee with pre-tax salary reduction contributions. Qualified health plan expenses do not include amounts the employee paid with after-tax contributions.

> **Note.** For more information about determining the amount of qualified health plan expenses taken into account for purposes of the credits, see the IRS guidance available at **uofi.tax/20a1x3** [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs#basic].

Periods of Time for Which Credits are Available[11]

The credits for qualified leave wages apply to wages paid for the period beginning on April 1, 2020, and ending on December 31, 2020. Wage payments made after the end of this period may be eligible for the credits if the wages are for leave taken between those dates.

Special Issues for Employers: Taxation and Deductibility of Wages

Eligible employers must include the full amount of the credits for qualified leave wages (and allocable qualified health plan expenses and the employer's share of the Medicare tax on the wages) in gross income.

An eligible employer can generally deduct the qualified leave wages (and allocable qualified health plan expenses and the employer's share of Medicare tax on the qualified wages) as ordinary and necessary expenses in the tax year that the wages are paid or incurred.

10. See IRC §106(a).

11. See IRS Notice 2020-21, 2020-16 IRB 660.

SUMMARY OF LEAVE CREDITS

The following chart from IRS Pub. 5419, *New COVID-19 Employer Tax Credits,* provides a summary of the FFCRA leave credits.

Leave Credits

The paid sick leave credit and paid family leave credit are available for eligible employers who pay qualified sick leave wages and/or qualified family leave wages from 4/1/2020 through 12/31/2020, and who have fewer than 500 employees.

Type of Credit	IF an employee is unable to work because:	Then
Paid Sick Leave Credit	• They're subject to a COVID-19 quarantine or isolation order. • They're advised to self-quarantine because of COVID-19. • They have COVID-19 symptoms and are seeking a medical diagnosis.	The credit is at the employee's regular rate of pay, up to $511 per day and $5,110 in total up to 80 hours. The employer is also eligible for credits for qualified health plan expenses for the employee and the employer's portion of Medicare tax expenses related to the qualified wages.
Paid Sick Leave Credit	• They're caring for someone who is subject to a COVID-19 quarantine or isolation order, or for someone who is advised to self-quarantine because of COVID-19. • They're caring for a child whose school or place of care is closed due to COVID-19. • They're caring for a child whose child care provider is unavailable due to COVID-19.	The credit is for two-thirds of the employee's regular rate of pay, up to $200 per day and $2,000 in total, for up to 80 hours. The employer is also eligible for credits for qualified health plan expenses for the employee and the employer's portion of Medicare tax related to the qualified wages.
Paid Family Leave Credit	• They're caring for a child whose school or place of care is closed due to COVID-19 • They're caring for a child whose child care provider is unavailable due to COVID-19.	• This credit is equal to two-thirds of the employee's regular rate of pay, capped at $200 per day or $10,000 in total. • Up to 10 weeks of qualifying leave can be counted toward the Family Leave Credit. This can be combined with the sick leave credit, so an employer could be entitled to a credit for pay for up to 12 weeks – 2 weeks of sick leave and 10 weeks of family leave. • The employer is also eligible for credits for qualified health plan expenses for the employee and the employer's portion of Medicare tax related to the qualified wages.

For more details, see: www.irs.gov/coronavirus/new-employer-tax-credits

NEW LAW: PAYROLL CREDIT FOR REQUIRED PAID SICK LEAVE[12]

The FFCRA **requires** eligible employers to provide employees with paid sick leave if the employee is unable to work for any of the following reasons.

1. The employee is under a federal, state, or local quarantine or isolation order related to COVID-19.
2. The employee has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
3. The employee is experiencing symptoms of COVID-19 and seeking a medical diagnosis.
4. The employee is caring for an individual who is subject to a federal, state, or local quarantine or isolation order related to COVID-19, or has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
5. The employee is caring for their child if the child's school or place of care has been closed, or the childcare provider is unavailable due to COVID-19 precautions.
6. The employee is experiencing any other substantially similar condition specified by the U.S. Department of Health and Human Services (HHS).

An employee who cannot work due to a circumstance described in items 1–3 above is entitled to paid sick leave for up to two weeks (up to 80 hours) at the employee's regular pay rate, or, if higher, the federal minimum wage or any applicable state or local minimum wage. The maximum allowable amount is $511 per day, or a total of $5,110. A part-time worker is eligible for leave equal to the average number of hours the employee works for a 2-week period.[13]

An employee who cannot work due to a circumstance described in items 4–6 above is entitled to paid sick leave for up to two weeks (up to 80 hours) at two-thirds of the employee's regular pay rate or, if higher, the federal minimum wage or any applicable state or local minimum wage. The maximum allowable amount is $200 per day, or a total of $2,000.

The eligible employer is entitled to a refundable tax credit equal to 100% of the amount of the required paid sick leave. The amount of the credit also includes the employer's share of Medicare tax imposed on those wages. The employer is **not** subject to the employer portion of social security tax on those wages. However, qualified leave wages are subject to withholding of federal income tax and the **employee's** share of social security and Medicare taxes.

Example 1. Eli Gible Company pays $10,000 in qualified sick leave wages during the second quarter of 2020. Eli Gible does not owe the employer's share of social security tax on the sick leave wages, but it owes Medicare taxes of $145 ($10,000 × 1.45%). Therefore, Eli Gible is entitled to a $10,145 credit for the family leave wages and the Medicare tax on those wages.

Eli Gible is still required to withhold the **employee's** share of social security and Medicare taxes on the qualified leave wages paid.

> **Note.** Employers who are subject to the RRTA are not subject to either social security tax or Medicare tax on the sick leave wages. Therefore, they do not get a credit for Medicare tax.

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12. FFCRA §7001; *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Mar. 31, 2020. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Apr. 8, 2020; *Technical Explanation of Division G, "Tax Credits for Paid Sick and Paid Family and Medical Leave," of H.R. 6201, the "Families First Coronavirus Response Act"* (JCX-10-20). Mar 17, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=fileinfo&id=5251] Accessed on Apr. 9, 2020.

13. *Families First Coronavirus Response Act: Employer Paid Leave Requirements.* U.S. Department of Labor. [www.dol.gov/agencies/whd/pandemic/ffcra-employer-paid-leave] Accessed on Apr. 9, 2020.

In addition, the allowed credit is increased by the amount of qualified health plan expenses that are properly allocable to the sick leave wages for which the credit is allowed. (Qualified health plan expenses are defined earlier.)

Reporting the Wages[14]

Employers must report the amount of qualified sick leave wages and qualified family leave wages paid to employees on Form W-2, *Wage and Tax Statement,* box 14, or a separate statement. The qualified sick leave wages paid due to circumstances 1–3 above must be reported separately from those wages paid due to circumstances 4–6 and separately from qualified family leave wages.

The employer may want to include a statement with the following language with the Form W-2 or equivalent statement.

> *Included in Box 14, if applicable, are amounts paid to you as qualified sick leave wages or qualified family leave wages under the Families First Coronavirus Response Act. Specifically, up to three types of paid qualified sick leave wages or qualified family leave wages are reported in Box 14:*
>
> - *Sick leave wages subject to the $511 per day limit because of care you required;*
> - *Sick leave wages subject to the $200 per day limit because of care you provided to another; and*
> - *Emergency family leave wages.*
>
> *If you have self-employment income in addition to wages paid by your employer, and you intend to claim any qualified sick leave or qualified family leave equivalent credits, you must report the qualified sick leave or qualified family leave wages on Form 7202, Credits for Sick Leave and Family Leave for Certain Self-Employed Individuals, included with your income tax return and reduce (but not below zero) any qualified sick leave or qualified family leave equivalent credits by the amount of these qualified leave wages. If you have self-employment income, you should refer to the instructions for your individual income tax return for more information.*

Claiming the Credit

Eligible employers can claim tax credits for **qualified leave wages** paid to employees for leave taken beginning on April 1, 2020, and ending on December 31, 2020.

Employers claim the credits on their federal employment tax returns (e.g., Form 941, *Employer's Quarterly Federal Tax Return).* However, they can recover the money more quickly by reducing their federal employment tax deposits. If the federal employment taxes are insufficient to cover the amount of the credits, the employer can request an advance payment of the credits from the IRS by submitting Form 7200, *Advance Payment of Employer Credits Due to COVID-19.*

14. IRS Notice 2020-54, 2020-31 IRB 226.

Example 2. Use the same facts as **Example 1.** Eli Gible claims $3,800 of the credit by reducing its federal employment tax deposits. It files the following Form 7200 to request advance payment of the remaining credit amount of $6,345 ($10,145 credit – $3,800).

Form **7200** (March 2020) Department of the Treasury Internal Revenue Service

Advance Payment of Employer Credits Due to COVID-19

► Go to *www.irs.gov/Form7200* for instructions and the latest information.

OMB No. 1545-0029

Name (not your trade name) **Eli Gible Company**	**Employer identification number (EIN)** **36-1122333**
Trade name (if any)	Applicable calendar quarter (check one) **(2)** ☒ April, May, June
Number, street, and apt. or suite no. If a P.O. box, see instructions. **2708 Breezy Lane**	**(3)** ☐ July, August, September **(4)** ☐ October, November, December
City or town, state, and ZIP code. If a foreign address, also complete spaces below. (See instructions.) **Wendy, IL 60111**	
Foreign country name / Foreign province/county	Foreign postal code
Does a third-party payer file your employment tax return? (See instructions.) If "Yes," enter its name.	Third-party payer's EIN (if applicable)

Tip: File Form 7200 if you can't reduce your employment tax deposits to fully account for these credits that you expect to claim on your employment tax return for the applicable quarter. Don't reduce your employment tax deposits and request advanced credits for the same expected credits. You will need to reconcile your advanced credits and reduced deposits on your employment tax return. You can't request an advance payment of the credit for sick and family leave for self-employed individuals.

Part I Tell Us About Your Employment Tax Return

A Check the box to indicate which employment tax return form you file (or will file for 2020):
(1) ☒ 941, 941-PR, or 941-SS **(2)** ☐ 943 or 943-PR **(3)** ☐ 944 or 944(SP) **(4)** ☐ CT-1

B Is this a new business started on or after January 1, 2020? . . . ► ☐ **Yes** ☒ **No**
If "Yes," skip line C unless you've already filed Form 941, Form 941-PR, or Form 941-SS for at least one quarter of 2020.

C Amount reported on line 2 of your most recently filed Form 941 (or wages reported on Schedule R (Form 941), column (c), by your third-party payer (see instructions)). If you file a different employment tax return, see instructions . . . ► **20,000**

D Enter the total number of employees you have. See instructions . . . ► **4**

Part II Enter Your Credits and Advance Requested

1	Total employee retention credit for the quarter. See instructions			1	
2	Total qualified sick leave wages eligible for the credit and paid this quarter. See instructions			2	**10,145**
3	Total qualified family leave wages eligible for the credit and paid this quarter. See instructions			3	
4	Add lines 1, 2, and 3			4	**10,145**
5	Total amount by which you have already reduced your federal employment tax deposits for these credits for this quarter	5	**3,800**		
6	Total advanced credits requested on previous filings of this form for this quarter	6	**0**		
7	Add lines 5 and 6			7	**3,800**
8	**Advance requested.** Subtract line 7 from line 4. If zero or less, don't file this form			8	**6,345**

Third-Party Designee
Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See the instructions for details. ☐ **Yes.** Complete below. ☒ **No**
Designee's name ► and phone number ►
Select a 5-digit personal identification number (PIN) to use when talking to the IRS ►

Sign Here
Under penalties of perjury, I declare that I have examined this form, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Printed title
Printed name		Best daytime phone

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	PTIN	Check ☐ if self-employed
Firm's name ►			Firm's EIN ►	
Firm's address ►			Phone no.	

How To File Fax your completed form to 855-248-0552.

For Privacy Act and Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 56392D Form **7200** (3-2020)

Employers claiming the credit for qualified leave wages (and allocable health plan expenses and employer's share of Medicare taxes) must keep records and documentation supporting each employee's leave to substantiate the claim for the credits. In addition, the employer must retain the Forms 941 and 7200 and any other applicable documents sent to the IRS requesting the credit.

In order for employers to claim the paid sick and family leave credits, the IRS has revised Form 941 and is revising Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees;* Form 944, *Employer's Annual Federal Tax Return;* and Form CT-1, *Employer's Annual Railroad Retirement Tax Return.* The revised employment tax returns provide for any credits in excess of the taxes imposed to be credited against other employment taxes. Any remaining balance is refunded to the employer.

On July 29, 2020, the IRS issued a temporary regulation[15] and a proposed regulation[16] to authorize the IRS to assess, reconcile, and recapture any portion of the payroll credits that were erroneously paid or refunded in excess of the actual amount allowed.

Any credit amount that is erroneously refunded or credited to an employer is treated as an underpayment of the taxes imposed. The IRS assesses and collects the erroneous credit amount in the same manner as it assesses and collects taxes. The erroneous credit amount must reflect any credit amounts advanced to an employer. The temporary regulations apply to all credit refunds under FFCRA §§7001 and 7003 advanced or paid after April 1, 2020.

Note. The temporary and proposed regulations also apply to advanced payments of refundable employment tax credits under the CARES Act. The CARES Act is discussed later in this chapter.

NEW LAW: PAYROLL CREDIT FOR REQUIRED PAID FAMILY LEAVE[17]

An employee who is unable to work may be entitled to qualified family leave wages. **Qualified family leave wages** are wages that eligible employers must pay eligible employees for periods of leave during which they are unable to work (or telework) due to a need for leave to care for a child if the child's school or place of care has been closed, or because the childcare provider is unavailable, due to COVID-19. The first 10 days for which an employee takes leave for this reason may be unpaid; however, an employee may be entitled to receive qualified sick leave wages (as previously defined) during that 10-day period. In addition, the employee may be entitled to receive other forms of paid leave under the eligible employer's policy.

The paid family leave is **in addition to** the paid sick leave credit. The amount of the family leave is two-thirds of the employee's regular pay, up to a maximum of $200 per day, and an aggregate of $10,000. An employee is entitled to up to 10 weeks (or 50 days) of qualifying leave for purposes of the family leave credit.

Example 3. Miranda takes 14 weeks of leave from her employer, Weathering Roofs, Inc., because her daughter's childcare provider is closed due to COVID-19. The leave occurs during the period from May 2020 through August 2020. Miranda is a salaried employee and she earns $2,000 per week (or $400 per day). Weathering Roofs is an eligible employer for purposes of the sick and family leave credits.

Miranda is entitled to the following amounts of leave.

- Paid sick leave of $2,000 ($400 regular pay rate per day × 2/3 × 10 days maximum = $2,667, **capped at a maximum of $2,000)**
- Paid family leave of $10,000 ($400 regular pay rate per day × 2/3 × 50 days maximum = $13,333, **capped at a maximum of $10,000)**

Therefore, Miranda is entitled to a total of $12,000 of paid sick leave and family leave.

15. TD 9904, 85 Fed. Reg. 45514.

16. REG-111879-20, 85 Fed. Reg. 45551.

17. FFCRA §7003; *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Mar. 31, 2020. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Apr. 15, 2020.

An eligible employer is entitled to a refundable tax credit equal to the required paid family and medical leave (qualified family leave wages) paid to its employees. The amount of the credit also includes the eligible employer's share of Medicare tax imposed on those wages and the cost of maintaining health insurance coverage for the employee during the leave period. The employer is not subject to the employer portion of social security tax imposed on the leave wages.

Note. Eligible employers subject to the RRTA are not subject to social security tax or Medicare tax on the qualified family leave wages. Therefore, they do not get a credit for the Medicare tax.

Claiming the Credit

Eligible employers can claim tax credits for qualified family leave wages paid to employees (plus allocable qualified health plan expenses and the employer's share of Medicare taxes) for leave taken beginning on April 1, 2020, and ending on December 31, 2020.

Eligible employers that pay qualified family leave wages can retain an amount of all federal employment taxes equal to the amount of the qualified leave wages paid, plus the allocable qualified health plan expenses and the amount of the employer's share of Medicare tax imposed on those wages, rather than depositing the employment taxes with the IRS. The federal employment taxes that can be retained include federal income taxes withheld from employees, the employees' share of social security and Medicare taxes, and the employer's share of social security and Medicare taxes for **all** employees.

Employers claim the credits on their federal employment tax returns (e.g., Form 941). However, they can recover the money more quickly by reducing their federal employment tax deposits. If the federal employment taxes are insufficient to cover the amount of the credits, the employer can request an advance payment of the credits from the IRS by submitting **Form 7200.**

Example 4. In the second quarter of 2020, Charming Prints Co. paid the following amounts, which qualify for the family leave credit.

Family leave wages	$4,500
Allocable qualified health plan expenses	400
Employer share of Medicare tax on family leave wages ($4,500 × 1.45%)	65
Total	$4,965

Charming Prints paid $30,000 total wages in the second quarter, including the $4,500 of family leave wages. The company's payroll tax liability for the second quarter after applying the family leave credit is $2,756, which is calculated as follows.

Employer portion social security taxes (($30,000 total wages − $4,500 leave wages) × 6.2%)	$1,581
Employee portion social security taxes ($30,000 total wages × 6.2%)	1,860
Total Medicare taxes (before credit for Medicare taxes on leave wages) ($30,000 × 2.9%)	870
Federal income tax withholding on wages	3,410
Total taxes	$7,721
Less: total family leave credit (calculated above)	(4,965)
Tax liability after credit	$2,756

As shown above, Charming Prints' total second quarter tax liability is $7,721. Charming Prints retains $4,965 of this amount and deposits the balance due of $2,756 on its required deposit dates.

Charming Prints' accountant, Cindy, prepares the worksheet from the Form 941 instructions to calculate the family leave wage credit. The worksheet and second quarter Form 941 follow.

Note. Form 941 has been updated. Note the new sections of lines 11 and 13, and in part 3.

Note. Employers can also defer the employer's share of social security taxes. This is reported on line 13b of Form 941. This is further discussed in the CARES Act section of this chapter.

For Example 4

Worksheet 1. Credit for Qualified Sick and Family Leave Wages and the Employee Retention Credit

Keep for Your Records

Determine how you will complete this worksheet

If you paid both qualified sick and family leave wages and qualified wages for purposes of the employee retention credit this quarter, complete Step 1, Step 2, and Step 3. If you paid qualified sick and family leave wages this quarter but you didn't pay any qualified wages for purposes of the employee retention credit this quarter, complete Step 1 and Step 2. If you paid qualified wages for purposes of the employee retention credit this quarter but you didn't pay any qualified sick and family leave wages this quarter, complete Step 1 and Step 3.

Step 1.	**Determine the employer share of social security tax this quarter after it is reduced by any credit claimed on Form 8974 and any credit to be claimed on Form 5884-C**				
1a	Enter the amount of social security tax from Form 941, Part 1, line 5a, column 2	1a	3,162		
1b	Enter the amount of social security tax from Form 941, Part 1, line 5b, column 2	1b			
1c	Add lines 1a and 1b	1c	3,162		
1d	Multiply line 1c by 50% (0.50)	1d	1,581		
1e	If you're a third-party payer of sick pay that isn't an agent and you're claiming credits for amounts paid to your employees, enter the employer share of social security tax included on Form 941, Part 1, line 8 (enter as a positive number)	1e			
1f	Subtract line 1e from line 1d	1f	1,581		
1g	If you received a Section 3121(q) Notice and Demand during the quarter, enter the amount of the employer share of social security tax from the notice	1g			
1h	**Employer share of social security tax**. Add lines 1f and 1g			1h	1,581
1i	Enter the amount from Form 941, Part 1, line 11a (credit from Form 8974)	1i			
1j	Enter the amount to be claimed on Form 5884-C, line 11, for this quarter	1j			
1k	**Total nonrefundable credits already used against the employer share of social security tax.** Add lines 1i and 1j			1k	
1l	**Employer share of social security tax remaining.** Subtract line 1k from line 1h			1l	1,581
Step 2.	**Figure the sick and family leave credit**				
2a	Qualified sick leave wages reported on Form 941, Part 1, line 5a(i), column 1	2a			
2a(i)	Qualified sick leave wages included on Form 941, Part 1, line 5c, but not included on Form 941, Part 1, line 5a(i), column 1, because the wages reported on that line were limited by the social security wage base	2a(i)			
2a(ii)	Total qualified sick leave wages. Add lines 2a and 2a(i)	2a(ii)			
2b	Qualified health plan expenses allocable to qualified sick leave wages (Form 941, Part 3, line 19)	2b			
2c	Employer share of Medicare tax on qualified sick leave wages. Multiply line 2a(ii) by 1.45% (0.0145)	2c			
2d	**Credit for qualified sick leave wages.** Add lines 2a(ii), 2b, and 2c			2d	
2e	Qualified family leave wages reported on Form 941, Part 1, line 5a(ii), column 1	2e	4,500		
2e(i)	Qualified family leave wages included on Form 941, Part 1, line 5c, but not included on Form 941, Part 1, line 5a(ii), column 1, because the wages reported on that line were limited by the social security wage base	2e(i)			
2e(ii)	Total qualified family leave wages. Add lines 2e and 2e(i)	2e(ii)	4,500		
2f	Qualified health plan expenses allocable to qualified family leave wages (Form 941, Part 3, line 20)	2f	400		
2g	Employer share of Medicare tax on qualified family leave wages. Multiply line 2e(ii) by 1.45% (0.0145)	2g	65		
2h	**Credit for qualified family leave wages.** Add lines 2e(ii), 2f, and 2g			2h	4,965
2i	**Credit for qualified sick and family leave wages.** Add lines 2d and 2h			2i	4,965
2j	**Nonrefundable portion of credit for qualified sick and family leave wages.** Enter the smaller of line 1l or line 2i. Enter this amount on Form 941, Part 1, line 11b			2j	1,581
2k	**Refundable portion of credit for qualified sick and family leave wages.** Subtract line 2j from line 2i and enter this amount on Form 941, Part 1, line 13c			2k	3,384
Step 3.	**Figure the employee retention credit**				
3a	Qualified wages (excluding qualified health plan expenses) for the employee retention credit (Form 941, Part 3, line 21)	3a			
3b	Qualified health plan expenses allocable to qualified wages for the employee retention credit (Form 941, Part 3, line 22)	3b			
3c	Qualified wages (excluding qualified health plan expenses) paid March 13, 2020, through March 31, 2020, for the employee retention credit (Form 941, Part 3, line 24). Enter an amount here only for the second quarter Form 941	3c		*Caution: Only complete lines 3c and 3d for your second quarter 2020 Form 941.*	
3d	Qualified health plan expenses allocable to qualified wages paid March 13, 2020, through March 31, 2020, for the employee retention credit (Form 941, Part 3, line 25). Enter an amount here only for the second quarter Form 941	3d			
3e	Add lines 3a, 3b, 3c, and 3d	3e			
3f	**Retention credit.** Multiply line 3e by 50% (0.50)			3f	
3g	Enter the amount of the employer share of social security tax from Step 1, line 1l	3g			
3h	Enter the amount of the nonrefundable portion of the credit for qualified sick and family leave wages from Step 2, line 2j	3h			
3i	Subtract line 3h from line 3g	3i			
3j	**Nonrefundable portion of employee retention credit.** Enter the smaller of line 3f or line 3i. Enter this amount on Form 941, Part 1, line 11c			3j	
3k	**Refundable portion of employee retention credit.** Subtract line 3j from line 3f and enter this amount on Form 941, Part 1, line 13d			3k	

For Example 4

Form **941 for 2020: Employer's QUARTERLY Federal Tax Return** 950120
(Rev. April 2020) Department of the Treasury — Internal Revenue Service OMB No. 1545-0029

Employer identification number (EIN) 3 6 – 1 2 3 4 5 6 7

Name *(not your trade name)*

Trade name *(if any)* Charming Prints Co.

