Historic Stimulus Package Signed Into Law Amidst COVID-19 Pandemic

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On January 27, 2020, the Secretary of Health and Human Services declared a public health emergency for a novel coronavirus, the cause of the COVID-19 illness. On March 27, 2020, in response to the global COVID-19 pandemic and the resulting effects on the U.S. economy, President Trump signed into law the Coronavirus, Aid, Relief, and Economic Security (CARES) Act.[1] This historic $2 trillion economic stimulus package was one of three coronavirus-related relief bills to become law in a three-week timespan, and its provisions are designed to help mitigate the spread of the virus and to ease the economic toll on American families, businesses, and the healthcare system.

As financial professionals, you will likely be among the first to receive questions about what the stimulus package means for your clients. Who will receive the widely publicized stimulus checks? What help is available if someone lost their job? And your small business clients may be concerned about how to keep their businesses afloat, especially if they were impacted by the mandatory closing of non-essential businesses.

On a more obvious level within the financial planning space, changes made by the CARES Act to retirement plan distributions, plan loans, and RMDs in 2020 are ones that you should know. These parts of the legislation could, in some cases, mitigate some of the financial effects of the COVID-19 pandemic. While the CARES Act is some 880 pages in length, what follows is a summary of some of the key provisions to help you address the most common questions and concerns you will likely encounter in the days ahead.

Special Note: The information contained below is based upon information that, in some cases, may be fluid and subject to change in interpretation. Some of the provisions will need further guidance and clarification from the IRS, Department of Labor, and any other governmental agencies. Until such guidance is issued, the development of specific sales strategies around these legislative changes is discouraged. To stay updated on the most recent COVID-19-related IRS announcements, visit www.irs.gov/coronavirus and www.dol.gov/coronavirus.

Always encourage your clients or prospects to consult their tax and legal advisors for guidance on how the new law may impact their unique situations. Also note that the Act contains many provisions that are not included here. The ones outlined below are designed to help you navigate the most frequent questions related to the Act.

Stimulus Checks

An estimated $300 billion dollars of the $2 trillion package was allocated to pay most adult Americans $1,200 (or $2,400 for joint returns), plus an additional $500 for each dependent child under the age of 17.[2] Specifically excluded are those who are claimed as a dependent on someone else's tax return, a non-resident alien, an estate, or a trust.

Referred to as the 2020 "recovery rebate" in section 2201 of the Act, estimates indicate that 83% of Americans can expect to be eligible for the rebate.

Who is Eligible?

Eligible individuals are those with adjusted gross income (AGI) in 2019 of less than $75,000, joint filers with AGI of less than $150,000, and heads of households with less than $112,500. If 2019 returns have not yet been filed, information from 2018 federal tax returns will be used to determine the amount of the rebate. Those with no taxable income or those receiving Social Security, Railroad Retirement benefits, or means-tested non-taxable SSI are also eligible for the rebate.[3] For those not required to file a tax return, IRS will base a rebate for these individuals using additional tools, such as SSA-1099 for Social Security benefits and Form RRB-1099 for Railroad Retirement benefits. No action is required to receive the rebate if you have direct deposit information on file with the IRS. For those who have not filed a tax return, refer to the instructions here: www.irs.gov/newsroom/economic-impact-payments-what-you-need-to-know. Others will receive a check by mail. Treasury Secretary Steve Mnuchin has stated that the anticipated timeline is approximately three weeks.

Eligibility Phase-Out

The amount of the credit is reduced by $5 for every $100 over the applicable threshold. The credit is phased out completely at $99,000 (single), $146,500 (head of household), and $198,000 (joint filers).

Practical Implications

It is unclear whether individuals who failed to meet the income requirements to receive a rebate check based on AGI in 2018 or 2019, but who may qualify in 2020 due to coronavirus-related reduction in income, will be eligible for the rebate, or whether there may be other rounds of rebates in the future. The Act simply states that no refund or credit will be allowed after December 31, 2020. The rebate is also referred to as an "advance credit" for tax year 2020, which would indicate that the rebate will be used to offset any tax refunds for taxable year 2020. Hopefully additional guidance will be forthcoming.

Additional Unemployment Insurance Benefits

Broadening of Eligibility Criteria

Roughly $260 billion of the stimulus package is allocated to cover the cost of an expected record number of unemployment insurance claims. The legislation broadens eligibility for those adversely impacted by COVID-19 to include self-employed individuals, independent contractors, gig workers, and those with limited work histories. Eligible individuals must provide self-certification that they are able and available to work, and can attest to being adversely impacted in their ability to work due to COVID-19. Those with the ability to telework with pay, or anyone receiving paid sick leave or other paid leave, are ineligible.[4] The Department of Labor has established a quick reference page regarding the changes to unemployment insurance under the CARES Act here: www.careeronestop.org/coronavirus.aspx. It is also recommended that impacted individuals and employers check with their local state's unemployment insurance website for state-specific guidelines.

Emergency Increase in Unemployment Compensation

This provision provides an additional $600 in weekly federal benefits over and beyond what the state permits, and the additional federal increase is available for up to four months. The bill also adds 13 weeks of federally-funded unemployment insurance to the state maximum of 26 weeks for those who have exhausted state benefits and remain unemployed due to the COVID-19 pandemic, through December 31, 2020. The seven-day waiting period is waived, allowing benefits to be available during the first week of unemployment.[5]

The same provisions have been added to the Railroad Unemployment Insurance Act.

Practical Implications

While unemployment insurance is taxable income, it is not considered earned income for purposes of the Social Security earnings test for benefits claimed prior to full retirement age. Therefore, unemployment compensation will not cause some or all of the Social Security benefits to be withheld for those who also file for benefits to cover expenses. However, states vary in whether Social Security benefits will affect the amount of entitlement to unemployment insurance. You may find information for your state's unemployment insurance agency here: www.careeronestop.org/WorkerReEmployment/Toolkit/find-unemployment-benefits.aspx.

Retirement Plan Changes

10% Early Withdrawal Penalty on Retirement Plans and IRAs

The 10% early withdrawal penalty will not apply to any "coronavirus-related distribution" on retirement plans and IRAs up to a combined $100,000 per year, made on or after January 1, 2020, and before December 31, 2020.[6] Income taxes on eligible distributions may be spread ratably over three years and may be recontributed to any eligible retirement plan within three years, without regard to contribution limits and the normal 60-day rollover requirement. In the case of distributions from qualified retirement plans, the 20% mandatory withholding that normally applies to rollover-eligible distributions will not apply.

A coronavirus-related distribution, as defined in the Act, is one made to an individual:

1. Who is diagnosed with COVID-19 by a CDC-approved test; or
2. Whose spouse or dependent tests positive for COVID-19; or
3. Who experiences adverse consequences