Address 101 Galahad Lane
Number Street Suite or room number

Aurora IL 60502
City State ZIP code

Foreign country name Foreign province/county Foreign postal code

Report for this Quarter of 2020
(Check one.)

☐ **1:** January, February, March
☒ **2:** April, May, June
☐ **3:** July, August, September
☐ **4:** October, November, December

Go to *www.irs.gov/Form941* for instructions and the latest information.

Read the separate instructions before you complete Form 941. Type or print within the boxes.

Part 1: Answer these questions for this quarter.

		Column 1		Column 2		
1	Number of employees who received wages, tips, or other compensation for the pay period including: *June 12* (Quarter 2), *Sept. 12* (Quarter 3), or *Dec. 12* (Quarter 4)				1	
2	Wages, tips, and other compensation				2	30,000 . 00
3	Federal income tax withheld from wages, tips, and other compensation				3	3,410 . 00
4	If no wages, tips, and other compensation are subject to social security or Medicare tax					☐ Check and go to line 6.
5a	Taxable social security wages	25,500 . 00	× 0.124 =	3,162 . 00		
5a	(i) Qualified sick leave wages	.	× 0.062 =	.		
5a	(ii) Qualified family leave wages	4,500 . 00	× 0.062 =	279 . 00		
5b	Taxable social security tips	.	× 0.124 =	.		
5c	Taxable Medicare wages & tips	30,000 . 00	× 0.029 =	870 . 00		
5d	Taxable wages & tips subject to Additional Medicare Tax withholding	.	× 0.009 =	.		
5e	**Total social security and Medicare taxes.** Add Column 2 from lines 5a, 5a(i), 5a(ii), 5b, 5c, and 5d				5e	4,311 . 00
5f	**Section 3121(q) Notice and Demand—Tax due on unreported tips** (see instructions)				5f	.
6	**Total taxes before adjustments.** Add lines 3, 5e, and 5f				6	7,721 . 00
7	Current quarter's adjustment for fractions of cents				7	.
8	Current quarter's adjustment for sick pay				8	.
9	Current quarter's adjustments for tips and group-term life insurance				9	.
10	**Total taxes after adjustments.** Combine lines 6 through 9				10	7,721 . 00
11a	**Qualified small business payroll tax credit for increasing research activities.** Attach Form 8974				11a	.
11b	Nonrefundable portion of credit for qualified sick and family leave wages from Worksheet 1				11b	1,581 . 00
11c	Nonrefundable portion of employee retention credit from Worksheet 1				11c	.

► You MUST complete all three pages of Form 941 and SIGN it. Next ►

For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 17001Z Form **941** (Rev. 4-2020)

For Example 4

950220

Name (not your trade name)	Employer identification number (EIN)

Part 1: Answer these questions for this quarter. *(continued)*

11d	**Total nonrefundable credits.** Add lines 11a, 11b, and 11c	11d	1,581 . 00
12	**Total taxes after adjustments and nonrefundable credits.** Subtract line 11d from line 10	12	6,140 . 00
13a	**Total deposits for this quarter, including overpayment applied from a prior quarter and overpayments applied from Form 941-X, 941-X (PR), 944-X, or 944-X (SP) filed in the current quarter**	13a	2,756 . 00
13b	**Deferred amount of the employer share of social security tax**	13b	.
13c	**Refundable portion of credit for qualified sick and family leave wages from Worksheet 1**	13c	3,384 . 00
13d	**Refundable portion of employee retention credit from Worksheet 1**	13d	.
13e	**Total deposits, deferrals, and refundable credits.** Add lines 13a, 13b, 13c, and 13d	13e	6,140 . 00
13f	**Total advances received from filing Form(s) 7200 for the quarter**	13f	.
13g	**Total deposits, deferrals, and refundable credits less advances.** Subtract line 13f from line 13e	13g	6,140 . 00
14	**Balance due.** If line 12 is more than line 13g, enter the difference and see instructions	14	.

15 **Overpayment.** If line 13g is more than line 12, enter the difference [.] Check one: ☐ Apply to next return. ☐ Send a refund.

Part 2: Tell us about your deposit schedule and tax liability for this quarter.

If you're unsure about whether you're a monthly schedule depositor or a semiweekly schedule depositor, see section 11 of Pub. 15.

16 **Check one:**

☐ **Line 12 on this return is less than $2,500 or line 12 on the return for the prior quarter was less than $2,500, and you didn't incur a $100,000 next-day deposit obligation during the current quarter.** If line 12 for the prior quarter was less than $2,500 but line 12 on this return is $100,000 or more, you must provide a record of your federal tax liability. If you're a monthly schedule depositor, complete the deposit schedule below; if you're a semiweekly schedule depositor, attach Schedule B (Form 941). Go to Part 3.

☒ **You were a monthly schedule depositor for the entire quarter.** Enter your tax liability for each month and total liability for the quarter, then go to Part 3.

Tax liability:	**Month 1**	2,150 . 00
	Month 2	2,000 . 00
	Month 3	1,990 . 00
Total liability for quarter		6,140 . 00 **Total must equal line 12.**

☐ **You were a semiweekly schedule depositor for any part of this quarter.** Complete Schedule B (Form 941), Report of Tax Liability for Semiweekly Schedule Depositors, and attach it to Form 941. Go to Part 3.

▶ **You MUST complete all three pages of Form 941 and SIGN it.** Next ➡

Page **2** Form **941** (Rev. 4-2020)

For Example 4

950920

Name (not your trade name)	Employer identification number (EIN)

Part 3: Tell us about your business. If a question does NOT apply to your business, leave it blank.

17 **If your business has closed or you stopped paying wages** . . . . ☐ Check here, and

enter the final date you paid wages [/ /]; also attach a statement to your return. See instructions.

18 **If you're a seasonal employer and you don't have to file a return for every quarter of the year** . . . ☐ Check here.

19	**Qualified health plan expenses allocable to qualified sick leave wages**	19	.
20	**Qualified health plan expenses allocable to qualified family leave wages**	20	400 . 00
21	**Qualified wages for the employee retention credit**	21	.
22	**Qualified health plan expenses allocable to wages reported on line 21**	22	.
23	**Credit from Form 5884-C, line 11, for this quarter**	23	.
24	**Qualified wages paid March 13 through March 31, 2020, for the employee retention credit (use this line only for the second quarter filing of Form 941)**	24	.
25	**Qualified health plan expenses allocable to wages reported on line 24 (use this line only for the second quarter filing of Form 941)**	25	.

Part 4: May we speak with your third-party designee?

Do you want to allow an employee, a paid tax preparer, or another person to discuss this return with the IRS? See the instructions for details.

☒ Yes. Designee's name and phone number **Cindy Rella** **815-555-0012**

Select a 5-digit personal identification number (PIN) to use when talking to the IRS. **1 2 3 4 5**

☐ No.

Part 5: Sign here. You MUST complete all three pages of Form 941 and SIGN it.

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

✗ **Sign your name here** [ ]

Print your name here [ ]

Print your title here [ ]

Date [/ /]

Best daytime phone [ ]

Paid Preparer Use Only Check if you're self-employed . . . ☐

Preparer's name		PTIN	
Preparer's signature		Date	/ /
Firm's name (or yours if self-employed)		EIN	
Address		Phone	
City	State	ZIP code	

Page **3** Form **941** (Rev. 4-2020)

Employers claiming the credit must retain records supporting each employee's leave to substantiate the claim for the credit. Employers should also retain Forms 941 (or other employment tax return) and the Forms 7200 on which the credits were claimed.

NEW LAW: CREDIT FOR SICK LEAVE FOR SELF-EMPLOYED INDIVIDUALS[18]

An eligible self-employed individual is allowed a credit for a qualified sick leave equivalent amount. An **eligible self-employed individual** is defined as an individual who regularly carries on any trade or business and would be entitled to receive paid sick leave during the tax year under the FFCRA if the individual were an employee of an employer that is subject to the requirements of the FFCRA.

The FFCRA provides eligible self-employed individuals with a tax credit for paid sick leave if the self-employed individual is unable to work or telework for any of the following reasons.

1. The self-employed individual is under a federal, state, or local quarantine or isolation order related to COVID-19.
2. The self-employed individual has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
3. The self-employed individual experiences symptoms of COVID-19 and seeks a medical diagnosis.
4. The self-employed individual cares for an individual who is subject to a federal, state, or local quarantine or isolation order related to COVID-19, or has been advised by a healthcare provider to self-quarantine due to concerns related to COVID-19.
5. The self-employed individual cares for their child if the child's school or place of care has been closed, or the childcare provider is unavailable due to COVID-19 precautions.
6. The self-employed individual experiences any other substantially similar condition specified by the secretary of HHS.

If an eligible self-employed individual is unable to work or telework because of a circumstance described in items 1–3 above, the **qualified sick leave equivalent amount** is equal to the number of days (up to a maximum of 10 days) during the tax year that the individual cannot perform services in the applicable trade or business for one of those three reasons, multiplied by the lesser of the following.

- $511
- 100% of the individual's average daily SE income for the tax year

If an eligible self-employed individual is unable to work or telework because of a circumstance described in items 4–6 above, the **qualified sick leave equivalent amount** is equal to the number of days (up to a maximum of 10 days) during the tax year that the individual cannot perform services in the trade or business for one of those three reasons, multiplied by the lesser of the following.

- $200
- 67% of the individual's average daily SE income for the tax year

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18. FFCRA §7002; *Technical Explanation of Division G, "Tax Credits for Paid Sick and Paid Family and Medical Leave," of H.R. 6201, the "Families First Coronavirus Response Act"* (JCX-10-20). Mar 17, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=fileinfo&id=5251] Accessed on Apr. 14, 2020; *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Mar. 31, 2020. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Apr. 14, 2020; *COVID-19-Related Tax Credits: Special Issues for Employees and Additional Questions FAQs.* Apr. 28, 2020. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-special-issues-for-employees-and-additional-questions-faqs#specific] Accessed on Aug. 1, 2020.

The days that can be taken into account in determining the qualified sick leave equivalent amount are those during the period beginning on April 1, 2020, and ending on December 31, 2020.

Average daily SE income is defined as the individual's net earnings from self-employment for the tax year divided by 260.

Claiming the Credit

The refundable credit is claimed on the self-employed individual's Form 1040, *U.S. Individual Income Tax Return,* for the 2020 tax year.

The self-employed individual can fund the qualified sick leave equivalent amount by taking into account the credit to which the individual is entitled in determining required estimated tax payments. This means a self-employed individual can reduce payments of estimated income taxes that they would otherwise be required to make if the individual was not entitled to the credit on their Form 1040.

Self-employed individuals claiming the qualified sick leave equivalent or qualified family leave equivalent credit report the qualified sick leave and qualified family leave wage amounts on Form 7202. Any qualified sick leave or qualified family leave equivalent credits are reduced (but not below zero) by the amount of qualified leave wages.

NEW LAW: CREDIT FOR FAMILY LEAVE FOR SELF-EMPLOYED INDIVIDUALS[19]

An eligible self-employed individual is allowed a credit for a qualified family leave equivalent amount. An **eligible self-employed individual** is defined as an individual who regularly carries on any trade or business and would be entitled to receive qualified family leave during the tax year under the FFCRA if the individual were an employee of an employer that is subject to the requirements of the FFCRA.

The **qualified family leave equivalent amount** for an eligible self-employed individual is an amount equal to the number of days (up to 50) during the tax year that the self-employed individual cannot perform services for which they would be entitled to paid family leave if the individual were employed by an eligible employer (described earlier), multiplied by the lesser of the following.

- $200
- 67% of the average daily SE income of the individual for the tax year

The days that can be taken into account in determining the qualified family leave equivalent amount are those during the period beginning on April 1, 2020, and ending on December 31, 2020.

Average daily SE income is defined as the individual's net earnings from self-employment for the tax year divided by 260.

Claiming the Credit

The refundable credit is claimed on the self-employed individual's Form 1040 for the 2020 tax year.

The self-employed individual can fund the qualified family leave equivalent amount by taking into account the credit to which the individual is entitled in determining required estimated tax payments. This means a self-employed individual can reduce payments of estimated income taxes that they would otherwise be required to make if the individual was not entitled to the credit on their Form 1040.

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19. FFCRA §7004; *COVID-19-Related Tax Credits for Required Paid Leave Provided by Small and Midsize Businesses FAQs.* Mar. 31, 2020. IRS. [www.irs.gov/newsroom/covid-19-related-tax-credits-for-required-paid-leave-provided-by-small-and-midsize-businesses-faqs] Accessed on Apr. 16, 2020.

CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY ACT

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act)[20] was signed into law by the president on March 27, 2020. The CARES Act responds to the COVID-19 outbreak and its impact on the economy, public health, state and local governments, individuals, and businesses. Among other provisions, the $2 trillion economic relief package provides cash flow assistance to small businesses through federally guaranteed loans, provides emergency economic relief for small businesses to meet their payroll and expenses, requires the DOL to provide pandemic unemployment assistance to certain workers, and provides access to healthcare for COVID-19 patients.[21]

In addition, the CARES Act includes the following **tax-related provisions,** which are discussed in this section.

- Recovery rebates for individuals
- Special rules for use of retirement funds
- Temporary waiver of required minimum distribution (RMD) rules
- Above-the-line deduction for charitable contributions
- Modification of charitable contribution limits
- Exclusion for certain employer payments of student loans
- Employee retention credit
- Delay of payment of employer payroll taxes
- Modifications for net operating losses (NOLs)
- Modification of loss limitations
- Modification of limitation on business interest
- Technical amendment for qualified improvement property (QIP)

PAYCHECK PROTECTION PROGRAM

The CARES Act, §1102, established the Paycheck Protection Program (PPP).

> **Note.** At the time this workbook went to press, information regarding the PPP was still rapidly evolving. Please refer to the 2020 *University of Illinois Federal Tax Workbook Supplement* for updated information and guidance on the PPP. This can be found at **uofi.tax/supplement** [https://taxschool.illinois.edu/downloads.html].

20. PL 116-136.

21. *H.R. 748—CARES Act.* Congress.gov. [www.congress.gov/bill/116th-congress/house-bill/748] Accessed on Apr. 22, 2020.

RECOVERY REBATES FOR INDIVIDUALS[22]

Old Law

Congress enacted a recovery rebate income tax credit as part of the Economic Stimulus Act of 2008.[23] Taxpayers could receive advance refunds of the refundable credit before they filed their 2008 federal income tax returns. The **basic component** of the credit was equal to the greater of the following.

- Net income tax liability, not to exceed $600 ($1,200 for a joint return)
- $300 ($600 for a joint return) if the eligible individual had:
  - Qualifying income of at least $3,000, or
  - Net income tax liability of at least $1 and gross income greater than the sum of the applicable basic standard deduction amount and one personal exemption (two personal exemptions for a joint return)

For purposes of the credit, **net income tax liability** was the excess of the sum of the individual's regular tax liability and alternative minimum tax over the sum of all nonrefundable credits (other than the child tax credit). **Qualifying income** is defined as the sum of the eligible individual's earned income, social security benefits, and veteran's payments.

If an individual was eligible for any part of the basic component, they may also have been eligible for the qualifying child component. The qualifying child component was $300 for each of the individual's qualifying children.

The credit was phased out at a rate of 5% of adjusted gross income (AGI) above $75,000 ($150,000 for joint returns).

On their 2008 tax returns, taxpayers could reconcile the recovery rebate amount (using 2008 information) with any advance amount they received in 2008 (using 2007 information). If the recovery rebate amount minus the advance refund amount was a positive number, the taxpayer could claim that amount as a refundable credit against their 2008 tax liability. However, if the result was negative, the negative amount did not increase the taxpayer's 2008 tax liability.

> **Note.** The reconciliation of the 2020 recovery rebates appears to be consistent with the treatment of the 2008 payments.

New Law

The CARES Act provides a recovery rebate refundable credit for 2020. This credit is commonly called the "economic impact" payment or "stimulus" payment. Taxpayers may receive an advance refund before filing a 2020 tax return.

An eligible individual is allowed a refundable credit for the 2020 tax year equal to the sum of:

- $1,200 ($2,400 if married filing jointly (MFJ)), and
- $500 for each qualifying child of the individual.

---

22. CARES Act §2201; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on May 12, 2020; *Economic Impact Payment Information Center.* IRS. [www.irs.gov/coronavirus/economic-impact-payment-information-center] Accessed on May 15, 2020.

23. PL 110-185.

An **eligible individual** is any individual **other than** the following.

1. Taxpayers with AGI in excess of threshold amounts
2. Dependent
3. Taxpayer without a social security number (SSN) valid for employment
4. Nonresident alien
5. Incarcerated individual
6. Deceased individual
7. Estate or trust

A **qualifying child** is defined as one who meets the following requirements.[24]

1. The child is the son, daughter, stepchild, eligible foster child, brother, sister, stepbrother, stepsister, half-brother, half-sister, or a descendant of any of them.
2. The child was under age 17 at the end of the tax year and is younger than the individual eligible for the payment, or the child is permanently or totally disabled.
3. The child is claimed as a dependent on the 2018 or 2019 tax return (or information regarding the child was entered on the "Non-Filers: Enter Payment Info Here" tool that was available on the IRS website).
4. The child is a U.S. citizen, U.S. national, or U.S. resident alien.
5. The child lived with the individual eligible for the payment for more than half the tax year.
6. The child did not provide over half of their own support for the tax year.
7. The child has a valid SSN or adoption taxpayer identification number.

Eligible individuals receive a recovery rebate of $1,200 (or $2,400 for MFJ filers) if they have AGI up to the following amounts.

- $75,000 for individuals whose filing status was single or married filing separately (MFS)
- $112,500 for head of household (HoH)
- $150,000 for MFJ

The credit is phased out at a 5% rate if the individual's AGI is in one of the following ranges.

- $75,000–$99,000 for single and MFS filers
- $112,500–$136,500 for HoH filers
- $150,000–$198,000 for MFJ filers

24. *Economic Impact Payments: Qualifying Child Requirements.* May 8, 2020. IRS. [www.irs.gov/newsroom/economic-impact-payments-qualifying-child-requirements] Accessed on May 15, 2020.

Advance Payments of Credit. In 2020, many taxpayers received the recovery rebate credit as an advance refund paid via direct deposit to their bank, as a check issued by the Treasury Department, or by a debit card from Money Network Cardholder Services.[25] The amount of the advance refund is calculated in the same way as the recovery rebate credit, except that the calculation is made on the basis of the tax return filed for 2019, if available, or on the basis of the tax return filed for 2018.

Many individuals who did not file an income tax return for 2018 or 2019 also received advance refunds. Treasury used information provided on Form SSA-1099, *Social Security Benefit Statement,* or Form RRB-1099, *Social Security Equivalent Benefit Statement,* to issue the advance refund. In addition, recipients of supplemental security income or benefit payments from the Department of Veterans Affairs also received $1,200 payments, even if they did not file a 2018 or 2019 tax return.

On the 2020 tax return, taxpayers will reconcile the recovery rebate amount using 2020 information with any advance payment received during 2020. If the recovery rebate amount less the advance refund amount is a positive number, the taxpayer can claim that amount as a refundable credit against their 2020 income tax liability. If the result is negative, the taxpayer's 2020 tax liability is not increased by the negative amount.

The advance refund amount is not includable in the taxpayer's gross income. It will not reduce the taxpayer's refund or increase the amount they owe when they file their 2020 income tax return.

Social Security Number Required. Individuals must have a valid SSN to receive a recovery rebate payment. When spouses file jointly, both spouses must have valid SSNs to receive a payment, unless either spouse is a member of the U.S. Armed Forces at any time during the tax year. In that situation, only one spouse needs to have a valid SSN.

When spouses file MFS, the spouse who has an SSN may qualify for a recovery rebate. The other spouse may not qualify if they do not have an SSN.

In addition, a qualifying child is not taken into account for purposes of the $500 payment unless they have a valid identification number, which for this purpose is an SSN or an adoption taxpayer identification number.

Paying Back the Recovery Rebate. In some cases, parents received a $500 payment in 2020 for a child who turned 17. These parents **will not have to repay** the amount received for a child who turned 17 in 2020.

Parents who are not married to each other and do not file a joint return cannot both claim their qualifying child as a dependent. The parent who claimed the child on their 2019 return may have received a recovery rebate payment for the qualifying child. When the parent who did not receive a recovery rebate for their child files their 2020 tax return, they may be able to claim up to an additional $500 per qualifying child on their return if they qualify to claim the child on their 2020 return.[26]

In addition, a taxpayer will not be required to repay any amount they received if their AGI was above the threshold amounts listed earlier.

25. *Economic Impact Payment Information Center.* Aug. 5, 2020. IRS. [www.irs.gov/coronavirus/economic-impact-payment-information-center] Accessed on Aug. 10, 2020.

26. IRS News Rel. IR-2020-93 (May 11, 2020).

However, a payment made to someone who died before receipt of the recovery rebate advance payment should be returned to the IRS. The entire payment must be returned unless the payment was made to joint filers and one spouse had not died before receipt of the payment. In this case, only the portion of the payment made with respect to the decedent must be returned.

Observation. The IRS issued a list of frequently asked questions (FAQ) about the recovery rebates. The FAQs can be accessed at **uofi.tax/20a1x4** [www.irs.gov/coronavirus/economic-impact-payment-information-center].

SPECIAL RULES FOR USE OF RETIREMENT FUNDS[27]

Old Law

A distribution from a qualified retirement plan,[28] a tax-sheltered annuity plan (i.e., a 403(b) plan), an eligible deferred compensation plan of a state or local government employer (i.e., a governmental 457(b) plan), or an individual retirement arrangement (IRA) is generally included in income for the year in which it is distributed. Moreover, a distribution from a qualified retirement plan, a 403(b) plan, or an IRA received before the taxpayer attains age 59½ is subject to a 10% additional tax (often referred to as the early withdrawal tax, or early withdrawal penalty) assessed on the amount includable in income. Certain exceptions to the 10% additional tax are available under IRC §72(t).

Note. The 10% additional tax does not apply to distributions from a governmental 457(b) plan.

Note. For information about the various exceptions to the 10% additional tax, see the 2020 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: Retirement Plan Distributions.

Employer-sponsored retirement plans can offer loans to participants. However, unless the loan satisfies certain requirements, the amount of the loan is treated as a distribution from the retirement plan. These requirements include the following.

1. The loan amount cannot exceed the lesser of 50% of the participant's account balance or $50,000 (taking into account the outstanding balances of prior loans).
2. The loan's repayment period is no longer than five years (except for a loan to purchase a home).
3. Substantially level amortization of the loan is required over the loan term, with payments required to be made at least quarterly.

New Law

A provision in the CARES Act allows an exception to the 10% early withdrawal tax for a coronavirus-related distribution of $100,000 or less from a qualified retirement plan, a 403(b) plan, or an IRA. A **coronavirus-related distribution** is defined as any distribution from a qualified retirement plan, 403(b) plan, governmental §457(b) plan, or an IRA made after December 31, 2019, and before December 31, 2020, to an individual:

- Who was **diagnosed with the virus** SARS-CoV-2 or with COVID-19 by a test approved by the Centers for Disease Control and Prevention (CDC); or

27. CARES Act §2202; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 27, 2020.

28. See IRC §401(a).

- Whose **spouse or dependent is diagnosed with the virus** or disease by a CDC-approved test; 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 childcare 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, or other factors as determined by the Secretary of the Treasury (or the Secretary's delegate).

A taxpayer includes the income attributable to a coronavirus-related distribution ratably over a 3-year period beginning with the year of the distribution. However, the taxpayer can elect to include the entire amount of the distribution in income in the year they receive it.

Any portion of a coronavirus-related distribution can be recontributed to an eligible retirement plan that can accept rollover contributions. The recontribution can be made at any time during the 3-year period beginning the day after the date on which the taxpayer received the distribution. Any amount recontributed within the 3-year period is treated as a rollover. Therefore, it is not includable in income. If a portion of the distribution has not yet been included in the taxpayer's income at the time of the recontribution, the remaining amount is not includable in income. In addition, the taxpayer can file amended returns to claim a refund of the tax attributable to the amount of the distribution previously included in income.

Example 5. In November 2020, Carina, age 48, received a coronavirus-related distribution of $60,000 from her 401(k) plan. The distribution is not subject to the 10% early withdrawal tax.

Carina includes $20,000 in income each year from 2020 to 2022. Carina files her 2022 tax return in April 2023. In October 2023, she recontributes $60,000 to her 401(k) plan, and this amount is treated as a rollover. Carina can file amended returns to claim a refund of the tax attributable to the amount previously included in income for the 2020, 2021, and 2022 tax years.

Example 6. Use the same facts as **Example 5,** except Carina recontributes $60,000 to her 401(k) plan in March 2023. When she prepares her 2022 return in April 2023, she does not include the ratable $20,000 portion in her 2022 income. Carina files amended returns to claim a refund for the tax attributable to the $40,000 she included in income for the 2020 and 2021 tax years.

The CARES Act modifies the rules applicable to loans. For a qualified individual, a loan is not treated as a distribution if the maximum loan amount from a qualified employer plan during the 180-day period beginning on the date of enactment (i.e., from March 27, 2020, to September 23, 2020) is the lesser of 100% of the present value of the participant's nonforfeitable accrued account balance or $100,000.

For a qualified individual who has an outstanding loan from a qualified employer plan on or after March 27, 2020 (the date the CARES Act was enacted), the due date for any repayment is delayed by one year, if the due date for the repayment falls during the period beginning on March 27, 2020, and ending on December 31, 2020. Any subsequent repayment dates are adjusted to reflect the 1-year delay. In addition, the repayment delay is disregarded for purposes of the requirement that a loan be repaid within five years.

TEMPORARY WAIVER OF RMD RULES[29]

Old Law

Employer-provided qualified retirement plans and IRAs are subject to RMD rules. A qualified retirement plan for this purpose includes a tax-qualified plan described in §401(a) (e.g., a defined benefit pension plan or 401(k) plan), an employee retirement annuity described in §403(a), a tax-sheltered annuity described in §403(b), and a governmental 457(b) plan.

RMDs generally must begin by April 1 of the calendar year following the calendar year in which the account owner reaches age 72. Prior to January 1, 2020, the age after which RMDs were required to begin was 70½. For an employer-provided qualified retirement plan, the RMD beginning date for an individual who is not a 5% owner of the employer maintaining the plan can be delayed to April 1 of the year after the year in which the individual retires if the plan allows this later distribution date. For all subsequent years, the individual must take the RMD by December 31.

Note. For more information about RMDs, see the 2020 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: Retirement Plan Distributions.

New Law

For the **2020 calendar year,** no RMD is required from an IRA, employer-provided tax-qualified plan described in §401(a), an employee retirement annuity described in §403(a), a 403(b) plan, or a governmental 457(b) plan. The CARES Act provision waives the 2020 RMD for lifetime distributions to employees and IRA owners and for after-death distributions to beneficiaries.

For an individual whose required beginning date for minimum distributions was April 1, 2020 (because, for example the individual attained age 70½ in 2019), the provision waives the RMD for the distribution that would have been required to be made in 2020 because no distribution was made in 2019.

For an individual whose required beginning date is April 1, 2021 (because, for example, the individual attains age 72 in 2020), the first year for which an RMD would have been required is 2020. Under the CARES Act provision, no distribution is required for 2020, and, therefore, no distribution is required to be made by April 1, 2021. As a result, that individual's RMD for 2021 will be required to be made by December 31, 2021.

With respect to an individual who dies and whose interest is required to be distributed within five years, the 5-year period is determined without taking calendar year 2020 into account.

Note. For guidance about the waiver of 2020 RMDs, including information about the extension of the 60-day deadline for the rollover of certain distributions, see IRS Notice 2020-51.

29. CARES Act §2203; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 28, 2020.

ABOVE-THE-LINE DEDUCTION FOR CHARITABLE CONTRIBUTIONS[30]

Old Law

An individual's AGI is determined by subtracting certain "above-the-line" deductions from their gross income. These deductions include (but are not limited to) losses from the sale or exchange of property, contributions to certain IRAs, contributions to a qualified retirement plan by a self-employed individual, and certain education-related expenses.

An income tax deduction is allowed for charitable contributions, subject to certain limitations. The deduction allowed to individual taxpayers is available only if the taxpayer elects to itemize deductions.

New Law

The CARES Act allows an eligible individual to claim an above-the-line deduction of up to $300 for qualified charitable contributions made during the 2020 tax year. An **eligible individual** for this purpose is a taxpayer who does not itemize deductions for 2020. The $300 limit is a **per-return** limit. Therefore, married taxpayers who file a joint return and do not itemize deductions can deduct up to $300 in charitable contributions on the joint return.[31]

A **qualified charitable contribution** is a **cash** contribution for which a deduction is allowable under IRC §170. Contributions of noncash property are not allowed as above-the-line charitable contributions.

Under the CARES Act provision, qualified contributions must be made to an organization described in §170(b)(1)(A), which includes churches, educational organizations, medical research organizations, hospitals, and public charities. Contributions for purposes of this provision cannot be made to a supporting organization described in IRC §509(a)(3) or to a donor-advised fund.

MODIFICATION OF CHARITABLE CONTRIBUTION LIMITS DURING 2020[32]

Old Law

Individual taxpayers who itemize their deductions can deduct charitable donations of cash or property to qualifying organizations. Limits apply to the total dollar amount that a taxpayer can deduct. Before the Tax Cuts and Jobs Act (TCJA) was enacted, most cash contributions were generally limited to 50% of the taxpayer's contribution base. For years during the TCJA period (2018–2025), individuals may deduct cash contributions up to **60%** of their contribution base for contributions to organizations described in §170(b)(1)(A).[33] The **contribution base** is the taxpayer's AGI, computed without any NOL carryback. Other limits may apply, depending on the type of organization to which the contribution was made and the type of property contributed.

The charitable contribution deduction for corporations is limited to 10% of the corporation's taxable income calculated with certain adjustments.

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30. CARES Act §2204; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 24, 2020.

31. *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 24, 2020.

32. CARES Act §2205; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 27, 2020.

33. IRC §170(b)(1)(G)(i).

For charitable contributions of inventory, a taxpayer's deduction is generally limited to the taxpayer's basis (which is usually cost) in the inventory, or the fair market value of the inventory, if less. For certain contributions of inventory, a C corporation can claim an enhanced deduction equal to the lesser of the following.

- Basis plus half of the item's appreciation
- Two times basis

Any taxpayer engaged in a trade or business, regardless of whether the taxpayer is a C corporation, can claim an enhanced deduction for contributions of food inventory. The enhanced deduction is available only for food that qualifies as "apparently wholesome food," which is defined as food intended for human consumption that meets all quality and labeling standards imposed by federal, state and local laws, and regulations.

For taxpayers other than C corporations, the total deduction for donations of food inventory generally cannot exceed 15% of the taxpayer's net income for the tax year from all sole proprietorships, S corporations, or partnerships from which contributions of apparently wholesome food are made. For C corporations, such contributions are subject to a limitation of 15% of taxable income, with certain adjustments. Qualifying food inventory contributions in excess of the 15% limitation can be carried forward and treated as qualifying food inventory contributions in each of the five succeeding tax years.

New Law

Under the CARES Act provision, an individual taxpayer can deduct qualified contributions up to the amount by which **100%** of the taxpayer's contribution base exceeds the deduction for other charitable contributions. Contributions in excess of this amount are carried forward to subsequent tax years.

For corporations, the deduction for qualified contributions is allowed up to **25% of the corporation's taxable income.** Contributions in excess of this amount are carried forward to subsequent tax years.

Charitable contributions that exceed the applicable percentage limitation may be carried forward for up to five years subject to the applicable contribution base in succeeding years.

Qualified contributions are **cash** contributions paid **during 2020** to a charitable organization described in §170(b)(1)(A). **Contributions for purposes of this provision cannot be made to a supporting organization described in §509(a)(3) or to a donor-advised fund.** Contributions of noncash property are not qualified contributions. A qualified charitable contribution does not include an amount that is treated as a contribution in the tax year because it was carried forward from a prior contribution year under §§170(b)(1)(G) or (d)(1).

For charitable contributions of food inventory made during 2020 that qualify for the enhanced deduction, the 15% limitation is increased to 25%.

Practitioner Planning Tip

Because of the increased limits on charitable contributions for 2020, it may make sense to "lump" charitable contributions into the 2020 tax year for taxpayers who are financially able to do so.

EXCLUSION FOR CERTAIN EMPLOYER PAYMENTS OF STUDENT LOANS[34]

Old Law

Under IRC §127, an employee can exclude up to $5,250 per year of educational assistance provided by their employer from their gross income for income tax purposes and from wages for employment tax purposes. The following requirements must be satisfied for the exclusion to apply.

1. The educational assistance must be provided under the employer's separate written plan.
2. The employer's educational assistance program must not discriminate in favor of highly compensated employees.
3. No more than 5% of the amounts paid or incurred by the employer during the year for educational assistance under a qualified program may be provided for the class of individuals consisting of more-than-5% owners of the employer and the spouses or dependents of the owners.

Educational assistance for purposes of the exclusion is defined as the employer's payment of expenses incurred by or on behalf of the employee for the employee's education. Such expenses include tuition, fees and similar payments, books, supplies, and equipment. Educational assistance **does not include** payments for the following.

- Tools or supplies that the employee can retain after completing a course
- Meals, lodging, or transportation
- Any education involving sports, games, or hobbies

The education does not need to be related to the employee's job or part of a degree program. Educational assistance qualifies for exclusion only if the employer does not offer the employee a choice between educational assistance and remuneration includable in the employee's income.

The exclusion applies only for education provided to the employee. It does not apply to assistance provided for the employee's spouse or child.

Employer-provided educational assistance is generally excludable from gross income for income tax purposes and wages for employment tax purposes only if the educational expenses qualify as a working condition fringe benefit under IRC §132(d) or as a qualified tuition reduction under IRC §117(d).

New Law

A provision in the CARES Act expands the definition of the term "educational assistance" excludable from income and from wages to include payments of principal or interest made by an employer on a qualified education loan (as defined in IRC §221(d)(1)) incurred by an employee. The loan must be incurred for the employee's education. The exclusion applies to payments made to the employee or a lender after March 27, 2020, and before January 1, 2021.

Under this provision, payments are subject to the general requirements of §127 (described earlier), including the $5,250 limit, the requirement that assistance is provided pursuant to the employer's separate written plan, and the nondiscrimination requirement.

The employee cannot claim a deduction under IRC §221 for interest paid on student loans if an exclusion on the amount is allowable under the provision.

34. CARES Act §2206; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 28, 2020.

EMPLOYEE RETENTION CREDIT[35]

Old Law

At various times, Congress has enacted employee retention credits against employer income tax in response to natural disasters.[36] The previous versions of employee retention credits generally provided a 40% credit for wages (up to a $6,000 maximum wage per employee) paid by certain employers to employees employed in the applicable disaster zone when the employer's business was inoperable because of the disaster.[37]

New Law

The employee retention credit (ERC) is a refundable tax credit available to employers that is equal to 50% of qualified wages that eligible employers pay to their employees. The ERC applies to qualified wages (including allocable qualified health plan expenses) **paid after March 12, 2020,** and before January 1, 2021. The maximum amount of qualified wages that can be taken into account for each employee for all calendar quarters is $10,000. Therefore, the maximum credit for qualified wages paid to any employee is $5,000.

> **Caution.** As explained earlier, the FFCRA requires certain employers to pay sick or family leave wages to employees who cannot work due to circumstances related to COVID-19. Employers are entitled to refundable tax credits for the required leave paid under the FFCRA provisions. The same wages cannot be counted for both the ERC available under the CARES Act and the credits available under the FFCRA. **In addition, an eligible employer cannot receive the ERC if it receives a PPP loan authorized under the CARES Act.**

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35. CARES Act §2301; *FAQs: Employee Retention Credit under the CARES Act.* Apr. 10, 2020. IRS. [www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act] Accessed on Apr. 23, 2020; *COVID-19-Related Employee Retention Credits: General Information FAQs.* Apr. 29, 2020. IRS. [www.irs.gov/newsroom/covid-19-related-employee-retention-credits-general-information-faqs] Accessed on Aug. 1, 2020.

36. See, e.g., PL 115-123 §20103 (providing a credit in response to 2017 California wildfires); PL 115-63 §503, as amended by PL 115-123 §20201(b) (providing a credit in response to Hurricanes Harvey, Irma, and Maria); and former IRC §1400R (providing a credit in response to Hurricanes Katrina, Rita, and Wilma).

37. *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 24, 2020.

Eligible Employer. An **eligible employer** for purposes of the ERC is an employer that carries on a trade or business during 2020, including a tax-exempt organization, that meets one of the following conditions.

- Fully or partially suspends operation during any calendar quarter in 2020 because of orders from a governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19
- Experiences a significant decline in gross receipts during the calendar quarter

Note. Governmental employers are not eligible employers for the ERC. In addition, self-employed individuals are not eligible for the credit for their SE earnings or services.

Partially Suspended Operations. A trade or business is considered to **partially suspend operations** if an appropriate governmental authority imposes restrictions upon the business operations by limiting commerce, travel, or group meetings due to COVID-19 to such a degree that the operation can still continue to operate but not at its normal capacity.

Example 7. Governor Pritzker of Illinois issued an executive order suspending on-premises consumption at restaurants and bars in Illinois to reduce the spread of COVID-19. The executive order permitted restaurants and bars to continue sales to the public through delivery, drive-through, and curbside pick-up services.[38] This resulted in a partial suspension of the trade or business operations due to an order of an appropriate governmental authority with respect to restaurants and bars in Illinois that provided full sit-down services, a dining room, or other onsite facilities for customers prior to the executive order.

Significant Decline in Gross Receipts. A **significant decline** in gross receipts occurs beginning with the first quarter in which an employer's gross receipts for a calendar quarter in 2020 are less than 50% of its gross receipts for the same calendar quarter in 2019. The significant decline in gross receipts ends with the first calendar quarter that follows the first calendar quarter for which the employer's 2020 gross receipts for the quarter are greater than 80% of its gross receipts for the same calendar quarter during 2019.

Example 8. Rally Company's gross receipts for 2019 and 2020 are shown in the following table.

	2019 Gross Receipts	2020 Gross Receipts	2020 Gross Receipts as a Percentage of 2019 Gross Receipts
First quarter	$210,000	$100,000	47.6%
Second quarter	200,000	95,000	47.5%
Third quarter	230,000	190,000	82.6%
Fourth quarter	250,000	230,000	92.0%

Rally Company had a significant decline in gross receipts starting with the first quarter of 2020 because its gross receipts were less than 50% of the same quarter in 2019. The significant decline ended with the fourth quarter of 2020, which is the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019. Accordingly, Rally Company is an eligible employer for purposes of the ERC for the first, second, and third quarters of 2020.

38. *State of Illinois Coronavirus (COVID-19) Response.* State of Illinois. [www2.illinois.gov/sites/coronavirus/Resources/Pages/ExecutiveOrders.aspx] Accessed on Apr. 23, 2020.

Qualified Wages. Qualified wages are wages (as defined in IRC §3121(a)) and compensation (as defined in IRC §3231(e)) paid by an eligible employer to employees after March 12, 2020, and before January 1, 2021. Qualified wages include qualified health plan expenses that are properly allocable to the wages.

The definition of qualified wages depends on the average number of full-time employees employed by the eligible employer in 2019.

For employers that averaged **more than 100 full-time employees in 2019,** qualified wages are the wages paid to an employee for time that the employee is **not providing services** for either of the following reasons.

1. A full or partial suspension of operations by a governmental order due to COVID-19
2. A significant decline in gross receipts

For employers with more than 100 full-time employees in 2019, the amount of an employee's qualified wages taken into account may not exceed what the employee would have been paid for working an equivalent period during the 30 days immediately preceding the period of economic hardship.

For employers that averaged **100 or fewer full-time employees in 2019,** qualified wages are the wages paid to **any employee** during any period of economic hardship described in items 1 or 2 above.

Observation. The CARES Act does not require employers to pay qualified wages. This is in contrast to the FFCRA, which does require certain employers to pay sick or family leave wages to employees who are unable to work due to a circumstance related to COVID-19.

Qualified health plan expenses that are properly allocable to qualified wages are amounts paid or incurred by the employer to provide and maintain a group health plan, to the extent such amounts are excluded from the employees' income as coverage under an accident or health plan.[39]

Note. If a taxpayer claims a credit under this provision, rules similar to the rules of IRC §§51(i)(1) and 280C(a) apply. Thus, for example, an ERC may not be generated by an individual employer hiring their children.[40]

IRC §51(i)(1) states that no wages are taken into account for an individual who is a related party.[41] If the taxpayer is a corporation, no wages are taken into account if paid to an individual who owns more than 50% of the value of the corporation's outstanding stock. If the taxpayer is an entity other than a corporation, no wages are taken into account if paid to any individual who owns more than 50% of the capital and profits interest in the entity.

Calculating the Credit. As mentioned earlier, the ERC is 50% of the qualified wages (including qualified health plan expenses) that an eligible employer pays in a calendar quarter. The maximum amount of qualified wages taken into account for each employee for all calendar quarters is $10,000. Therefore, the maximum allowable credit for qualified wages paid to any employee is $5,000.

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39. *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 24, 2020.

40. Ibid.

41. See IRC §152(d)(2) for definition of related party for this purpose.

Example 9. Use the same facts as **Example 8.** Rally Company paid Brenda $8,000 in qualified wages in the second quarter of 2020 and $8,000 in qualified wages in the third quarter of 2020. The ERC available to Rally Company for the qualified wages paid to Brenda is $4,000 ($8,000 wages × 50%) in the second quarter and $1,000 (($10,000 maximum wages – $8,000 second quarter qualified wages) × 50%) in the third quarter.

Claiming the Credit. Eligible employers report their total qualified wages and the related credits for each calendar quarter on their federal employment tax returns (e.g., Form 941).

In anticipation of receiving the ERC, eligible employers can fund the payment of qualified wages by accessing federal employment taxes otherwise required to be deposited with the IRS or by requesting an advance of the credit. This means that an eligible employer that pays qualified wages to its employees before it is required to deposit federal employment taxes with the IRS for that quarter can reduce the amount of federal employment taxes it deposits for that quarter by half the amount of qualified wages paid in that quarter. The employer must account for the reduction in deposits on the federal employment tax return it files for the quarter.

Observation. For qualified wages paid from March 13 through March 31, 2020, the employer claims the credit on the second quarter Form 941.[42]

Example 10. Landis Frames is an eligible employer for purposes of the ERC. It paid $10,000 in qualified wages (including qualified health plan expenses), and is therefore entitled to a $5,000 credit. Landis Frames is otherwise required to deposit federal employment taxes of $8,000 for taxes withheld from all its employees for wages paid in the same quarter as the $10,000 of qualified wages.

Landis Frames can keep up to $5,000 of the $8,000 of taxes it is otherwise required to deposit. Therefore, it is required to deposit only the remaining $3,000 on the due date for the deposit. Landis Frames later accounts for the $5,000 it retained when it files its Form 941 for the quarter.

If the employer does not have sufficient federal employment taxes it is otherwise required to deposit in a sufficient amount to fund their qualified wages, the employer can file a Form 7200 to claim an advance refund. The employer should first reduce its remaining federal employment tax deposits for wages paid in the same calendar quarter by the amount of the anticipated ERC. The employer can then file the Form 7200 to claim an advance refund for the full amount of the anticipated credit for which it did not have sufficient federal employment tax deposits.

No Double Benefit. An eligible employer can receive the tax credits for the qualified leave wages under the FFCRA and the ERC under the CARES Act. However, it **cannot** receive the credits for the same wages. The qualified wages for which an employer may claim the ERC does not include the amount of qualified sick and family leave wages for which the employer receives tax credits under the FFCRA.

42. Instructions for Form 941.

DELAY OF PAYMENT OF EMPLOYER PAYROLL TAXES[43]

Old Law[44]

Employers that pay wages and withhold federal income and FICA taxes are required to deposit those taxes in a timely manner. With certain exceptions, an employer generally must deposit employment taxes on a monthly or semi-weekly schedule. The applicable deposit schedule is determined based on the employer's total tax liability reported during a lookback period. Employment taxes that are not deposited on a timely basis are subject to penalties.

Self-employed persons are required to make estimated tax payments equal to 90% of the current year's tax liability or 100% of the prior year's tax liability by the applicable deadlines. A penalty is imposed if the tax shown on the self-employed person's return is $1,000 or more.

New Law

The CARES Act permits employers to defer payment of the employer's share of social security taxes and certain railroad retirement taxes. For railroad employers, the taxes that may be deferred are the taxes imposed under IRC §3221(a) that are attributable to the 6.2% rate in effect under IRC §3111(a).

The deferral applies to deposits and payments of the employer's share of social security tax otherwise required to be made during the period beginning March 27, 2020, and ending December 31, 2020. Employers report the deferred payments and deposits on Form 941.

950220

Name *(not your trade name)*	Employer identification number (EIN)

Part 1: Answer these questions for this quarter. *(continued)*

11d	**Total nonrefundable credits.** Add lines 11a, 11b, and 11c	11d	.
12	**Total taxes after adjustments and nonrefundable credits.** Subtract line 11d from line 10	12	.
13a	**Total deposits for this quarter, including overpayment applied from a prior quarter and overpayments applied from Form 941-X, 941-X (PR), 944-X, or 944-X (SP) filed in the current quarter**	13a	.
13b	**Deferred amount of the employer share of social security tax**	13b	.
13c	**Refundable portion of credit for qualified sick and family leave wages from Worksheet 1**	13c	.
13d	**Refundable portion of employee retention credit from Worksheet 1**	13d	.
13e	**Total deposits, deferrals, and refundable credits.** Add lines 13a, 13b, 13c, and 13d	13e	.

All employers can defer the payment of the employer's share of social security tax during the relevant period beginning March 27, 2020, and ending December 31, 2020.

> **Note.** If taxes have already been paid, there is no deferral available.[45]

43. CARES Act §2302; *Deferral of employment tax deposits and payments through December 31, 2020.* Apr. 16, 2020. IRS. [www.irs.gov/newsroom/deferral-of-employment-tax-deposits-and-payments-through-december-31-2020] Accessed on Apr. 24, 2020.

44. *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 24, 2020.

45. Instructions for line 13b, Form 941.

The employer must deposit half of the deferred share of social security tax by **December 31, 2021.** The other half must be deposited by **December 31, 2022.** The same dates apply to deferred payments by self-employed persons of 50% of the social security tax on SE income. To the extent an employer deposits the deferred taxes by the applicable due dates, such deposits are treated as timely.

Self-Employment Taxes. The CARES Act allows self-employed individuals to defer payment of certain SE taxes. Self-employed persons can defer paying the 50% of social security tax on net earnings from SE income for the period beginning March 27, 2020, and ending December 31, 2020.

For SECA tax purposes, the deferred taxes are not treated as taxes subject to estimated tax payments until the applicable dates. Therefore, half of the deferred taxes are subject to estimated tax payments by December 31, 2021, and the other half is subject to estimated tax payments by December 31, 2022.

MODIFICATIONS FOR NET OPERATING LOSSES[46]

Old Law

An NOL generally occurs when the taxpayer's business deductions exceed the taxpayer's gross income. A taxpayer generally can deduct an NOL carried to the tax year. Under the TCJA, the NOL deduction is limited to 80% of taxable income determined without taking the NOL deduction into account for NOLs arising in tax years beginning after December 31, 2017. Excess losses can generally be **carried forward indefinitely** but cannot be carried back. Carryovers of NOLs to other tax years are adjusted to take into account the 80% taxable income limitation.

Special rules apply to NOLs in certain circumstances. These include the following.

- A 2-year carryback is provided for certain farming losses.
- A 2-year carryback and 20-year carryforward is provided for NOLs of property and casualty insurance companies (an insurance company as defined in IRC §816(a) other than a life insurance company). Such insurance companies are also exempted from the 80% taxable income limitation.

NOLs that arose in tax years beginning before January 1, 2018, are not subject to the 80% limitation. Moreover, such NOLs are subject to the carryback rules and 20-year carryforward limitations that were in effect for tax years beginning before January 1, 2018.

New Law

80% Limitation. The CARES Act retroactively suspends the application of the 80% taxable income limitation for tax years beginning after December 31, 2017, and before January 1, 2021. The 80% limitation continues to apply for any tax year beginning after December 31, 2020, and to NOLs arising in tax years beginning after December 31, 2017, carried to such year.

The CARES Act clarifies that the 80% taxable income limitation is calculated without regard to any of the following deductions.

- The NOL deduction under IRC §172
- The qualified business income deduction (QBID) under IRC §199A
- The IRC §250 deduction for foreign-derived intangible income

46. CARES Act §2303; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 30, 2020.

Carrybacks of NOLs. The CARES Act provides that any NOL arising in a tax year beginning after December 31, 2017, and before January 1, 2021, is carried back to the five tax years preceding the year of the loss.[47] The taxpayer takes such NOLs into account in the earliest tax year in the carryback period, carrying forward unused amounts to each succeeding tax year.[48]

> **Note.** The purpose of this provision is to allow taxpayers to use NOLs to offset taxable income in prior or future years so that taxpayers have more liquidity from tax refunds and from reduced current and future tax liability.

Practitioner Planning Tip

Because the tax rates for both individuals and corporations were higher before the TCJA changes became effective with the 2018 tax year, carrying back an NOL to a pre-2018 tax year can be very beneficial to the taxpayer.

Waiving a Carryback. Under §172(b)(3), a taxpayer can elect to waive the entire carryback period for an NOL arising in a tax year beginning in 2018 or 2019. This election must be made by the due date (including extensions) for filing the taxpayer's return for the first tax year ending after March 27, 2020 (the date on which the CARES Act was enacted). A taxpayer makes the election by attaching to its federal tax return for the first tax year ending after March 27, 2020, a separate statement for each of the 2018 or 2019 tax years for which the taxpayer intends to make the election. The election statement must state that the taxpayer is electing to apply §172(b)(3) under Rev. Proc. 2020-24 and the tax year for which the statement applies. **This election is irrevocable.**[49]

Moreover, any taxpayer entitled to a carryback can elect to relinquish the entire carryback period for an NOL for **any** tax year. This election must be made by the due date (including extensions) for filing the taxpayer's return for the tax year of the NOL for which the election is to be in effect. **Once the election is made, it is irrevocable.**[50]

> **Note.** The CARES Act does not change the unlimited carryforward period allowed for tax years beginning after December 31, 2017.

47. IRC §172(b)(1)(D).
48. Rev. Proc. 2020-24, 2020-18 IRB 750.
49. Ibid.
50. IRC §172(b)(3).

Obtaining a Refund from an NOL Carryback. Under IRC §6411, a taxpayer can file an application for a tentative carryback adjustment of the tax liability for a prior tax year affected by an NOL carryback. Corporate taxpayers must make the application on Form 1139, *Corporation Application for Tentative Refund.* Taxpayers other than corporations must make the application on Form 1045, *Application for Tentative Refund.* The Code and regulations require that such an application must be filed within 12 months after the close of the tax year in which the NOL arose.[51] A taxpayer can obtain a quick tentative tax refund from an NOL carryback using the tentative adjustment procedure. This allows a taxpayer to receive a credit or refund within 90 days. As an alternative, a taxpayer can file an amended return for the carryback year, but it generally takes longer to obtain a refund.[52]

The CARES Act did not provide additional time to file tentative carryback adjustment applications for NOLs arising in a tax year beginning after December 31, 2017, and ending before March 27, 2019, even though the time to file such applications had already expired by the time the CARES Act was enacted. Taxpayers whose losses in such tax years can now be carried back to an earlier tax year under the CARES Act generally must file amended returns to claim refunds or credits resulting from the change in the law.[53]

Note. The Treasury Department and the IRS granted a 6-month extension of time to file Form 1045 or Form 1139 to taxpayers that have an NOL that arose in a tax year that began during calendar year 2018 and ended on or before June 30, 2019. For example, a taxpayer with an NOL that arose in a tax year ending on December 31, 2018, normally would have to file Form 1045 or Form 1139, as applicable, by December 31, 2019 (i.e., 12 months after the end of the tax year). The 6-month extension gave such taxpayers until June 30, 2020, to file the Form 1045 or Form 1139.[54]

MODIFICATION OF LOSS LIMITATIONS[55]

Old Law

An **excess business loss (EBL)** of a taxpayer other than a corporation is not allowed for tax years beginning after December 31, 2017, and before January 1, 2026. The disallowed EBL is treated as an NOL for purposes of determining any NOL carryover to subsequent years.

An EBL is defined as the excess of the taxpayer's aggregate deductions attributable to trades or businesses over the sum of aggregate gross income or gain attributable to trades or businesses plus a threshold amount. The **threshold amount** for a tax year beginning in 2018 is $250,000 ($500,000 for MFJ taxpayers). The threshold amount is indexed each year for inflation.

For tax years beginning **before** January 1, 2018, and **after** December 31, 2025, a limitation on **excess farm losses** applies to noncorporate taxpayers. Therefore, the excess farm loss limitation does **not** apply for tax years beginning after December 31, 2017, and before January 1, 2026.

51. IRC §6411(a); Treas. Reg. §1.6411-1(c).

52. IRS Notice 2020-26, 2020-18 IRB 744; *Reversed Elections, Amended Returns, and NOL Carrybacks: The IRS Provides Guidance on CARES Act Tax Changes.* Nitti, Tony. Apr. 13, 2020. Forbes. [www.forbes.com/sites/anthonynitti/2020/04/13/reversed-elections-amended-returns-and-nol-carrybacks-the-irs-provides-guidance-on-cares-act-tax-changes/#66cef8101286] Accessed on May 1, 2020.

53. IRS Notice 2020-26, 2020-18 IRB 744.

54. Ibid.

55. CARES Act §2304; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on May 18, 2020.

Under the excess farm loss limitation, if a noncorporate taxpayer receives an applicable subsidy for the tax year, the amount of the excess farm loss is disallowed for the tax year and is carried forward and treated as a deduction in the next tax year. An excess farm loss is defined as the excess of aggregate deductions attributable to farming businesses over the sum of aggregate gross income or gain attributable to farming businesses plus a threshold amount. The threshold amount is the greater of:

- $300,000 ($150,000 for MFS taxpayers), or
- For the five consecutive tax years preceding the tax year, the excess of the aggregate gross income or gain attributable to the taxpayer's farming businesses over the aggregate deductions.

New Law

Under the CARES Act, the EBL limitation does not apply for tax years beginning in 2018, 2019, or 2020. In addition, the excess farm loss limitation does not apply for tax years beginning after 2017 and before 2026.

The CARES Act provision makes technical amendments. It clarifies that for tax years beginning after 2020 and before 2026, any EBL of a noncorporate taxpayer is not allowed for the tax year and the EBL not allowed is carried forward and treated as part of the taxpayer's NOL carryover in subsequent tax years.

The CARES Act clarifies that the aggregate business deductions taken into account to determine the taxpayer's EBL for the tax year are calculated without regard to any NOL deduction under §172 or QBID under §199A.

The provision clarifies that an EBL does not take into account any deductions, gross income, or gains attributable to any trade or business of performing services as an employee.

Moreover, the provision clarifies that any capital loss deductions are not taken into account in calculating the EBL. The amount of capital gain taken into account in calculating the EBL cannot exceed the lesser of capital gain net income from a trade or business or capital gain net income.

> **Note.** For more information about EBLs, see the 2020 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 3: Net Operating and Excess Business Losses.

MODIFICATION OF LIMITATION ON BUSINESS INTEREST[56]

Note. Businesses entitled to use cash accounting (i.e., those with average revenue not exceeding $26 million for 2020) are not subject to the limitation on deducting business interest.[57]

Old Law

The deduction for business interest expense is generally limited under IRC §163(j) to the sum of the following.

- Business interest income of the taxpayer for the tax year
- 30% of the taxpayer's **adjusted taxable income** for the tax year (not less than zero)
- Floor plan financing interest

Adjusted taxable income is defined in §163(j)(8) as the taxpayer's taxable income calculated without regard to the following.

- Any item of income, gain, deduction, or loss that is not properly allocable to a trade or business
- Any business interest or business interest income
- The amount of any NOL deduction
- The amount of any QBID
- For tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion

The amount of business interest expense not allowed as a deduction for the tax year can be carried forward indefinitely.

The business interest expense limitation under §163(j) **does not apply** to any taxpayer (other than a tax shelter prohibited from using the cash method under IRC §448(a)(3)) that meets the **$25 million gross receipts test** of §448(c). A taxpayer meets the gross receipts test for a tax year if the entity's average annual gross receipts for the 3-tax-year period ending with the preceding tax year does not exceed $25 million. The $25 million threshold is adjusted for inflation for tax years beginning after December 31, 2018.[58] For 2020, the threshold amount is $26 million.[59]

For a partnership, the interest limitation under §163(j) is generally applied at the partnership level. A partner generally must make its own §163(j) calculation for business interest expense it incurs at the partner level. The partner's business interest income and adjusted taxable income are determined without regard to the partner's distributive share of the partnership's income, gain, deduction, or loss. Similar rules apply to an S corporation and its shareholders.

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56. CARES Act §2306; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on Apr. 28, 2020.

57. IRC §163(j)(5).

58. IRC §448(c)(4).

59. Rev. Proc. 2019-44, 2019-47 IRB 1093.

Special rules pertaining to the carryforward of disallowed business interest expense apply only to partnerships and their partners. For a partnership, the general taxpayer-level carryforward rule does not apply. Instead, any business interest expense that is not allowed as a partnership deduction for the tax year (excess business interest expense) is allocated to the partners. A partner cannot deduct excess business interest expense in the year it is allocated to the partner. Instead, under §163(j)(4)(B)(ii), a partner can deduct its share of the partnership's excess business interest expense in any future year, to the extent that the amount is based on the partner's distributive share of excess business interest income and excess taxable income of the partnership. Any amount not allowed as a deduction is generally carried forward.

The performance of services as an employee is not considered a trade or business for purposes of calculating the business interest deduction limitation. Consequently, wages are excluded from adjusted taxable income.

A taxpayer can make an election under §163(j)(7)(B) to exclude from the business interest deduction limitation any of the following real property trades or businesses (i.e., an **electing real property trade or business).**

- Real property development
- Redevelopment
- Construction
- Reconstruction
- Acquisition
- Conversion
- Rental
- Operation
- Management
- Leasing
- Brokerage

When the election is made for a real property trade or business, interest paid or accrued by that business is not considered business interest subject to the business interest deduction limitation. Once made, the election is irrevocable. When an election is made to exclude a real property trade or business from the business interest limitation, that business must use the alternative depreciation system (ADS) for certain property including nonresidential real property, residential rental property, and QIP.[60]

Taxpayers can also make an election under §163(j)(7)(C) to exclude certain farming businesses (i.e., electing farming business) from the business interest deduction limitation. These include farming businesses defined under the uniform capitalization rules and specified agricultural or horticultural cooperatives (as defined in §199A(g)).[61]

When an election is made to exclude a farming business from the business interest limitation, that business must use ADS for any property with a recovery period of 10 years or more and that is not eligible for bonus depreciation.[62]

> **Note.** For more information about the business interest limitation under §163(j), see the 2018 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: New Legislation — Business Concerns. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

60. IRC §§163(j)(10)(A) and 168(g)(8).
61. IRC §§163(j)(7)(A)(iii) and (C).
62. IRC §168(g)(1)(G).

New Law

A provision in the CARES Act generally increases the percentage of the taxpayer's adjusted taxable income from 30% to 50% to calculate the deduction for business interest expense for tax years beginning in 2019 or 2020. For partnership tax years beginning in 2019, the increased percentage does not apply. Instead, partners that were allocated a partnership's excess business interest expense for a tax year beginning in 2019 are permitted to deduct 50% of the excess business interest in the partnership's first tax year beginning in 2020. The other 50% of the excess business interest is subject to the limitations of §163(j)(4)(B)(ii).

Taxpayers can elect out of the application of the increase in the adjusted taxable income percentage for any tax year to which the increase applies. Partners can elect out of the special rule for 2019 excess business interest.

A taxpayer can elect to substitute the adjusted taxable income for its last tax year beginning in 2019 for its adjusted taxable income for a tax year beginning in 2020. For a partnership, the election is made at the partnership level.

If the election to substitute adjusted taxable income from a taxpayer's tax year beginning in 2019 is made and the taxpayer has a short tax year beginning in 2020, the deductible interest expense for 2020 is calculated as follows.

$$\text{2020 deductible interest expense} = \text{Taxpayer's 2019 adjusted taxable income} \times \frac{\text{\# months in short tax year beginning in 2020}}{12} \times 50\%$$

Example 11. Briefyear Company had adjusted taxable income of $20 million for the 2019 tax year. Briefyear has $1 million of adjusted taxable income in its short tax year starting on January 1, 2020, and ending on March 31, 2020. In addition, Briefyear has $5 million of business interest expense in its short 2020 tax year.

Briefyear makes the election to substitute adjusted taxable income from its tax year beginning in 2019 for its adjusted taxable income for the 2020 tax year. As a result, its deductible interest expense for 2020 is $2.5 million, which is calculated as follows.

$$\begin{aligned}\text{2020 deductible interest expense} &= \$20\text{ million} \times \frac{\text{3 months in 2020 tax year}}{12} \times 50\% \\ &= \$20\text{ million} \times 0.25 \times 50\% \\ &= \$2.5\text{ million}\end{aligned}$$

Withdrawing a §163(j) Election.[63] A real property trade or business or a farming business (i.e., an electing real property trade or business or an electing farming business) that elected out of the application of the business interest limitation under §163(j) for the 2018, 2019, or 2020 tax year can withdraw the election. To do so, the taxpayer must timely file an amended federal income tax return, amended Form 1065, *U.S. Return of Partnership Income,* or an administrative adjustment request (AAR) under IRC §6227, as applicable for the tax year in which the election was made. An election withdrawal statement must be included with the return.

The amended federal income tax return or amended Form 1065 must generally be filed on or before October 15, 2021, but not later than the applicable period of limitations for the tax year for which the amended return is being filed. The amended return (or AAR) must include the adjustment to taxable income for the withdrawn §163(j)(7) election and any associated adjustments to taxable income or tax liability. A taxpayer must also file amended federal tax returns or AARs for any affected succeeding tax years.

63. Rev. Proc. 2020-22, 2020-18 IRB 745.

The election withdrawal statement should be titled "Revenue Procedure 2020-22 Section 163(j)(7) Election Withdrawal." The election withdrawal statement should contain the taxpayer's name, address, and SSN or employer identification number (EIN). It should state that the taxpayer is withdrawing its election under §§163(j)(7)(B) or 163(j)(7)(C), as applicable, pursuant to Rev. Proc. 2020-22.

Making a Late §163(j) Election.[64] A taxpayer can make a §163(j)(7) election for the 2018, 2019, or 2020 tax year by filing an amended federal income tax return, amended Form 1065, or AAR, as applicable. Except for certain partnerships subject to the centralized partnership audit regime under the Bipartisan Budget Act of 2015,[65] the amended federal return must be filed by October 15, 2021, but no later than the applicable limitations period for the tax year for which the amended return is filed.

The amended federal return, amended Form 1065, or AAR must include the taxable income adjustment for the late §163(j)(7) election and any associated adjustments to taxable income or tax liability. Associated adjustments also must be made on amended returns or AARs, as applicable, for any affected succeeding tax year.

The election statement should be titled "Revenue Procedure 2020-22 Late Section 163(j)(7) Election." It should contain the following information.

1. Taxpayer's name
2. Taxpayer's address
3. Taxpayer's SSN or EIN
4. Description of taxpayer's electing trade or business, including the principal business activity code
5. Statement that the taxpayer is making an election under §163(j)(7)(B) (electing real property trade or business) or §163(j)(7)(C) (electing farming business), as applicable

A taxpayer that makes a §163(j)(7) election must determine its depreciation on the amended return or AAR for the property affected by the late election using the ADS.

TECHNICAL AMENDMENT FOR QIP[66]

Old Law

When the definition of QIP was added to IRC §168(e) under the TCJA, language providing a 15-year recovery period for such property was inadvertently omitted. Consequently, the IRS and Treasury Department took the position that QIP placed in service after December 31, 2017, is recoverable over 39 years, rather than the 15-year period that was intended.

As mentioned earlier, the ADS is required to be used for certain property held by an electing real property trade or business and an electing farming business. Under the ADS, all property is depreciated using the straight-line method over recovery periods generally equal to the class life of the property. Under the TCJA, QIP has a 40-year ADS recovery period, rather than the 20-year period that was intended.

64. Ibid.

65. See Rev. Proc. 2020-23, 2020-18 IRB 1.

66. CARES Act §2307; *Description of the Tax Provisions of Public Law 116-136, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act* (JCX-12R-20). Apr. 23, 2020. Joint Committee on Taxation. [www.jct.gov/publications.html?func=startdown&id=5256] Accessed on May 12, 2020.

New Law

The CARES Act clarifies that QIP is 15-year property under modified accelerated cost recovery system (MACRS) and 20-year property under ADS. In addition, the CARES Act provision clarifies that the 15-year MACRS (or 20-year ADS) period only applies if the QIP is made by the taxpayer. For example, if a taxpayer purchases a building, any QIP previously placed in service by the seller does not qualify as QIP with respect to the buyer.

This provision applies as if included in the TCJA (i.e., for property placed in service after December 31, 2017).

Practitioner Planning Tip

Due to a drafting error in the TCJA, QIP had a 39-year MACRS recovery life, rather than the 15-year life that was intended. Under the ADS, the recovery period for QIP was 40 years. Because its MACRS recovery period was over 20 years, QIP was ineligible for bonus depreciation. The CARES Act made a correction such that the MACRS recovery period now has the desired 15-year life. This correction is retroactive to 2018. Consequently, a taxpayer that made the election out of the business interest limitation may want to withdraw the election so that it can claim bonus depreciation on QIP.

Note. QIP under the CARES Act is covered in more detail in the 2020 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 2: Depreciation.

FURTHER CONSOLIDATED APPROPRIATIONS ACT, 2020

On December 20, 2019, the president signed into law the Further Consolidated Appropriations Act, 2020[67] (FCAA). The FCAA is part of an omnibus spending package. It contains various provisions designed to enhance retirement security (contained in the Setting Every Community Up for Retirement Enhancement (SECURE) Act) as well as several tax provisions, including the following.[68]

- Repeal of certain Affordable Care Act (ACA)[69] taxes
- Disaster tax relief
- Extensions of expired or expiring tax provisions

The material that follows summarizes the tax and retirement provisions contained in the FCAA.

67. PL 116-94.

68. *House Message on H.R. 1865 — The Further Consolidated Appropriations Act, 2020.* Dec. 19, 2019. Senate RPC. [www.rpc.senate.gov/legislative-notices/house-message-on-hr-1865_the-further-consolidated-appropriations-act-2020] Accessed on Mar. 16, 2020.

69. PL 111-148.

REPEAL OF CERTAIN ACA TAXES

Medical Device Excise Tax[70]

Old Law. The ACA imposed a tax equal to 2.3% of the sale price of any taxable medical device by the manufacturer, producer, or importer of such device. This tax was to become effective in 2013, but was delayed several times. It was scheduled to apply to sales of medical devices after December 31, 2019.[71]

New Law. The FCAA repealed the medical device excise tax effective for sales after December 31, 2019.

Repeal of Annual Fee on Health Insurance Providers[72]

Old Law. The ACA imposed an annual fee that applied to any covered entity engaged in the business of providing health insurance for U.S. health risks. Under the provision, the aggregate annual fee was apportioned among the providers based on a ratio designed to reflect relative market share of U.S. health insurance business. The first fees were due September 30, 2014. The fee was suspended for 2017 and again for 2019.[73]

New Law. The FCAA repeals the annual fee on health insurance providers effective for calendar years beginning after December 31, 2020. The fee is still in effect for 2020.[74]

Repeal of Excise Tax on High Cost Employer-Sponsored Health Coverage[75]

Old Law. An ACA provision imposed an excise tax (often called the "Cadillac-plan tax") on insurers if the aggregate value of employer-sponsored health insurance coverage for an employee exceeded a threshold amount. This excise tax was originally set to become effective in 2018 but was delayed until 2020 by the Consolidated Appropriations Act, 2016.[76] Then, in January 2018, the effective date was further delayed until 2022.[77]

New Law. Effective for tax years beginning after December 31, 2019, the FCAA repealed the excise tax on high-cost employer-sponsored health coverage.

DISASTER TAX RELIEF

Overview

The FCAA contains the following provisions relating to disaster tax relief.[78]

- Disaster-related rules for use of retirement funds
- Employee retention credit for employers affected by qualified disasters
- Other disaster-related tax relief provisions

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70. FCAA, Division N, §501.

71. IRC §4191, which was stricken under the FCAA.

72. FCAA, Division N, §502.

73. ACA §9010; *Affordable Care Act Provision 9010 — Health Insurance Providers Fee.* Jan. 14, 2020. IRS. [www.irs.gov/businesses/corporations/affordable-care-act-provision-9010] Accessed on Apr. 2, 2020.

74. *Affordable Care Act Provision 9010 — Health Insurance Providers Fee.* Jan. 14, 2020. IRS. [www.irs.gov/businesses/corporations/affordable-care-act-provision-9010] Accessed on Apr. 2, 2020.

75. FCAA, Division N, §503.

76. PL 114-113, §101.

77. PL 115-120, §4002.

78. FCAA, Title II, §201.

For purposes of the disaster relief contained in the FCAA, the term **qualified disaster area** is defined as any area in which a major disaster was declared by the president during the period between January 1, 2018, and February 18, 2020 (60 days after the enactment of the FCAA), except the California wildfire disaster area defined in the Bipartisan Budget Act of 2018.

The term **incident period** means the period specified by the Federal Emergency Management Agency as the period during which the disaster occurred. For purposes of the FCAA, this period is not treated as beginning before January 1, 2018, or ending after January 19, 2020 (30 days after the enactment of the FCAA).[79]

Withdrawals from Retirement Funds[80]

Old Law. A distribution from an eligible retirement plan is generally included in income. Unless an exception applies, a distribution from a qualified retirement plan, a 403(b) plan, or an IRA that the taxpayer receives before turning age 59½ is subject to a 10% early withdrawal tax on the amount includable in income.[81]

An **eligible retirement plan** includes the following.

- A qualified pension, profit-sharing, or stock bonus plan (including a 401(k) plan)
- A qualified annuity plan
- A tax-sheltered annuity contract
- A governmental 457 deferred compensation plan
- A traditional, simplified employee pension (SEP), savings incentive match plan for employees (SIMPLE), or Roth IRA

New Law. Under the FCAA, the 10% early withdrawal tax does not apply to any qualified disaster distribution of up to $100,000. However, the early withdrawal tax may apply to any distributions the taxpayer received in excess of $100,000. A **qualified disaster distribution** is defined as any distribution from an eligible retirement plan made:

- On or after the first day of the incident period of a qualified disaster and before June 17, 2020 (180 days after the enactment of the FCAA), and
- To an individual whose main home at any time during the incident period of the qualified disaster is located in the qualified disaster area and who sustained an economic loss because of the disaster.

A taxpayer can generally repay any portion of a qualified disaster distribution that is eligible for tax-free rollover treatment to an eligible retirement plan. The taxpayer has three years from the day after the date they received the distribution to make a repayment. Amounts that are repaid are treated as a trustee-to-trustee transfer and are not included in income.

Qualified disaster distributions are generally included in the taxpayer's income in equal amounts over three years. However, the taxpayer can make an election to include the entire distribution in their income in the year they receive it.

> **Note.** For more information about reporting and repaying qualified disaster distributions, see IRS Pub. 590-B, *Distributions from Individual Retirement Arrangements (IRAs)*.

79. FCAA, Title II, §201(4).

80. FCAA, Title II, §202; IRS Pub. 590-B, *Distributions from Individual Retirement Arrangements (IRAs)*.

81. IRC §72(t); *Topic No. 558 Additional Tax on Early Distributions from Retirement Plans Other than IRAs.* Jul. 7, 2020. IRS. [www.irs.gov/taxtopics/tc558] Accessed on Aug. 3, 2020.

Employee Retention Credit for Employers Affected by Qualified Disasters[82]

Old Law.[83] Eligible employers may claim a California wildfire employee retention credit equal to 40% of qualified wages paid to each eligible employee during the tax year. An **eligible employer** is one that conducted a trade or business on October 8, 2017, in the California wildfire disaster area and that trade or business was inoperable on any day after October 8, 2017, and before January 1, 2018, because of damage sustained from the wildfires. An **eligible employee** is one whose principal place of employment on October 8, 2017, was in the California wildfire disaster area and was employed by an eligible employer. **Qualified wages** is defined as wages paid or incurred by an eligible employer to an eligible employee on any day after October 8, 2017, and before January 1, 2018, that occurs during the period:

- Beginning on the date the trade or business first became inoperable, and
- Ending on the date on which the trade or business resumes significant operations.

The maximum amount of qualified wages that may be taken into account for any individual is $6,000.

New Law. Eligible employers can claim a 2018 through 2019 qualified disaster employee retention credit equal to 40% of the qualified wages paid to each eligible employee during the tax year. The amount of qualified wages that can be taken into account for any employee for the tax year cannot exceed $6,000 (reduced by the amount of qualified wages taken into account for the employee for any prior tax year).

The term **eligible employer** is any employer:

- That conducted an active trade or business in a qualified disaster zone at any time during the incident period of the qualified disaster; and
- The trade or business was inoperable at any time beginning on the first day of the incident period of the qualified disaster and ending on December 20, 2019 (the date of the enactment of the FCAA), as a result of damage from the qualified disaster.

An **eligible employee** is an employee whose principal place of employment with the eligible employer (determined immediately before the qualified disaster) was in the qualified disaster zone.

Qualified wages is defined as wages paid or incurred by an eligible employer with respect to an eligible employee at any time on or after the date the trade or business first became inoperable at the principal place of employment, and ending on the earlier of:

- The date on which the trade or business resumes significant operations, or
- The date that is 150 days after the last day of the incident period of the qualified disaster.

An employer claims the credit on Form 5884-A, *Employee Retention Credit.*

Suspension of Limitation on Qualified Contributions[84]

Old Law. Individuals may deduct cash contributions up to 60% of their contribution base for charitable contributions to organizations described in IRC §170(b)(1)(A). The increased deduction limit applies to the 2018–2025 tax years (the TCJA period). The amount disallowed because of the 60% limitation can be carried forward for five years.[85]

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82. FCAA, Title II, §203.

83. PL 115-123, §20103.

84. FCAA, Title II, §204.

85. IRC §170(b)(1)(G).

New Law. Under the FCAA, the percentage limits on qualified contributions are generally disregarded. However, the total of qualified contributions is allowed as a deduction only to the extent that the aggregate of such contributions does not exceed the excess of the taxpayer's contribution base over the amount of all other charitable contributions allowed under §170(b)(1). **Contribution base** is defined in §170(b)(1)(H) as the taxpayer's AGI calculated without regard to any NOL carryback to the tax year. The amount disallowed because of the AGI limitation can be carried forward for five years.

For this purpose, **qualified contribution** is defined as any charitable contribution (as defined in §170(c)) if the following conditions are satisfied.

- The contribution is paid during the period beginning on January 1, 2018, and ending on February 18, 2020 (60 days after enactment of the FCAA), in cash to an organization described in §170(b)(1)(A).
- The contribution is made for relief efforts in one or more qualified disaster areas.
- The taxpayer obtains contemporaneous written acknowledgment that the contribution was used for relief efforts.
- The taxpayer has elected the application of these rules with respect to the contribution.

Example 12. Jolene contributed $75,000 in 2019 for disaster-relief efforts in her home state of Texas, which suffered severe storms and flooding in February 2019. A federal disaster declaration was issued for the area. Jolene made no other charitable contributions in 2019. She obtained a contemporaneous written acknowledgment that her contribution was used for relief efforts.

Jolene's 2019 AGI was $75,000, and she had no NOL carrybacks to 2019. She can take a deduction for the entire $75,000 she contributed if she elects the application of the increased contribution provisions on her tax return.

Contributions made in order to establish or maintain a donor-advised fund (as defined in IRC §4966(d)(2)) are not qualified contributions.

Qualified Disaster-Related Personal Casualty Losses[86]

Old Law.[87] Qualified disaster-related personal casualty losses are deductible regardless of whether the aggregate net losses exceed 10% of the taxpayer's AGI. To be deductible, the losses must exceed $500 per casualty.[88] A net disaster loss is defined as the excess of qualified disaster-related personal casualty losses over personal casualty gains. For this purpose, the term qualified disaster-related personal casualty losses is defined as losses that arose in the California wildfire disaster area on or after October 8, 2017, and that are attributable to the wildfires in that area.

An individual who incurred a net disaster loss and does not itemize deductions can increase their standard deduction by the amount of the net disaster loss. The increase in the standard deduction amount is also allowed as a deduction for purposes of calculating alternative minimum taxable income (AMTI).

New Law. Under the FCAA, the definition of a **qualified disaster loss** is expanded to include an individual's casualty and theft of personal-use property that is attributable to a major disaster that was declared by the president before February 19, 2020. The incident period for the disaster must have occurred during the period beginning January 1, 2018, and before December 21, 2019. However, these qualified disaster losses do not include the losses attributable to California wildfires in January 2018 (which received special relief in 2018).[89]

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86. FCAA, Title II, §204(b).

87. PL 115-123 §20104(b).

88. IRS Pub. 976, *Disaster Relief.*

89. IRS Pub. 547, *Casualties, Disasters, and Thefts.*

As was the case before the enactment of the FCAA, taxpayers can deduct qualified disaster-related personal casualty losses regardless of whether the aggregate net losses exceed 10% of the taxpayer's AGI. To be deductible, the losses must exceed $500 per casualty. An individual who incurred a net disaster loss and does not itemize deductions can increase their standard deduction by the amount of the net disaster loss. The increase in the standard deduction amount is also allowed as a deduction for purposes of calculating AMTI.[90]

In addition, a taxpayer who incurred a casualty loss from a federally declared disaster that occurred in an area warranting public or individual assistance (or both) can make an election to deduct the disaster loss on the tax return for the tax year immediately preceding the year in which the disaster occurred. If the taxpayer makes this election, the loss is treated as having occurred in the preceding year.[91]

Note. For information about making the election to claim the disaster-related loss in the preceding year and other rules concerning disaster losses, see IRS Pub. 547, *Casualties, Disasters, and Thefts.*

Special Rule for Determining Earned Income[92]

Old Law. The amount of earned income credit (EIC) that a taxpayer qualifies for is based on a combination of factors including the number of children, the amount of earned income received during the year, and the taxpayer's filing status.[93]

Under the TCJA, a taxpayer can claim a child tax credit (CTC) of $2,000 per qualifying child. To the extent the CTC exceeds the taxpayer's tax liability, the taxpayer can qualify for a refundable additional child tax credit (ACTC) equal to 15% of earned income in excess of $2,500. Under the TCJA, the maximum refundable ACTC is $1,400 per qualifying child for 2020.[94]

New Law. Under the FCAA, if the earned income of a qualified individual is **less** than the earned income of that individual for the preceding tax year, the individual can determine their refundable ACTC and their EIC by substituting their earned income for the preceding tax year for the earned income of the applicable tax year.

A **qualified individual** for this purpose is defined as any individual whose main home at any time during the incident period of a qualified disaster was located:

- In the qualified disaster zone for the qualified disaster, or
- In the qualified disaster area for the qualified disaster (but outside of the qualified disaster zone) and such individual was displaced from their main home because of the qualified disaster.

90. Ibid.

91. Ibid.

92. FCAA, Title II, §204(c).

93. *Earned Income Tax Credit Income Limits and Maximum Credit Amounts.* Apr. 2, 2020. IRS. [www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-tax-credit-income-limits-and-maximum-credit-amounts] Accessed on Apr. 3, 2020.

94. IRC §24; Rev. Proc. 2019-44, 2019-47 IRB 1093.

TAX EXTENDERS

The expired or expiring tax provisions extended by the FCAA are summarized in the following table.

FCAA Section	IRC Section	Description	Previous Expiration Date	New Expiration Date
101	108(a)(1)	Exclusion from gross income of discharge of qualified principal residence indebtedness	Dec. 31, 2017	Dec. 31, 2020
102	163(h)(3)(E)	Mortgage insurance premiums treated as qualified residence interest	Dec. 31, 2017	Dec. 31, 2020
103	213(f)	Reduction of medical expense deduction floor from 10% to 7.5%	Dec. 31, 2018	Dec. 31, 2020
104	222(e)	Qualified tuition and fees deduction	Dec. 31, 2017	Dec. 31, 2020
105	4121(e)	Black lung disability trust fund excise tax	Dec. 31, 2018	Dec. 31, 2020
111	45A(f)	Indian employment credit	Dec. 31, 2017	Dec. 31, 2020
112	45G(f)	Railroad track maintenance credit	Dec. 31, 2017	Dec. 31, 2022
113	45N(e)	Mine rescue team training credit	Dec. 31, 2017	Dec. 31, 2020
114	168(e)(3)(A)	Classification of certain race horses as 3-year property	Dec. 31, 2017	Dec. 31, 2020
115	168(i)(15)	7-year recovery period for motorsports entertainment complexes	Dec. 31, 2017	Dec. 31, 2020
116	168(j)(9)	Accelerated depreciation for business property on Indian reservations	Dec. 31, 2017	Dec. 31, 2020
117	181(g)	Expensing rules for certain film, television, and live theatrical productions	Dec. 31, 2017	Dec. 31, 2020
118	1391(d)	Empowerment zone tax incentives	Dec. 31, 2017	Dec. 31, 2020
119	N/A [95]	American Samoa economic development credit	Dec. 31, 2017	Dec. 31, 2020
121	40A(g), 6426(c)	Biodiesel and renewable diesel	Dec. 31, 2017	Dec. 31, 2022
122	40(b)(6)	Second generation biofuel producer credit	Dec. 31, 2017	Dec. 31, 2020

95. See PL 109-432 §119.

FCAA Section	IRC Section	Description	Previous Expiration Date	New Expiration Date
123	25C(g)(2)	Nonbusiness energy property	Dec. 31, 2017	Dec. 31, 2020
124	30B(k)(1)	Qualified fuel cell motor vehicles	Dec. 31, 2017	Dec. 31, 2020
125	30C(g)	Alternative fuel vehicle refueling property credit	Dec. 31, 2017	Dec. 31, 2020
126	30D(g)(3)(E)(ii)	2-wheeled plug-in electric vehicle credit	Dec. 31, 2017	Dec. 31, 2020
127	45(d), 48(a)(5)(C)	Credit for electricity produced from certain renewable resources	Dec. 31, 2017	Dec. 31, 2020
128	45(e)(10)	Production credit for Indian coal facilities changed from 12-year period to 15-year period	N/A	Dec. 31, 2020
129	45L(g)	Energy efficient homes credit	Dec. 31, 2017	Dec. 31, 2020
130	168(l)(2)(D)	Special allowance for second generation biofuel plant property	Dec. 31, 2017	Dec. 31, 2020
131	179D(h)	Energy efficient commercial buildings deduction	Dec. 31, 2017	Dec. 31, 2020
132	451(k)(3)	Special rule for sales or dispositions to implement restructuring policy for qualified electric utilities	Dec. 31, 2017	Dec. 31, 2020
133	6426(d), 6426(e)(3)	Extension and clarification of excise tax credits relating to alternative fuels	Dec. 31, 2017	Dec. 31, 2020
134	4611(f)	Oil spill liability trust fund rate	Dec. 31, 2018	Dec. 31, 2020
141	45D(f)	New markets tax credit	Dec. 31, 2019	Dec. 31, 2020 [a]
142	45S	Employer credit for paid family and medical leave	Dec. 31, 2019	Dec. 31, 2020
143	51(c)(4)	Work opportunity credit	Dec. 31, 2019	Dec. 31, 2020
144	263A(f)(4)(B)	Certain provisions related to beer, wine, and distilled spirits	Dec. 31, 2019	Dec. 31, 2020
145	954(c)(6)(C)	Look-through rule for related controlled foreign corporations	Dec. 31, 2019	Dec. 31, 2020
146	35(b)(1)(B)	Credit for health insurance costs of eligible individuals	Dec. 31, 2019	Dec. 31, 2020

[a] With carryover period extended through Dec. 31, 2025.

OTHER FCAA PROVISIONS

Repeal of Unrelated Business Taxable Income for Certain Fringe Benefits[96]

Old Law. Effective for amounts paid or incurred after December 31, 2017, the TCJA treated disallowed employee fringe benefits as additions to an exempt organization's unrelated business taxable income (UBTI). Disallowed fringe benefits are nondeductible expenses and specifically include the following.[97]

- Qualified transportation fringe benefits
- Qualified parking facilities
- On-premises athletic facilities

New Law. The FCAA repealed the increase in UBTI for certain fringe benefits provided by exempt organizations. The repeal takes effect as if it had been included in the TCJA (i.e., for amounts paid or incurred after December 31, 2017).

SECURE ACT

The SECURE Act was enacted as Division O of the FCAA. The SECURE Act contains major changes that affect retirement and pension accounts, as well as other related provisions.

Multiple and Pooled Employer Plans[98]

Old Law. A multiple employer retirement plan is a plan maintained by two or more employers who are not related under the following Code sections.[99]

- IRC §414(b) (controlled groups)
- §414(c) (trades or businesses under common control)
- §414(m) (affiliated service groups)

Multiple employer plans must comply with the qualification rules under IRC §401(a). This includes rules related to eligibility, vesting, distribution, etc. If one of the participating employers fails a qualification requirement or if the plan itself fails to satisfy a qualification requirement, then the plan is disqualified for all participating employers.[100] This is sometimes called the "one bad apple rule."[101]

New Law.[102] The SECURE Act provides relief from the one bad apple rule. For plan years beginning after December 31, 2020, a plan will not be treated as failing to meet the applicable requirements under §401(a) merely because one or more employers subject to the plan fail to comply with qualification requirements. This provision also applies to a plan that consists of IRAs described in IRC §408.

To qualify for relief from the one bad apple rule, the terms of the plan must provide that if any employer in the plan fails to take the required actions, the plan assets attributable to employees of that employer will be transferred to a plan maintained only by such employer.

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96. FCAA, Division Q, §302.

97. IRC §512(a)(7), which was stricken by the FCAA.

98. SECURE Act §101.

99. IRM 7.11.7.1.1 (2017).

100. IRM 7.11.7.3 (2015)

101. See, e.g., *SECURE retirements now a reality for businesses.* Carroll, Bob. Dec. 21, 2019. MassMutual. [blog.massmutual.com/post/secure-act-business] Accessed on Mar. 25, 2020.

102. IRC §413(e).

In addition, employers can participate in a **pooled employer plan,** which is an individual account plan established or maintained for the purpose of providing benefits to employees of two or more employers. A pooled employer plan does not include a plan maintained by employers that have a common interest other than having adopted the plan. A pooled employer plan must be administered by a pooled plan provider, who serves as the plan fiduciary. This provision is effective for plan years beginning after December 31, 2020.

Increase in Cap for Automatic Enrollment Safe Harbor[103]

Old Law. IRC §401(k) plans must meet special nondiscrimination tests. These can be satisfied by complying with the actual deferral-percentage (ADP) test, the ADP safe-harbor provisions, the automatic enrollment safe-harbor requirements, or the SIMPLE 401(k) provisions.[104]

An automatic enrollment feature allows an employer to automatically deduct elective deferrals from an employee's wages unless the employee elects not to contribute or to contribute a different amount. Any plan that allows elective salary deferrals (e.g., 401(k) plans) can have this feature.[105]

A qualified automatic contribution arrangement (QACA) is a safe harbor plan that uses an automatic enrollment feature. In addition, mandatory employer contributions are required. A plan that includes a QACA is not subject to annual ADP testing or the actual contribution percentage nondiscrimination testing if certain additional requirements are met.[106]

Under a QACA, each employee who is eligible to participate in the plan is treated as having made elective deferral contributions equal to a certain default percentage of compensation. In order to not have default elective deferrals made, an employee must make an affirmative election specifying a deferral percentage (which can be zero, if desired). If an employee does not make an affirmative election, the default deferral percentage must meet the following conditions.[107]

- It must be applied uniformly.
- It must be at least 3% in the first plan year that it applies to an employee and through the end of the following year.
- It must increase to at least 4% in the second plan year.
- It must increase to at least 5% in the third plan year.
- It must increase to at least 6% in the fourth plan year and all subsequent years.

New Law. Under the SECURE Act, effective for plan years beginning after December 31, 2019, the default deferral percentage cannot exceed 10% during the first plan year that it applies to an employee. Moreover, it cannot exceed 15% after the first year.[108] Under prior law, the maximum deferral percentage for any year was 10%.[109]

103. SECURE Act §102.

104. Treas. Reg. §1.401(k)-1(b)(1)(ii).

105. *Retirement Topics — Automatic Enrollment.* Jan. 9, 2020. IRS. [www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-automatic-enrollment] Accessed on Mar. 18, 2020.

106. IRS Pub. 560, *Retirement Plans for Small Business.*

107. Ibid; IRC §401(k)(13)(C)(iii).

108. IRC §401(k)(13)(C)(iii).

109. SECURE Act §102.

Increase in Credit Limit for Small Employer Pension Plan Startup Costs[110]

Old Law. Prior to the enactment of the SECURE Act, eligible small employers could claim a tax credit for qualified startup costs incurred in establishing or administering an eligible employer plan. The credit amount was 50% of the qualified startup costs up to a maximum of $500 for the first credit year and each of the two tax years immediately following the first credit year.[111]

An **eligible small employer** is one that had no more than 100 employees during the tax year preceding the first credit year who received at least $5,000 of compensation during that year.[112] However, an employer is not an eligible small employer if it established or maintained a qualified employer plan for substantially the same employees who are in the new qualified employer plan during the three tax years preceding the first credit year.[113]

Qualified startup costs are expenses paid or incurred in connection with either of the following.[114]

- Establishing or administering an eligible employer plan
- The retirement-related education of employees with respect to the plan

An **eligible employer plan** is a qualified employer plan (as defined in IRC §4972(d)) with at least one non-highly compensated employee who is eligible to participate.[115]

The **first credit year** is generally the tax year in which the eligible employer plan becomes effective. However, an employer can elect to have the preceding tax year be the first credit year and claim the credit for qualified startup costs paid or incurred during that tax year.[116]

> **Example 13.** Safe Company is an eligible small employer. Its eligible plan is first effective on January 1, 2018. Safe Company can elect to treat 2017 as the first credit year and claim the credit on its 2017 tax return for qualified startup costs incurred in 2017.

Eligible small employers use Form 8881, *Credit for Small Employer Pension Plan Startup Costs,* to claim the credit.

New Law. For tax years beginning after December 31, 2019, the SECURE Act increases the credit limit for small employer pension plan startup costs. The credit is 50% of qualified startup costs, up to the greater of:[117]

- $500, or
- The lesser of:
  - $250 for each employee who is not a highly compensated employee, or
  - $5,000.

As was the case under prior law, the credit can be taken for the first credit year and each of the following two tax years. Alternatively, the employer can elect to have the preceding tax year be the first credit year.

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110. SECURE Act §104.
111. IRC §45E(b)(1), prior to amendment by the SECURE Act; Instructions for Form 8881 (2017).
112. Instructions for Form 8881; IRC §§45E(c) and 408(p)(2)(C)(i).
113. Instructions for Form 8881; IRC §45E(c)(2).
114. Instructions for Form 8881; IRC §45E(d)(1)(A).
115. Instructions for Form 8881; IRC §45E(d)(2).
116. Instructions for Form 8881.
117. IRS Pub. 560, *Retirement Plans for Small Business.*

Small Employer Automatic Enrollment Credit.[118]

Old Law. There was no provision for an automatic enrollment credit under prior law.

New Law. The SECURE Act added IRC §45T, under which an eligible employer can claim a tax credit when it sponsors a qualified employer plan that includes an eligible automatic contribution arrangement. The credit is $500 per year for the 3-year period starting with the first tax year beginning after December 31, 2019. The credit can first be claimed on the employer's 2020 return.[119]

An **eligible employer** for this purpose is defined as an employer that had no more than 100 employees who received at least $5,000 of compensation from the employer in the preceding year.[120]

A **qualified employer plan** is defined under §4972(d) as one of the following.

- Any plan meeting the requirements of IRC §401(a) (i.e., qualified pension, profit sharing, and stock bonus plans), which includes a trust exempt from tax under IRC §501(a)
- IRC §403(a) qualified annuity plans
- Any SEP plan (within the meaning of §408(k))
- Any SIMPLE retirement account (within the meaning of IRC §408(p))

An **eligible automatic contribution arrangement** is defined as an employer plan arrangement under which:[121]

- A participant can elect to have the employer make payments as contributions under the plan on behalf of the participant, or to the participant directly in cash; or
- The participant is treated as having elected to have the employer contribute a uniform percentage of their compensation until the participant specifically elects not to have such contributions made (or elects contributions made at a different percentage).

The arrangement must also meet the notice requirements specified in IRC §414(w)(4).

Repeal of Maximum Age for Traditional IRA Contributions[122]

Old Law. Under prior law, a taxpayer could not make contributions to a traditional IRA if they reached age 70½ by the end of the tax year. This was true even if the taxpayer continued to work and earn taxable compensation after age 70½. Taxable compensation includes the following types of income.[123]

- Wages, salaries, tips, professional fees, bonuses, and other amounts received for providing personal services
- Commissions
- SE income
- Nontaxable combat pay
- Taxable alimony and separate maintenance payments

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118. SECURE Act §105.

119. IRS Pub. 560, *Retirement Plans for Small Business.*

120. IRC §§45T(c) and 408(p)(2)(C)(i).

121. IRC §414(w)(3).

122. SECURE Act §107.

123. IRS Pub. 590-A, *Contributions to Individual Retirement Arrangements (IRAs).*

> **Note.** For divorce decrees and separate maintenance agreements entered into or modified after December 31, 2018, the TCJA repealed the deduction for alimony and separate maintenance payments by the payor spouse and the inclusion in income by the recipient spouse. For divorces after 2018, alimony is not included in the definition of compensation under IRC §219 as amended by the TCJA. For more information, see the 2018 *University of Illinois Federal Tax Workbook,* Volume A, Chapter 5: Divorce. This can be found at **uofi.tax/arc** [taxschool.illinois.edu/taxbookarchive].

A qualified charitable distribution (QCD) can be used to satisfy the taxpayer's RMD.[124] A QCD is a transfer by a trustee or custodian from a taxpayer's IRA made directly by the trustee to a charitable organization. The distribution must be made on or after the date that the individual for whom the plan is maintained attains age 70½. Only the amount of the distribution that would otherwise be included in the taxpayer's gross income counts toward the QCD. The total QCD amount cannot exceed $100,000 per taxpayer per year.[125]

New Law. The SECURE Act repeals the rule that prohibits taxpayers from making traditional IRA contributions after they reach age 70½. Accordingly, a taxpayer can continue to make contributions to a traditional IRA after that age as long as they earn taxable compensation. This is effective for tax years beginning after December 31, 2019.

For tax years beginning after December 31, 2019, the amount of QCDs not included in gross income is reduced by the aggregate amount of IRA deductions allowed for all tax years ending on or after the taxpayer attains age 70½.

Example 14. Angela is 72 in 2020. She makes a deductible IRA contribution of $7,000 in 2020 and makes another deductible IRA contribution of $7,000 in 2021. She retires from her job at the end of 2021 and does not make any IRA contributions in 2022.

If Angela wants to take a QCD in 2022, the maximum amount she can exclude from income is $86,000 ($100,000 – $14,000 total IRA deductions after age 70½).

Practitioner Planning Tip

Although a taxpayer with taxable compensation income can continue to make traditional IRA contributions after age 70½, they are required to take RMDs when they attain age 72 (assuming they had not attained age 70½ on or before December 31, 2019). Rather than taking RMDs and making traditional IRA contributions during the same year, it may be more advantageous to make a Roth IRA contribution. Because there are no RMDs for Roth IRAs, the tax benefits can be extended over a longer period.

124. IRS Notice 2007-7, 2007-5 IRB 395.

125. IRC §408(d)(8).

Portability of Lifetime Income Options[126]

Old Law. Distributions from a retirement plan or IRA can generally be rolled over by depositing the distributed amount in another retirement plan or IRA within 60 days. Such rollovers are not taxable. Alternatively, a plan participant can request that the plan administrator make a direct transfer to another retirement plan or IRA.[127]

New Law. The SECURE Act allows qualified defined contribution plans, 403(b) plans, and governmental 457(b) plans to make direct trustee-to-trustee transfers of lifetime income investments to another employer-sponsored retirement plan or IRA. It also allows distributions of a lifetime income investment in the form of a qualified plan distribution annuity if a lifetime income investment is no longer held as an investment option under the plan.[128] Such distributions may be made within 90 days of the date on which the lifetime income investment is no longer authorized to be held as an investment option under the plan.[129]

A **lifetime income investment** is defined as an investment option designed to provide an employee with election rights:[130]

- That are not uniformly available for other investment options under the plan, and
- That are to a lifetime income feature available through a contract or other arrangement offered under the plan (or under another eligible retirement plan if paid by means of a direct trustee-to-trustee transfer to such other eligible retirement plan).

This provision applies to plan years beginning after December 31, 2019.

Participation in 401(k) Plan for Employees Working Over 500 Hours[131]

Old Law. If a business hires employees who meet the 401(k) plan eligibility requirements, the employees must be allowed to participate in the plan. Under prior law, an employee could be lawfully excluded from participation in a 401(k) plan if they meet **any** of the following conditions.[132]

- Has not attained age 21
- Has not completed a year of service during which they worked at least 1,000 hours
- Is covered by a collective bargaining agreement that does not provide for participation in the plan, if retirement benefits were the subject of good-faith bargaining
- Is a nonresident alien and who receives no earned income (within the meaning of IRC §911(d)(2)) from the employer that constitutes income from sources within the United States

New Law. Under the SECURE Act, an employee must be allowed to make elective deferrals to a 401(k) plan after they have completed three consecutive years of service, during each of which they have worked at least 500 hours (but less than 1,000). To be eligible, the employee must have attained age 21 by the end of the 3-year period. This provision is effective for plan years beginning after December 31, 2020, and does not apply to collectively bargained plans. In determining whether the employee has worked at least 500 hours during three consecutive years of service, 12-month periods beginning before January 1, 2021, are not taken into account.

126. SECURE Act §109.

127. *Rollovers of Retirement Plan and IRA Distributions.* Feb. 6, 2020. IRS. [www.irs.gov/retirement-plans/plan-participant-employee/rollovers-of-retirement-plan-and-ira-distributions] Accessed on Mar. 27, 2020.

128. *The Setting Every Community Up for Retirement Enhancement Act of 2019 (The SECURE Act).* House Committee on Ways and Means. [waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/SECURE%20Act%20section%20by%20section.pdf] Accessed on Mar. 19, 2020.

129. IRC §401(a)(38)(A), as amended by the SECURE Act.

130. IRC §401(a)(38)(B)(ii), as amended by the SECURE Act.

131. SECURE Act §112.

132. IRC §410.

Employers are **not** required to make nonelective or matching contributions on behalf of employees who are eligible to participate in the 401(k) plan solely because they worked at least 500 hours (but less than 1,000 hours) during three consecutive years.

Observation. Under the new rules, employers maintaining a 401(k) plan will be required to have dual eligibility requirements under which an employee must complete either:

- One year of service during which they worked at least 1,000 hours, or
- Three consecutive years of service during which the employee worked at least 500 hours each year.

The employer may elect to exclude employees who fall into the second category from testing under the nondiscrimination and top-heavy rules.[133] For information about the nondiscrimination and top-heavy rules, see IRS Pub. 560, *Retirement Plans for Small Business.*

Penalty-Free Retirement Plan Withdrawals for Birth or Adoption of Child[134]

Old Law. To discourage people from taking withdrawals from IRAs or qualified retirement plans, most early withdrawals (i.e., before the taxpayer reaches age 59½) are subject to a 10% penalty in addition to the income taxes due on the withdrawal.[135] The Code provides several exceptions to the early-withdrawal penalty.

New Law. The SECURE Act added a new exception to the penalty for early withdrawals. Effective for withdrawals after December 31, 2019, a taxpayer can take a maximum of $5,000 from a qualified plan or IRA within one year after the birth or adoption of a child. Such distributions are not subject to the 10% penalty.[136]

If a taxpayer takes a distribution after the birth or adoption of a child, they can repay any or all of the distribution amount by making one or more contributions to an eligible retirement plan that accepts rollover contributions. The taxpayer must be a beneficiary of the retirement plan and be eligible to make contributions.[137]

Practitioner Planning Tip

Unlike the 3-year repayment window for distributions taken from a retirement plan after a qualified disaster (discussed earlier), the SECURE Act provision does not specify any time limit for repayment of a withdrawal taken after the birth or adoption of a child. As long as the distribution is made within one year after the birth or adoption, it appears that the parent can pay back the funds at any time if they choose to do so as long as they are eligible to make contributions to an eligible retirement plan.

133. *The Setting Every Community Up for Retirement Enhancement Act of 2019 (The SECURE Act).* House Committee on Ways and Means. [waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/SECURE%20Act%20section%20by%20section.pdf] Accessed on Mar. 19, 2020.

134. SECURE Act §113.

135. IRC §72(t)(1).

136. IRC §72(t)(2)(H).

137. IRC §72(t)(2)(H)(v).

> **Note.** For more information about the exceptions to the early-withdrawal penalty, see the 2020 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: Retirement Plan Distributions.

Increase in Age for Required Minimum Distributions[138]

Old Law. Under prior law, an annual RMD must be made starting in the year when the traditional IRA account holder or qualified retirement plan participant reaches age 70½. However, the first RMD can be delayed until April 1 of the year following the year the taxpayer attains age 70½.

New Law. Under the SECURE Act, the prior rule applies for taxpayers who reached the age of 70½ in 2019. Taxpayers who reach age 70½ in 2020 or later years must take their first RMD by April 1 of the year after they reach age 72.

However, the CARES Act, which was enacted on March 27, 2020, waives the 2020 RMD requirement. The CARES Act provisions are discussed earlier.

> **Note.** For more information about the increase in age for RMDs, see the 2020 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: Retirement Plan Distributions.

Expansion of §529 Plans[139]

Old Law. Section 529 plans, also known as qualified tuition programs, are tax-advantaged savings plans to encourage future savings for education costs. Under these plans, individuals can prepay or contribute to an account for a designated beneficiary's qualified higher education expenses (QHEE) at an eligible educational institution. Distributions from §529 plans are not taxable when used to pay for QHEE or up to $10,000 for tuition at an elementary or secondary public, private, or religious school.[140]

> **Note.** For a thorough explanation of §529 plans, including expenses that qualify as QHEE, see IRS Pub. 970, *Tax Benefits for Education.*

New Law. For distributions made from §529 plans after 2018, QHEE is expanded under the SECURE Act to include the following.[141]

- Certain expenses required for a designated beneficiary's participation in certain apprenticeship programs
- No more than $10,000 paid as principal or interest on a qualified student loan of the designated beneficiary or the designated beneficiary's sibling

Apprenticeship Programs.[142] For distributions from §529 plans after 2018, expenses for fees, books, supplies, and equipment required for the designated beneficiary's participation in an apprenticeship program registered and certified with the Secretary of Labor under the National Apprenticeship Act[143] are treated as QHEE. Therefore, distributions for such expenses are not taxable.

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138. SECURE Act §114; *Retirement Plan and IRA Required Minimum Distribution FAQs.* Mar. 18, 2020. IRS. [www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distributions#3] Accessed on Mar. 19, 2020.

139. SECURE Act §302.

140. IRC §§529(c)(3)(B), (c)(7), and (e)(3); IRS Pub. 970, *Tax Benefits for Education.*

141. IRS Pub. 970, *Tax Benefits for Education.*

142. Ibid.

143. See 29 USC §50.

Payments on Student Loans.[144] For distributions made from §529 plans after 2018, up to $10,000 paid as principal or interest on qualified student loans[145] of the designated beneficiary or the designated beneficiary's sibling are treated as QHEE and are, therefore, not taxable.

The $10,000 allowance for payments on qualified student loans is a **lifetime limit.** The amount of distributions treated as QHEE for the loans of any individual cannot exceed $10,000, reduced by the amount of distributions treated as QHEE for all prior tax years.[146]

For purposes of the $10,000 limit, the amount treated as QHEE for the loans of the designated beneficiary's sibling are taken into account for the sibling and not for the designated beneficiary. For this purpose, a sibling includes a brother, sister, stepbrother, or stepsister.[147]

The taxpayer cannot take a deduction for student loan interest for any amount treated as QHEE.

Modification of Required Distribution Rules for Designated Beneficiaries[148]

Old Law. When the account owner of an IRA or qualified retirement account dies before reaching age 70½ (the age at which RMDs must begin prior to the enactment of the SECURE Act) and there is no designated beneficiary, the retirement account or IRA must be distributed within five calendar years after the date of the account owner's death.[149]

If the account owner died on or after the date RMDs must begin, a designated beneficiary must take RMDs after the year of the account owner's death based on the longer of the following.[150]

- The beneficiary's life expectancy
- The account owner's life expectancy

A **designated beneficiary** is any individual specified as a beneficiary by the deceased in the documentation maintained by the fiduciary of the account.[151]

Distributions from an eligible plan or IRA paid to a taxpayer's spouse after the taxpayer's death are treated as if the spouse were the taxpayer.[152] Accordingly, surviving spouses may roll over distributions from these plans into plans in their own names without paying taxes or penalties on the distributions.

New Law. The SECURE Act modified the RMD rules for designated beneficiaries that apply upon the death of the retirement plan participant or IRA owner after December 31, 2019. The entire interest in the account must be distributed by the end of the tenth year after the death, except for distributions made to eligible designated beneficiaries, who are allowed to take the distributions over their life expectancy.[153]

144. IRS Pub. 970, *Tax Benefits for Education.*

145. As defined in IRC §221(d).

146. IRC §529(c)(9)(B).

147. IRC §529(c)(9)(C).

148. SECURE Act §401.

149. IRS Pub. 590-B, *Distributions from Individual Retirement Arrangements (IRAs).*

150. Ibid.

151. IRC §401(a)(9)(E).

152. IRC §§402(c)(9) and 408(d)(3)(C).

153. IRC §401(a)(9)(H).

Eligible designated beneficiaries are one of the following types of people as of the date the account owner dies.[154]

- Surviving spouse of the deceased
- Minor child of the deceased
- Disabled
- Chronically ill
- A person who is not more than 10 years younger than the deceased and who does not qualify under the preceding categories

Note. Beneficiaries who do not qualify as designated beneficiaries or eligible designated beneficiaries must take the balance in the account over a period not to exceed five years after the account owner's death.[155] However, the CARES Act waives the 2020 RMD for lifetime distributions to employees and IRA owners and for after-death distributions to beneficiaries. This is discussed earlier in this chapter.

Note. For a thorough explanation of the RMD rules that apply under the SECURE Act, see the 2020 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 1: Retirement Plan Distributions.

Increase in Penalty for Failure to File[156]

Old Law. Prior to the enactment of the SECURE Act, the penalty for failure to file a tax return under IRC §6651(a) was $330.

New Law. Under the SECURE Act, the penalty for failure to file an income, estate, gift, employment and self-employment, and certain excise tax returns more than 60 days after the due date is the lesser of:[157]

- $435, or
- 100% of the amount required to be shown as tax on the return reduced by tax timely paid and credits claimed on the return.

The penalty does not apply if the taxpayer had reasonable cause for the late filing.

This change applies to returns that are due after December 31, 2019.

Increased Penalties for Failure to File Retirement Plan Returns[158]

Old Law. Most sponsors of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) are required to file Form 5500, *Annual Return/Report of Employee Benefit Plan,* annually. Certain small employers can file Form 5500-SF, *Short Form Annual Return/Report of Small Employee Benefit Plan,* or Form 5500-EZ, *Annual Return of A One-Participant (Owners/Partners and Their Spouses) Retirement Plan or A Foreign Plan.*[159]

Under prior law, the IRS penalty for late filing of a 5500-series return is $25 per day, up to a maximum of $15,000.

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154. *Retirement Plan and IRA Required Minimum Distributions FAQs.* Mar. 18, 2020. IRS. [www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distributions#3] Accessed on Mar. 27, 2020; IRC §401(a)(9)(E)(ii).

155. IRC §401(a)(9)(B)(ii).

156. SECURE Act §402.

157. IRC §6651(a).

158. SECURE Act §403.

159. *401(k) Plan Fix-It Guide — You haven't filed a Form 5500 this year.* Jan. 23, 2020. IRS. [www.irs.gov/retirement-plans/401k-plan-fix-it-guide-you-havent-filed-a-form-5500] Accessed on Mar. 20, 2020; *Form 5500 Series.* U.S. Department of Labor. [www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/reporting-and-filing/form-5500] Accessed on Mar. 20, 2020.

Caution. In addition to the IRS penalties, the DOL can impose a penalty for late filing of up to $1,100 per day, with no maximum.[160]

New Law. Under the SECURE Act, the IRS penalty for late filing of a 5500-series return is increased to $250 per day, up to a maximum of $150,000. The increased penalty amount applies to returns required to be filed after December 31, 2019.

Modification of Kiddie Tax Rules[161]

Old Law. For tax years **beginning before 2018,** a "kiddie tax" is imposed on the net unearned income of certain children. Under these rules, the child's net unearned income is taxed at the parents' tax rates if the parents' tax rates are higher than that of the child. The rest of a child's taxable income is taxed at the child's rates. Generally, the kiddie tax applies to a child if:[162]

1. The child has not reached age 19 by the close of the tax year, or the child is a full-time student under age 24, and either of the child's parents is alive at the time;
2. The child's unearned income exceeds a threshold amount ($2,100 for 2017); and
3. The child does not file a joint return.

The kiddie tax applies regardless of whether the child may be claimed as a dependent by either or both parents. For children above age 17, the kiddie tax applies only if the child's earned income does not exceed half the amount of support.[163]

The TCJA simplified the kiddie tax by applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Under the TCJA, taxable income attributable to net unearned income is taxed under the brackets that apply to trusts and estates, and earned income is taxed at rates and brackets that apply to unmarried taxpayers. Therefore, the child's tax is unaffected by the tax of the child's parent or the unearned income of the child's siblings. Before the SECURE Act was passed, this provision applied to the 2018–2025 tax years.[164]

New Law. The SECURE Act reversed the changes made to the kiddie tax rules under the TCJA. For tax years beginning after December 31, 2019, the child's net unearned income is taxed at the parents' tax rates if the parents' tax rates are higher than that of the child.

In addition, a taxpayer can retroactively apply the changes to the kiddie tax enacted under the SECURE Act. For tax years 2018 and/or 2019, the taxpayer can elect to calculate the tax on the unearned income of certain children using either the brackets and rates for estates and trusts or the parent's tax rate. The taxpayer can make this election for 2019 by including a statement with their return specifying "election to modify tax on unearned income." The statement can be made on the return (for example, on line 7 or at the top of Form 8615, *Tax for Certain Children Who Have Unearned Income*) or on an attachment filed with the return.[165]

A taxpayer can make this election for tax year 2018 by filing Form 1040-X, *Amended U.S. Individual Income Tax Return.* If the taxpayer makes this election, they should include a statement or an attachment with their amended return specifying "election to modify tax of unearned income."[166]

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160. *401(k) Plan Fix-It Guide — You haven't filed a Form 5500 this year.* Jan. 23, 2020. IRS. [www.irs.gov/retirement-plans/401k-plan-fix-it-guide-you-havent-filed-a-form-5500] Accessed on Mar. 20, 2020.

161. SECURE Act §501.

162. *Joint Explanatory Statement of the Committee of Conference.* [docs.house.gov/billsthisweek/20171218/Joint%20Explanatory%20Statement.pdf] Accessed on Mar. 24, 2020.

163. Ibid.

164. Ibid.

165. IRS Pub. 929, *Tax Rules for Children and Dependents.*

166. Ibid.

Other Provisions

The following table summarizes provisions contained in the SECURE Act other than those discussed previously.

SECURE Act Section	IRC Section	Description	Effective Date
103	401(k)	Rules relating to election of safe harbor 401(k) status	Plan years beginning after Dec. 31, 2019
106	219(f)	Certain taxable non-tuition fellowship and stipend payments treated as compensation for IRA purposes	Tax years beginning after Dec. 31, 2019
108	72(p)	Qualified employer plans prohibited from making loans through credit cards and other similar arrangements	Loans made after Dec. 20, 2019 (date of enactment)
110	403(b)	Treatment of custodial accounts on termination of 403(b) plans	Retroactively effective for tax years beginning after Dec. 31, 2008
111	403(b)	Clarification of retirement income account rules relating to church-controlled organizations	Years beginning before, on, or after Dec. 20, 2019
115	430	Special rules for minimum funding standards for community newspaper plans	Plan years ending after Dec. 31, 2017
116	408(o), 415(c)	Treating excluded difficulty of care payments as compensation for determining retirement contribution limitations	Various
201	401(b)	Plan adopted by filing due date for year may be treated as in effect as of close of year	Plans adopted for tax years beginning after Dec. 31, 2019
202	6058, 6011	Combined annual report for group of plans	Returns and reports for plan years beginning after Dec. 31, 2021
203	ERISA §105(a)	Disclosure regarding lifetime income	12 months after Treasury issues interim final rules, model disclosures, or certain assumptions
204	ERISA §404	Fiduciary safe harbor for selection of lifetime income provider	None provided
205	401	Modification of nondiscrimination rules to protect older, longer service participants	Various
206	ERISA §4006	Modification of Pension Benefit Guaranty Corp. premiums for cooperative and small-employer charity plans	None provided
301	139B	Benefits provided to volunteer firefighters and emergency medical responders	Tax years beginning after Dec. 31, 2019
404	6103(o)	Increase information sharing to administer excise taxes	None provided
601	N/A	Provisions relating to plan amendments	Various

TAXPAYER FIRST ACT: IMPLEMENTATION[167]

The Taxpayer First Act (TFA) was signed into law on July 1, 2019. The TFA's goal is to expand and strengthen taxpayer rights and to reform the IRS into a more taxpayer-friendly agency. To that end, the IRS is required to develop a comprehensive customer service strategy, modernize its technology, and enhance its cybersecurity.[168]

TAXPAYER ADVOCATE REPORT

On January 8, 2020, acting national taxpayer advocate (NTA), Bridget Roberts, released her 2019 annual report to Congress. The report highlighted that one of the key challenges facing the IRS is the implementation of the TFA.

> **Note.** The taxpayer advocate's 2019 annual report to Congress can be found at **uofi.tax/20a1x5** [taxpayeradvocate.irs.gov/Media/Default/Documents/2019-ARC/ARC19_Volume1.pdf].

The TFA made the most comprehensive revisions to IRS procedures since the IRS Restructuring and Reform Act of 1998. The TFA also requires the IRS to develop four strategic plans.

1. A comprehensive taxpayer service strategy, which was due to Congress by July 1, 2020
2. A comprehensive plan to redesign the IRS's organizational structure, which was due to Congress by September 30, 2020
3. A comprehensive employee training strategy that includes taxpayer rights training, which was due to Congress by July 1, 2020
4. A multi-year plan to meet IRS information technology needs

> **Note.** Because of the COVID-19 pandemic, the IRS incurred unforeseen delays in developing the TFA provisions. The IRS is expected to deliver these plans to Congress by December 2020.[169]

The NTA's 2019 report starts with a look at the TFA. The first group of the most serious problems identified by the NTA focuses on the IRS's efforts to reform its customer service strategy and the key issues it requires if it is going to transform the manner in which it serves taxpayers and practitioners. It also observes that the IRS's ability to improve customer service is linked to its information technology (IT) modernization efforts. IRS funding impacts the degree to which the IRS can address both of those areas.

The NTA identified several issues with the IRS's current approach to customer service that the new plan should address.

- Improving customer service begins with a cultural shift within the IRS.
- The IRS does not view itself as a service organization first and foremost.
- Customer service decisions are not informed by using multi-disciplined, comprehensive research into customer needs and preferences.
- Taxpayers need assistance navigating the complex tax system, including the agency itself.

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167. IRS News Rel. IR-2020-03 (Jan. 8, 2020); *National Taxpayer Advocate Annual Report to Congress 2019.* Taxpayer Advocate Service. [taxpayeradvocate.irs.gov/Media/Default/Documents/2019-ARC/ARC19_Volume1.pdf] Accessed on Mar. 6, 2020.

168. *Taxpayer First Act.* Feb. 7, 2020. IRS. [www.irs.gov/taxpayer-first-act] Accessed on Mar. 10, 2020.

169. *National Taxpayer Advocate Erin M. Collins releases her first Objectives Report.* Jun. 29, 2020. Taxpayer Advocate Service. [taxpayeradvocate.irs.gov/news/nta-releases-fy-2021-objectives-report-to-congress?category=Tax%20News] Accessed on Jul. 21, 2020; *Putting Taxpayers First, Improving Taxpayer Service.* Jul. 1, 2020. Taxpayer Advocate Service. [taxpayeradvocate.irs.gov/Media/Default/Documents/2021-JRC/JRC21_FullReport.pdf] Accessed on Jul. 21, 2020.

- Forcing taxpayers to use digital channels undermines taxpayer rights.
- There is a current absence of meaningful customer service measures to achieve desired results.
- Any strategy also needs to address the needs of practitioners who interact with the IRS on behalf of taxpayers.
- The strategy needs to include an implementation plan complete with cost estimates.

The NTA's 2019 report says that the IRS has established a dedicated office to oversee and coordinate its TFA implementation efforts. The office is led by the IRS's chief of staff and includes executives from the Wage & Investment Division, the Small Business/Self-Employed Division, and the chief information officer's IT function. The IRS did not include a representative from the taxpayer advocate service (TAS), which the NTA found "deeply concerning." Congress created the TAS to serve as the statutory voice of the taxpayer within the IRS. Over the last 20 years, the TAS has processed over 4.4 million cases resulting from problems with IRS systems or processes. The NTA report observed that this history gives the TAS unique insight, perspective, and information that could play a key role in identifying areas that need improvement while the IRS develops a comprehensive customer service strategy.

CYBERSECURITY AND IDENTITY PROTECTION[170]

The TFA requires the IRS to implement certain measures to address cybersecurity and identity protections. Accordingly, on February 3, 2020, the IRS launched **Identity Theft Central,** which is designed to improve online access to information about identity theft and data security protection for taxpayers, tax professionals, and businesses.

Identity Theft Central is located at **irs.gov/identitytheft**. It contains information about how to report identity theft, how taxpayers can protect themselves from phishing attacks and online scams, and other prevention measures.

The TFA mandates the following actions to bolster cybersecurity and identity protection.

1. Public-private partnership to address refund fraud
2. Electronic tax administration advisory committee (ETAAC)
3. Information sharing and analysis center (ISAC)
4. Confidentiality safeguards for federal and state contractors
5. Identity protection personal identification numbers (IP PIN)
6. Point of contact for identity theft victims
7. Notification of suspected identity theft
8. IRS management of stolen identity cases
9. Improper disclosure by return preparers
10. Limit on redisclosures of consent-based disclosures

170. *Taxpayer First Act—Cybersecurity and Identity Protections.* Feb. 6, 2020. IRS. [www.irs.gov/newsroom/taxpayer-first-act-cybersecurity-and-identity-protections] Accessed on Mar. 9, 2020; IRS News Rel. IR-2020-27 (Feb. 3, 2020).

Public-Private Partnership[171]

The TFA requires the IRS to work with the public and private sectors to protect taxpayers from identity theft refund fraud.

The IRS, state tax agencies, and the nation's tax industry work together as Security Summit partners on initiatives designed to improve awareness and outreach to combat identity theft. The Security Summit consists of the IRS, state tax agencies, and the tax community, including tax preparation firms, software developers, payroll and tax financial product processors, tax professional organizations, and financial institutions. This Security Summit partnership has involved taking steps to help educate and improve protections for taxpayers, tax professionals, and businesses. As part of this effort, the IRS redesigned the information into the streamlined Identity Theft Central to help people get information on identity theft, scams, and schemes.

Electronic Tax Administration Advisory Committee[172]

The TFA mandates that the ETAAC study and make recommendations to the IRS concerning additional measures to prevent identity theft and refund fraud.

Information Sharing and Analysis Center[173]

The TFA authorizes the IRS to participate in the ISAC. The TFA allows the IRS to disclose certain information to ISAC participants if the information helps with the following.

- Detecting or preventing identity theft tax refund fraud
- Validating a taxpayer's identity
- Authenticating taxpayer returns
- Detecting or preventing cybersecurity threats

Confidentiality Safeguards for Federal and State Contractors[174]

The IRS cannot provide taxpayer information to any contractors or other agents of a federal, state, or local agency unless the contractor can protect the confidentiality of the return information. In addition, the contractor must agree to conduct onsite compliance reviews every three years.

The federal, state, or local agency must submit a report of its findings to the IRS and annually certify that their contractors and other agents are meeting the requirements to protect the confidentiality of return information.

Identity Protection Personal Identification Numbers[175]

The Treasury Department must create a program to issue an IP PIN to any U.S. resident who requests one. The Treasury Department also must expand the IP PINs issued every year to people living in states that the IRS determines are appropriate. The number of states served by the program must continue to increase.

Point of Contact for Identity Theft Victims[176]

The TFA requires the IRS to establish single point-of-contact procedures for taxpayers whose tax return processing was delayed or negatively affected by tax-related identity theft. The contact will track the taxpayer's case until it is completed and coordinate with other IRS employees to resolve case issues as quickly as feasible.

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171. TFA §2001; *Security Summit.* Mar. 6, 2020. IRS. [www.irs.gov/newsroom/security-summit] Accessed on Mar. 9, 2020.

172. TFA §2002.

173. TFA §2003.

174. TFA §2004.

175. TFA §2005.

176. TFA §2006.

Notification of Suspected Identity Theft[177]

Beginning January 1, 2020, the TFA requires the IRS to notify a taxpayer of the following.

- If the IRS finds any suspected unauthorized use of the taxpayer's identity or any of the taxpayer's dependents
- If the IRS initiates an investigation of the suspected identity theft and the status of the investigation
- Whether the investigation proved there was unauthorized use of the taxpayer's identity
- Whether any action has been taken

In addition, when someone is charged with identity theft, the IRS must notify the victim as soon as possible, to provide the victim with the opportunity to pursue civil action against the suspected perpetrator.

IRS Management of Stolen Identity Cases[178]

The TFA requires the IRS to work with the NTA to develop and implement guidelines to reduce the burdens for identity theft tax refund fraud victims as they work with the IRS to resolve their tax issues. The guidelines were supposed to be implemented by July 2, 2020, and were to include procedures to reduce the following.

- Amount of time victims wait to receive their tax refunds
- Number of IRS employees that the victims need to interact with
- Timeframe to resolve issues related to the refund fraud

Improper Disclosure by Return Preparers[179]

The TFA increases the civil penalty for the unauthorized disclosure or use of information by tax return preparers. The penalty was $250 but was increased to $1,000 effective July 1, 2019. The penalty applies when the disclosure or use is made in connection with a crime relating to the misuse of another person's taxpayer identity.

The TFA also increases the calendar-year limit on such civil penalties from $10,000 to $50,000. The calendar-year limit is applied separately with respect to disclosures or uses made in connection with taxpayer identity theft.

The TFA increases the criminal penalty for knowing or reckless conduct to $100,000 for disclosures or uses in connection with taxpayer identity theft.

Limit on Redisclosures of Consent-Based Disclosures[180]

The TFA amended IRC §6103(c) by adding the following.

> *Persons designated by the taxpayer under this subsection to receive return information shall not use the information for any purpose other than the express purpose for which consent was granted and shall not disclose return information to any other person without the express permission of, or request by, the taxpayer.*

This provision limits the redisclosure and use of return information for taxpayers who have consented to the disclosure of their return information by the IRS to a third party under §6103(c). It only applies to disclosures made by the IRS after December 28, 2019, and any subsequent redisclosures and uses of such information.

177. TFA §2007.
178. TFA §2008.
179. TFA §2009.
180. TFA §2202.

TAXPAYER EXPERIENCE[181]

To improve the delivery of services to diverse taxpayers, the IRS must take action in the following areas.

1. Establish IRS independent office of appeals
2. Comprehensive customer service strategy
3. Low-income exceptions regarding offers-in-compromise
4. Community volunteer income tax assistance (VITA) programs
5. Low-income taxpayer clinics
6. Taxpayer assistance center closures
7. Seizure and sale of perishable goods
8. Whistleblower reforms
9. Information the IRS is to provide during phone calls
10. Misdirected tax refund deposits
11. E-filing by exempt organizations
12. IRS notice to tax-exempt organizations that fail to file

IRS Independent Office of Appeals[182]

The TFA renames the IRS Office of Appeals to the IRS **Independent** Office of Appeals. This office will continue to resolve tax controversies and impartially review IRS administrative decisions. However, new rules require it to make its referred case files available to:

- Individuals with AGI of $400,000 or less for the tax year to which the dispute relates, and
- Entities with gross receipts of $5 million or less for the tax year to which the dispute relates.

In addition, in cases where the IRS or chief counsel issues a notice of deficiency to a taxpayer and denies the taxpayer's request for referral to the IRS Independent Office of Appeals, the IRS is now required to issue a notice to explain the reasons and tell the taxpayer how to protest the denial.

Comprehensive Customer Service Strategy[183]

The TFA requires the IRS to develop a thorough customer service strategy and submit the plan to Congress. The IRS must also make the plan, updated guidance, and training materials available to the public.

The strategy must include best practices of customer service provided in the private sector, including online services, telephone call back, and employee training. It must include best practices to meet reasonable customer expectations.

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181. *Taxpayer First Act — Taxpayer Experience.* Feb. 26, 2020. IRS. [www.irs.gov/newsroom/taxpayer-first-act-taxpayer-experience] Accessed on Mar. 10, 2020.

182. TFA §1001.

183. TFA §1101.

Low-Income Exceptions Regarding Offers-In-Compromise[184]

The TFA provides a new method for low-income taxpayers to waive the application fee for an offer-in-compromise (OIC). A taxpayer now qualifies to waive the fee if their income does not exceed 250% of the federal poverty level. In the past, the IRS based fee waivers on a taxpayer's monthly gross income.

The new method uses AGI from the taxpayer's most recent tax return. If a taxpayer does not qualify under the new AGI method, they may request a waiver based on their current household gross monthly income for the next 12 months. The taxpayer enters this information on IRS Form 433-A (OIC), *Collection Information Statement for Wage Earners and Self-Employed Individuals.*

Community VITA Programs[185]

VITA program volunteers help prepare income tax returns for low-income and other underserved taxpayers. The TFA codifies the VITA program and allows the Treasury Department to allocate up to $30 million per year in matching VITA grants. Treasury can award grants to qualified entities to develop, expand, or continue qualified programs.

Low-Income Taxpayer Clinics[186]

The TFA permits Treasury Department personnel to advise taxpayers about low-income taxpayer clinics. Treasury personnel can provide information about the availability of clinics, eligibility requirements, locations, and clinic contact information.

Taxpayer Assistance Center Closures[187]

The TFA requires the IRS to publicly notify affected taxpayers 90 days before it closes a taxpayer assistance center. The notice must be available nonelectronically and include the date of the proposed closure and alternative ways for taxpayers to obtain assistance.

Seizure and Sale of Perishable Goods[188]

The TFA amends IRC §6336 such that property seized after July 2, 2019, can only be sold if it is perishable.

Whistleblower Reforms[189]

The TFA permits the IRS to exchange information with whistleblowers when doing so would aid an investigation. It requires the IRS to notify whistleblowers of the status of their claims at certain points in the review process. It also authorizes the IRS to provide status updates at other times upon written request, although such updates are not required.

In addition, the TFA prohibits whistleblowers from publicly disclosing information they receive from the IRS and extends anti-retaliation provisions to whistleblowers.

Information IRS Provides During Phone Calls[190]

The TFA requires the IRS to provide the following information when taxpayers are on hold with the IRS call center.

- Information about common tax scams
- How to report tax scams
- Tips on how to protect against identity theft and tax scams

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184. TFA §1102.
185. TFA §1401.
186. TFA §1402.
187. TFA §1403.
188. TFA §1404.
189. TFA §1405.
190. TFA §1406.

Misdirected Tax Refund Deposits[191]

The TFA requires the IRS to establish procedures for handling misdirected electronic tax refund deposits. The procedures should address the following.

- Allow taxpayers to report when an electronic refund was not transferred to their account
- Coordinate with financial institutions to identify and recover these payments
- Deliver refunds to the correct taxpayer accounts

E-Filing by Exempt Organizations[192]

The TFA mandates e-filing for all tax-exempt organizations required to file statements or returns in the Form 990 series or Form 8872, *Political Organization Report of Contributions and Expenditures.* In addition, the TFA requires the IRS to make the information provided on such forms available to the public as soon as possible in a machine-readable format.

IRS Notice to Tax-Exempt Organizations that Fail to File[193]

The TFA requires the IRS to provide notice to an organization that fails to file a Form 990-series return or postcard for two consecutive years. The notice must state that the IRS has no record of receiving such return for two consecutive years and inform the organization that their tax-exempt status will be canceled if the organization does not file a return or postcard by the due date for the next return or postcard. In addition, the notice must contain information about how to meet the annual information return and postcard requirements.

IRS MODERNIZATION[194]

TFA provisions designed to move the IRS further into the digital age while enhancing traditional interactions include the following.

1. Management of IRS information technology
2. Internet platform for Form 1099 filings
3. Streamlined critical pay authority
4. Disclosures for third-party income verification
5. Electronic filing of returns
6. Electronic taxpayer signatures to authorize action by their practitioner
7. Payment of taxes by debit and credit cards
8. Authentication of IRS e-services account users
9. Repeal of requirements regarding return-free tax system

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191. TFA §1407.

192. TFA §3101.

193. TFA §3102.

194. *Taxpayer First Act — IRS Modernization.* Mar. 10, 2020. IRS. [www.irs.gov/newsroom/taxpayer-first-act-irs-modernization] Accessed on Mar. 10, 2020.

Management of IRS Information Technology[195]

The TFA provides specific requirements regarding management of IRS IT. The IRS commissioner must appoint an IRS chief information officer (CIO). This position is currently filled by an acting CIO. The IRS CIO is responsible for developing, implementing, and maintaining IRS IT systems, and ensuring that technology is secure and integrated with IRS systems. The CIO must maintain operational control of all IRS technology and advocate for the IRS's technology needs, in consultation with the chief procurement officer.

In addition, the TFA requires the CIO to develop and implement a multiyear strategic plan for the IRS's IT. The plan must be reviewed and updated annually.

Internet Platform for Form 1099 Filings[196]

The TFA requires that the IRS develop an Internet portal by January 1, 2023, that enables taxpayers to file Forms 1099 electronically. The portal should be modeled after a Social Security Administration (SSA) system that allows employers to file Forms W-2 with the SSA. The website is to provide IRS resources and guidance and allow taxpayers to prepare, file, and distribute Forms 1099 and create and maintain tax records.

Streamlined Critical Pay Authority[197]

The TFA reauthorizes streamlined critical pay (SCP) authority for the IRS in regards to IT positions. The authority ends on September 30, 2025. The SCP authority provides a management tool to the IRS that enables it to quickly recruit and retain employees with high levels of expertise in technical or professional fields critical to the success of the IRS's restructuring project. The SCP authority was previously authorized for 10 years and extended twice.

Disclosures for Third-Party Income Verification[198]

The TFA requires that the IRS develop an automated system to receive third-party income verification forms. The new system will replace the current system, which relies on secure fax.

In addition, the TFA provision authorizes the IRS to charge a user fee on all income verification express service requests over a 2-year period to fund the new system.

Electronic Filing of Returns[199]

Under prior law, there was no requirement that individuals who file fewer than 250 information returns per year do so electronically. Under the TFA, the 250-return threshold is reduced to 100 in 2021, and further reduced to 10 after 2021.

For partnerships, the threshold was 200 for calendar year 2018 and 150 for 2019. It is reduced to 100 for calendar year 2020 and to 50 for 2021.

In addition, the TFA allows the IRS to waive the requirement that a tax return preparer must file electronically. A preparer can apply for a waiver and show that their inability to file electronically is because of the lack of Internet availability (other than dial-up or satellite service) in the location where the return preparation business operates.

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195. TFA §2101.
196. TFA §2102.
197. TFA §2103.
198. TFA §2201.
199. TFA §2301.

Electronic Signatures by Taxpayers to Authorize Practitioner Action[200]

The TFA mandates the IRS to publish guidance establishing uniform standards and procedures for the acceptance of taxpayers' electronic signatures. Such signatures are meant to authorize disclosure to a practitioner or for any power of attorney granted by a taxpayer to a practitioner.

Payment of Taxes by Debit and Credit Cards[201]

Under prior law, the IRS could not directly accept credit and debit card payments for taxes because of a restriction on paying card issuer fees. Instead, the IRS used a third-party processor to accept credit and debit card payments.

The TFA enables the IRS to directly accept credit, debit, or charge cards for income tax payments when the fee is paid by the taxpayer.

Authentication of Users of IRS E-Services Accounts[202]

The TFA requires the IRS to verify the identity of any person opening an e-services account before that person can use the service.

Repeal of Requirements Regarding Return-Free Tax System[203]

Legislation enacted in 1998 required the IRS to study the possibility of implementing a return-free tax system for tax years beginning after 2007. **The TFA repeals those requirements.**

IRS ORGANIZATION[204]

TFA provisions designed to pursue efficient and effective tax administration include the following.

1. Office of the Taxpayer Advocate
2. IRS organizational structure
3. Training of IRS employees
4. Prohibition on IRS rehiring certain fired employees
5. Notification of unauthorized inspection, etc. of returns

Office of the Taxpayer Advocate[205]

The TFA requires more coordination between the taxpayer advocate and oversight organizations and improves the way the IRS interacts with the TAS.

The TFA requires the IRS commissioner or deputy commissioner to respond to taxpayer advocate directives (TAD) within 90 days. In addition, the NTA must report to Congress when the IRS fails to address any TAD.

To the extent practical, the IRS must provide statistical support to the NTA upon request. The NTA is required to indicate whether the IRS reviewed or provided statistical information and determined it to be valid.

Moreover, the TFA requires the NTA to coordinate research efforts with the Treasury Inspector General for Tax Administration to avoid any duplication of efforts.

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200. TFA §2302.

201. TFA §2303.

202. TFA §2304.

203. TFA §2401.

204. *Taxpayer First Act — IRS Organization.* Jan. 24, 2020. IRS. [www.irs.gov/newsroom/taxpayer-first-act-irs-organization] Accessed on Mar. 10, 2020.

205. TFA §1301; *NTA Blog: Highlights of the Taxpayer First Act and Its Impact on TAS and Taxpayer Rights.* Nov. 21, 2019. Taxpayer Advocate Service. [taxpayeradvocate.irs.gov/news/NTA_Blog_Highlights_of_the_Taxpayer_First_Act_and_Its_Impact_on_TAS_and_Taxpayer_Rights?category=Tax%20News] Accessed on Mar. 11, 2020.

IRS Organizational Structure[206]

The TFA requires the Treasury Department to develop a comprehensive plan to redesign the organizational structure of the IRS. Treasury must submit the plan to Congress by September 30, 2020. The issues that the plan must address include the following.

- Streamline the IRS's structure to minimize duplicate services and responsibilities
- Position the IRS to combat cybersecurity and other threats
- Address whether the IRS criminal investigation division should report directly to the commissioner

One year after the IRS submits its plan to Congress, the former law about the IRS's organizational structure will cease to apply. The earlier law required the IRS to organize in operating units that serve groups of taxpayers with similar needs.

Training of IRS Employees[207]

The TFA requires the IRS to submit a written report to Congress by December 2020, providing a detailed training strategy for IRS employees.

Prohibition on IRS Rehiring Certain Fired Employees[208]

The TFA prohibits the IRS from rehiring any employee who was dismissed for misconduct.

Notification of Unauthorized Inspection of Returns[209]

The TFA requires the IRS to notify a taxpayer if the IRS or a federal or state agency recommends disciplinary action against an employee who accessed or disclosed the taxpayer's return or return information without permission.

ENFORCEMENT[210]

To enforce a fair and just tax system, the TFA mandates that the IRS address the following areas.

1. Structuring transactions and IRS seizures
2. Clarification of equitable relief from joint liability (innocent spouse relief)
3. Modification of procedures for issuance of third-party summons
4. Taxes collected by private collection agencies
5. Notice to taxpayer of IRS contact with third party
6. Designated summonses
7. Limits on actions by IRS contractors
8. Penalty for failure to file

206. TFA §1302.

207. TFA §2402; *IRS Responses to Administrative Recommendations Proposed in the National Taxpayer Advocate's 2019 Annual Report to Congress*. Taxpayer Advocate Service. [taxpayeradvocate.irs.gov/Media/Default/Documents/2021-JRC/JRC21_APP_01.pdf] Accessed on Jul. 22, 2020.

208. TFA §3001.

209. TFA §3002.

210. *Taxpayer First Act — Enforcement.* Feb. 26, 2020. IRS. [www.irs.gov/newsroom/taxpayer-first-act-enforcement] Accessed on Mar. 11, 2020.

Structuring Transactions and IRS Seizures[211]

The Bank Secrecy Act requires businesses to report currency transactions that exceed $10,000. These rules help federal law enforcement and agencies such as the IRS detect, monitor, and trace certain transactions and enforce laws.

Some people plan monetary transactions to deliberately fall below $10,000. This is called "structuring." Often, this is done to hide cash made from illegal activities. However, some people structure legally earned income to evade taxes.

The TFA changes the manner in which the IRS can respond to suspected structuring. In these situations, the IRS can only seize assets or require the taxpayer to forfeit assets under one of the following circumstances.

- The property to be seized came from an illegal source.
- The transactions were structured to conceal illegal activities beyond structuring.

The IRS must notify all persons who have an ownership interest in the property within 30 days after a seizure.

Further, a taxpayer can exclude from gross income any interest they receive from the federal government in connection with recovering property seized by the IRS in a structuring violation.

Clarification of Equitable Relief from Joint Liability[212]

Married persons who file joint tax returns are generally both responsible for all the tax that should be reported on their return. However, the Code provides relief from liability for certain "innocent spouses." For example, equitable relief is granted if it is deemed unfair to hold a person liable for their spouse's tax debt or assessment.

Taxpayers must request relief before the expiration of the collection period for the debt. If the debt was paid, the taxpayer must request relief before the end of the statutory period for claiming a refund or credit.

The TFA requires that the Tax Court review innocent spouse relief on a de novo basis, which means the court must review the case without taking into account previous decisions. Such reviews are based on the administrative record and any additional newly discovered or previously unavailable evidence.

Modification of Procedures for Issuance of Third-Party Summons[213]

For summonses served after August 15, 2019, the TFA prevents the IRS from issuing a "John Doe summons" unless it meets certain requirements. A John Doe summons is one that does not identify the person with respect to whose liability the summons is issued. The Code authorizes the IRS to issue a John Doe summons in connection with an investigation of a specific, unidentified person or ascertainable group or class of persons.[214]

The IRS can now issue a John Doe summons only if the information sought is narrowly tailored and relates to failure (or potential failure) to comply with provisions specified in the statute.

Taxes Collected by Private Collection Agencies[215]

The TFA prohibits the IRS from using private collection agencies to recover delinquent taxes from the following persons.

- Individuals whose income mainly consists of supplemental security income benefits
- Individuals whose income mainly consists of disability insurance benefit payments
- Individuals whose AGI is below 200% of the federal poverty level

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211. TFA §§1201 and 1202.

212. TFA §1203.

213. TFA §1204.

214. IRM 25.5.7.2 (Feb. 18, 2016).

215. TFA §1205.

This change applies to the definition of **inactive tax receivables** identified by the IRS after December 31, 2020. Previously, this term was defined as a condition in which more than one-third of the applicable limitations period has lapsed. The new requirement is that over two years has passed since assessment.

Moreover, the TFA changes the length of installment agreements that private debt collectors can offer. Instead of the previous limit of five years, collectors can now offer a 7-year agreement to individuals.

Notice to Taxpayer of IRS Contact with Third Party[216]

Prior to the TFA, the IRS could not contact anyone except the taxpayer to determine or collect taxes unless the IRS provided reasonable notice. The TFA now requires 45 days' notice before the period of contact begins. The contact period cannot exceed one year. Additionally, the TFA requires the IRS to notify the taxpayer only if there is an intent at the time the notice is issued for the IRS to make contact with anyone other than the taxpayer.

Designated Summonses[217]

The IRS commissioner and chief counsel must review and give written approval to issue a designated summons after August 14, 2019. The approval, which must be attached to the summons, must state facts establishing that the IRS previously requested the information. In addition, the TFA requires that the IRS certify in any subsequent proceedings that it made reasonable requests for the information.

Limits on Actions by IRS Contractors[218]

IRC §6103(n) provides limited circumstances under which returns and return information may be disclosed to any person for purposes of tax administration. Under the TFA, the IRS cannot provide information obtained under §6103(n) to a contractor unless the contractor needs it solely for the purpose of serving as an expert. This provision ensures that only IRS employees or the chief counsel's office can question a witness under oath when the witness's testimony was properly obtained under IRC §7602.

Penalty for Failure to File[219]

The TFA increased the minimum penalty for failure to file income, estate, gift, employment and self-employment, and certain excise tax returns from $205 to $330.[220] However, as mentioned earlier, the SECURE Act further increased the minimum penalty to $435. This increased penalty applies to returns with a due date (including extension, if any) after December 31, 2019.

If a return is filed more than 60 days after it is due and the taxpayer does not have reasonable cause for the late filing, the failure to file penalty cannot be less than the lesser of:

- $435, or
- 100% of the amount required to be shown as tax on the return reduced by timely payments and credits claimed on the return.

216. TFA §1206.
217. TFA §1207.
218. TFA §1208.
219. TFA §3201.
220. IRC §6651(a).

QUALIFIED OPPORTUNITY ZONE UPDATE

BACKGROUND

The TCJA introduced incentives for investments in qualified opportunity zones. Eligible capital gains can be temporarily deferred if they are reinvested in a qualified opportunity fund (QOF).[221]

A **qualified opportunity zone (QOZ)** is defined as a population census tract that is a low-income community designated as a QOZ.[222] IRS Notice 2018-48[223] contains a list of all population census tracts designated by the Treasury Department as QOZs.

The deferral of **capital gains** occurs when a taxpayer invests their capital gains in a QOF.[224] A QOF is any investment vehicle that is organized as a corporation or partnership for the purpose of investing in QOZ property that holds at least 90% of the entity's assets in QOZ property.[225]

Capital gains reinvested **within 180 days** into a QOF receive a **temporary deferral** from inclusion in taxable income.[226] The deferred gain must be recognized on the **earlier** of the date on which the opportunity zone investment is disposed of or December 31, 2026.[227]

In response to the ongoing COVID-19 pandemic, the IRS granted relief from compliance with the 180-day period in certain circumstances. IRS Notice 2020-39[228] provides that if a taxpayer's 180th day to invest in a QOF would have occurred on or after April 1, 2020, and before December 31, 2020, the taxpayer has until December 31, 2020, to invest the gain in a QOF. This relief is automatic; the taxpayer does not have to submit documents to the IRS to obtain the relief.

Capital gains reinvested in a QOF receive a **stepped-up basis.** The taxpayer's basis in the investment is increased by **10%** of the amount of gain deferred if the taxpayer holds the QOF investment for at least **five years** and by **an additional 5%** of the deferred gain if the taxpayer's holding period is at least **seven years.[229] Therefore, the taxpayer can potentially exclude up to 15% of the original gain from taxation** if they hold the investment at least seven years.

For any QOF investment held by the taxpayer **for at least 10 years,** the basis of such property is equal to the fair market value of such investment on the date the investment is sold or exchanged.[230]

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221. Treas. Reg. §1.1400Z2(a)-1(a)(1).
222. IRC §1400Z-1(a).
223. IRS Notice 2018-48, 2018-28 IRB 9.
224. IRC §1400Z-2(a)(1).
225. IRC §1400Z-2(d)(1).
226. IRC §1400Z-2(a)(1)(A).
227. IRC §1400Z-2(b)(1).
228. IRS Notice 2020-39, 2020-26 IRB 984.
229. IRC §1400Z-2(b)(2)(B).
230. IRC §1400Z-2(c).

Example 15. On June 30, 2019, Jessica sold IBD common stock for $225,000. She bought the stock on May 1, 2000, for $25,000. Therefore, she realized a $200,000 capital gain. She invested the $200,000 gain into a QOF on September 30, 2019, which is within the 180-day investment period.

If Jessica had not reinvested her gain in a QOF within the 180-day investment period, she would have owed $30,000 in taxes on her capital gain (assuming she is subject to a 15% long-term capital gains rate in 2019). By making the QOF investment, she can defer paying tax on any part of the gain until 2026.

After Jessica holds the QOF investment seven years, she receives a 15% step up in basis (10% after five years, and an additional 5% step up after seven years). Therefore, her stepped-up basis in the gain after seven years is $30,000 ($200,000 × 15%).

On December 31, 2026, Jessica **must** recognize the deferred gain from 2019. The original gain was $200,000; however, because of the previous step ups after five and seven years, her taxable gain is now $170,000 ($200,000 gain – $30,000 stepped-up basis). If the 15% long-term capital gain rate still applies, her tax due from this deferral will be $25,500 ($170,000 × 15%). This is $4,500 less than the $30,000 tax on capital gains she would have owed in 2019. In addition, she was able to delay paying the tax for several years (2019 to 2026).

Jessica sells her QOF investment on May 1, 2030, for $575,000. Her appreciation on the investment is $375,000 ($575,000 – $200,000 invested). This appreciation is tax-free because she invested in the QOF **for at least 10 years.** Jessica's timeline for her investment is summarized in the following table.

Date	Event
June 30, 2019	$200,000 gain realized
September 30, 2019	Gain reinvested in a QOF
September 30, 2024	10% basis increase ($200,000 × 10% = $20,000) (after 5 years)
September 30, 2026	Additional 5% basis increase ($200,000 × 5% = $10,000) (after 7 years)
December 31, 2026	Mandatory deferred gain recognition (($200,000 gain invested − $30,000 step ups) × 15% capital gain rate = $25,500)
May 1, 2030	Jessica sells her investment for $575,000. No tax is due on the $375,000 of appreciation on the $200,000 gain invested in the QOF.

A taxpayer must make an election to defer all or part of the gain that was invested in a QOF. The taxpayer makes the election on Form 8949, *Sales and Other Dispositions of Capital Assets.*

Note. For a thorough explanation of QOFs, see the 2019 *University of Illinois Federal Tax Workbook,* Volume B, Chapter 2: New Developments.

FINAL REGULATIONS

On January 13, 2020, the IRS published TD 9889, which finalized QOF regulations that were proposed in 2018 and 2019.[231] These regulations became effective on March 13, 2020.[232] Subsequent corrections to TD 9889 became effective on April 1, 2020, and are applicable as of January 13, 2020.[233]

The final regulations provide guidance for taxpayers eligible to make an election to temporarily defer the inclusion of certain eligible gains in their gross income. The final regulations also address the taxpayers' eligibility to increase the basis in their qualifying investment.

Highlights of the final regulations are described in this section.

Timing of Eligible Gains Recognition[234]

As mentioned earlier, QOF statutes permit the deferral of gain if the taxpayer makes an investment in a QOF. The gain is deferred until the earlier of an inclusion event or December 31, 2026. An **inclusion event** is defined in the final regulations as a transaction that reduces or terminates the QOF investor's qualifying investment for income tax purposes. In the case of distributions, an inclusion event constitutes a "cashing out" of the eligible taxpayer's qualifying investment in the QOF. Because of this, the taxpayer holding the reduced investment in the QOF after the inclusion event no longer possesses a qualifying investment. Accordingly, the inclusion event causes some or all of the gain to be recognized prior to December 31, 2026.[235]

The final regulations amend the general rule contained in the proposed regulations that provided that only capital gain may be invested in a QOF during the 180-day investment period. The final regulations clarify that only eligible gain taxable in the United States may be invested in a QOF.

The proposed regulations allowed only the amount of an investor's gains from the sale of business property that were greater than the investor's losses from such sales to be invested in QOFs. In addition, the 180-day investment period was required to begin on the last day of the investor's tax year. The final regulations allow a taxpayer to invest the entire amount of gains from the sale of business property without regard to losses. The beginning of the 180-day investment period is changed from the end of the year to the date of the sale of each asset.

Entity Gains. Partners in a partnership, shareholders of an S corporation, and beneficiaries of estates and nongrantor trusts have the option to start the 180-day investment period on the date that the entity's tax return is due (not including extensions).

Regulated Investment Companies and Real Estate Investment Trusts. For gains from a regulated investment company (RIC) or real estate investment trust (REIT), the final regulations clarify that the 180-day investment period generally starts at the close of the shareholder's tax year. Shareholders have the option of investing gains based on the 180-day investment period starting when the shareholder receives capital gain dividends from a RIC or REIT.[236]

Installment Sales. With respect to installment sale gains, the final regulations allow an eligible taxpayer to choose either of the following options for the date on which the 180-day period begins.

1. The date an installment payment is received for that tax year
2. The last day of the tax year in which the eligible gain under the installment method would be recognized (except for the deferral under the QOF regulations)

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231. IRS News Rel. IR-2019-212 (Dec. 19, 2019).

232. TD 9889, 85 Fed. Reg.1866.

233. TD 9889, 85 Fed. Reg. 19082.

234. *Final Regulations on Opportunity Zones: Frequently Asked Questions.* Department of the Treasury. [home.treasury.gov/news/press-releases/sm864] Accessed on May 20, 2020.

235. TD 9889, 85 Fed. Reg. 1866.

236. Ibid.

Treatment of IRC §1231 Gains. Under the proposed regulations, the only gain arising from property used in a taxpayer's trade or business (§1231 property) eligible for deferral under the QOF regulations was "capital gain net income" for the tax year. **Capital gain net income** was defined as the amount by which a taxpayer's §1231 gains for any tax year exceed §1231 losses for that year. A taxpayer can elect to defer some or all of this capital gain by making an investment of a corresponding amount in a QOF during the 180-day investment period.[237]

Unlike the net approach taken in the proposed regulations, the final regulations adopt a gross approach to eligible §1231 gains. This means that §1231 gains are taken into account without regard to any §1231 losses. Moreover, the final regulations provide that the 180-day period for investing an eligible §1231 gain amount for which a deferral election is to be made begins on the date of the sale or exchange that gives rise to the eligible §1231 gain.[238]

UPDATED FORMS

2020 FORM W-4[239]

The IRS redesigned Form W-4, *Employee's Withholding Certificate,* in an attempt to reduce the form's complexity and improve the accuracy of federal income tax withholding. Withholding allowances are no longer used on the new Form W-4. Due to changes in the law under the TCJA, taxpayers cannot claim personal exemptions or dependency exemptions.

Employees who have completed Forms W-4 before 2020 are not required to furnish a new form to their employers. Employers will continue to calculate withholding based on the information from the employee's most recently completed Form W-4. However, all new employees first paid after 2019 must use the new form. In addition, any employee who wants to adjust their withholding must use the new form.

The new Form W-4 has the following five steps.

Step 1. Personal information (e.g., name, address, filing status)

Step 2. Multiple jobs or spouse works

Step 3. Claim dependents

Step 4. Other adjustments (e.g., other non-job income, other deductions, extra withholding)

Step 5. Signature

Employees are only required to complete step 1 and step 5. However, if any of steps 2–4 are applicable, completing them makes the employee's withholding more accurately reflect their liability.

Example 16. Netzy Inc. hired Jeannette in January 2020. Jeannette has a 14-year-old son, files as head of household, and takes the standard deduction. She has no income except for her job with Netzy, where she earns an annual salary of $75,000. She completed the following Form W-4 and submitted it to Netzy.

237. *Opportunity Zones Frequently Asked Questions.* Oct. 22, 2019. IRS. [www.irs.gov/newsroom/opportunity-zones-frequently-asked-questions] Accessed on May 20, 2020.

238. TD 9889, 85 Fed. Reg.1866.

239. *FAQs on the 2020 Form W-4.* Jan. 21, 2020. IRS. [www.irs.gov/newsroom/faqs-on-the-2020-form-w-4] Accessed on May 26, 2020.

For Example 16

Form **W-4**

Department of the Treasury
Internal Revenue Service

Employee's Withholding Certificate

► Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay.
► Give Form W-4 to your employer.
► Your withholding is subject to review by the IRS.

OMB No. 1545-0074

2020

Step 1: Enter Personal Information

(a) First name and middle initial	Last name	(b) Social security number
Jeannette	Jones	913-00-1931
Address: 790 Landing Farm Way		► **Does your name match the name on your social security card?** If not, to ensure you get credit for your earnings, contact SSA at 800-772-1213 or go to *www.ssa.gov*.
City or town, state, and ZIP code: Kankakee, IL 60901		

(c) ☐ **Single or Married filing separately**
☐ **Married filing jointly** (or Qualifying widow(er))
☒ **Head of household** (Check only if you're unmarried and pay more than half the costs of keeping up a home for yourself and a qualifying individual.)

Complete Steps 2–4 ONLY if they apply to you; otherwise, skip to Step 5. See page 2 for more information on each step, who can claim exemption from withholding, when to use the online estimator, and privacy.

Step 2: Multiple Jobs or Spouse Works

Complete this step if you (1) hold more than one job at a time, or (2) are married filing jointly and your spouse also works. The correct amount of withholding depends on income earned from all of these jobs.

Do **only one** of the following.

(a) Use the estimator at *www.irs.gov/W4App* for most accurate withholding for this step (and Steps 3–4); **or**

(b) Use the Multiple Jobs Worksheet on page 3 and enter the result in Step 4(c) below for roughly accurate withholding; **or**

(c) If there are only two jobs total, you may check this box. Do the same on Form W-4 for the other job. This option is accurate for jobs with similar pay; otherwise, more tax than necessary may be withheld . . . . . ► ☐

TIP: To be accurate, submit a 2020 Form W-4 for all other jobs. If you (or your spouse) have self-employment income, including as an independent contractor, use the estimator.

Complete Steps 3–4(b) on Form W-4 for only ONE of these jobs. Leave those steps blank for the other jobs. (Your withholding will be most accurate if you complete Steps 3–4(b) on the Form W-4 for the highest paying job.)

Step 3: Claim Dependents

If your income will be $200,000 or less ($400,000 or less if married filing jointly):

Multiply the number of qualifying children under age 17 by $2,000 ► $ 2,000

Multiply the number of other dependents by $500 . . . . ► $

Add the amounts above and enter the total here . . . . **3** $ 2,000

Step 4 (optional): Other Adjustments

(a) Other income (not from jobs). If you want tax withheld for other income you expect this year that won't have withholding, enter the amount of other income here. This may include interest, dividends, and retirement income . . . . **4(a)** $

(b) Deductions. If you expect to claim deductions other than the standard deduction and want to reduce your withholding, use the Deductions Worksheet on page 3 and enter the result here . . . . **4(b)** $

(c) Extra withholding. Enter any additional tax you want withheld each **pay period** . **4(c)** $

Step 5: Sign Here

Under penalties of perjury, I declare that this certificate, to the best of my knowledge and belief, is true, correct, and complete.

► **Employee's signature** (This form is not valid unless you sign it.) ► **Date**

Employers Only

Employer's name and address	First date of employment	Employer identification number (EIN)

For Privacy Act and Paperwork Reduction Act Notice, see page 3. Cat. No. 10220Q Form **W-4** (2020)

FORM 1099-NEC[240]

The Protecting Americans from Tax Hikes Act of 2015 (PATH Act)[241] accelerated the due date for filing Forms 1099 that include nonemployee compensation from February 28 to January 31. In addition, the PATH Act eliminated the automatic 30-day extension for forms that include nonemployee compensation. In prior years, nonemployee compensation was reported in box 7 of Form 1099-MISC, *Miscellaneous Income.* Beginning with the 2020 tax year, Form 1099-NEC, *Nonemployee Compensation,* is used to report nonemployee compensation. The new form follows.

☐ CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.

OMB No. 1545-0116

2020

Form 1099-NEC

Nonemployee Compensation

1 Nonemployee compensation
$

Copy B
For Recipient

PAYER'S TIN

RECIPIENT'S TIN

2

RECIPIENT'S name

3

Street address (including apt. no.)

4 **Federal income tax withheld**
$

This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

City or town, state or province, country, and ZIP or foreign postal code

FATCA filing requirement ☐

Account number (see instructions)

5 State tax withheld	6 State/Payer's state no.	7 State income
$		$
$		$

Form **1099-NEC** (keep for your records) www.irs.gov/Form1099NEC Department of the Treasury - Internal Revenue Service

ELECTRONIC FILING OF FORM 1040-X[242]

On August 17, 2020, the IRS announced that taxpayers can now file file their Forms 1040-X electronically using tax software. The electronic filing of Form 1040-X was an IRS goal for several years.

Initially, the electronic filing option is only available for 2019 Forms 1040 and Forms 1040-SR, *U.S. Tax Return for Seniors.* Additional enhancements will be available in the future.

240. Instructions for Forms 1099-MISC and 1099-NEC.

241. PL 114-113.

242. IRS News Rel. IR-2020-182 (Aug. 17, 2020).

2020 FORM 1040

On August 18, 2020, the IRS released a draft version of the 2020 Form 1040, which follows. Notable changes are circled.

Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** **2020** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

August 18, 2020
DO NOT FILE

Filing Status Check only one box. ☐ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial	Last name	**Your social security number**
If joint return, spouse's first name and middle initial	Last name	**Spouse's social security number**

Home address (number and street). If you have a P.O. box, see instructions.		Apt. no.	**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ **You** ☐ **Spouse**
City, town, or post office. If you have a foreign address, also complete spaces below.	State	ZIP code	
Foreign country name	Foreign province/state/county	Foreign postal code	

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? ☐ **Yes** ☐ **No**

Standard Deduction **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☐ Were born before January 2, 1956 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1956 ☐ Is blind

Dependents (see instructions): If more than four dependents, see instructions and check here ▶ ☐

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) ✔ if qualifies for (see instructions): Child tax credit	Credit for other dependents
			☐	☐
			☐	☐
			☐	☐
			☐	☐

Attach Sch. B if required.

Standard Deduction for—
- Single or Married filing separately, $12,400
- Married filing jointly or Qualifying widow(er), $24,800
- Head of household, $18,650
- If you checked any box under *Standard Deduction,* see instructions.

1	Wages, salaries, tips, etc. Attach Form(s) W-2			1	
2a	Tax-exempt interest	2a	**b** Taxable interest	2b	
3a	Qualified dividends	3a	**b** Ordinary dividends	3b	
4a	IRA distributions	4a	**b** Taxable amount	4b	
5a	Pensions and annuities	5a	**b** Taxable amount	5b	
6a	Social security benefits	6a	**b** Taxable amount	6b	
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			7	
8	Other income from Schedule 1, line 9			8	
9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** ▶			9	
10	Adjustments to income:				
a	From Schedule 1, line 22	10a			
b	Charitable contributions if you take the standard deduction. See instructions	10b			
c	Add lines 10a and 10b. These are your **total adjustments to income** ▶			10c	
11	Subtract line 10c from line 9. This is your **adjusted gross income** ▶			11	
12	**Standard deduction or itemized deductions** (from Schedule A)			12	
13	Qualified business income deduction. Attach Form 8995 or Form 8995-A			13	
14	Add lines 12 and 13			14	
15	**Taxable income.** Subtract line 14 from line 11. If zero or less, enter -0-			15	

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2020)

Form 1040 (2020) Page **2**

DRAFT AS OF August 18, 2020 DO NOT FILE

16	**Tax** (see instructions). Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐	16	
17	Amount from Schedule 2, line 3	17	
18	Add lines 16 and 17	18	
19	Child tax credit or credit for other dependents	19	
20	Amount from Schedule 3, line 7	20	
21	Add lines 19 and 20	21	
22	Subtract line 21 from line 18. If zero or less, enter -0-	22	
23	Other taxes, including self-employment tax, from Schedule 2, line 10	23	
24	Add lines 22 and 23. This is your **total tax** ▶	24	
25	Federal income tax withheld from:		
a	Form(s) W-2 — 25a		
b	Form(s) 1099 — 25b		
c	Other forms (see instructions) — 25c		
d	Add lines 25a through 25c	25d	
26	2020 estimated tax payments and amount applied from 2019 return	26	
27	Earned income credit (EIC) — 27		
28	Additional child tax credit. Attach Schedule 8812 — 28		
29	American opportunity credit from Form 8863, line 8 — 29		
30	Recovery rebate credit. See instructions — 30		
31	Amount from Schedule 3, line 13 — 31		
32	Add lines 27 through 31. These are your **total other payments and refundable credits** ▶	32	
33	Add lines 25d, 26, and 32. These are your **total payments** ▶	33	

• If you have a qualifying child, attach Sch. EIC.
• If you have nontaxable combat pay, see instructions.

Refund

34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**	34	
35a	Amount of line 34 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐	35a	
▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings		
▶ d	Account number		
36	Amount of line 34 you want **applied to your 2021 estimated tax** ▶ 36		

Direct deposit? See instructions.

Amount You Owe

For details on how to pay, see instructions.

37	Subtract line 33 from line 24. This is the **amount you owe now** ▶	37	
	Note: Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.		
38	Estimated tax penalty (see instructions) ▶ 38		

Third Party Designee

Do you want to allow another person to discuss this return with the IRS? See instructions ▶ ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.) ▶
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.) ▶
Phone no.	Email address		

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ Self-employed
Firm's name ▶			Phone no.	
Firm's address ▶			Firm's EIN ▶	

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2020)

The notable changes include the following.

- The IRS added a question under the taxpayer name/address section asking whether the taxpayer had any financial interests in virtual currency during the year.
- **Line 10b** — A new line has been added for charitable contributions for taxpayers who take the standard deduction. As explained earlier, the CARES Act allows an eligible individual to claim an above-the-line deduction of up to $300 for contributions made in 2020.
- **Line 25** — In prior years, there was one line on which the taxpayer entered the total federal income tax withheld from Forms W-2 and 1099. On the draft 2020 Form 1040, there are separate lines on which the taxpayer enters the federal tax withheld from Forms W-2, Forms 1099, and other forms, as applicable.
- **Line 30** — A new line was added for the recovery rebate credit. These credits are discussed earlier in the chapter.
- **Line 37** — A note was added under line 37 warning the taxpayer that if they filed Schedule H, *Household Employment Taxes,* or Schedule SE, line 37 may not represent all the taxes they owe. The note directs the taxpayer to see Schedule 3, *Additional Credits and Payments,* line 12e, and its instructions for details. However, the draft instructions for Schedule 3 were not released before this workbook was published. This line appears to relate to the elective deferral of the **employer's portion** of social security tax for the period beginning March 27, 2020, and ending December 31, 2020. As explained earlier, the employer must pay half of the deferred social security tax by December 31, 2021, and the other half must be deposited by December 31, 2022. The same dates apply to deferred payments by self-employed persons of 50% of the social security tax on SE income.[243]

243. *IRS Releases Draft Form 1040: Here's What's New For 2020.* Erb, Kelly Phillips. Aug. 20, 2020. Forbes. [www.forbes.com/sites/kellyphillipserb/2020/08/20/irs-releases-draft-form-1040-heres-whats-new-for-2020/#3bc234e23356] Accessed on Aug. 24, 2020.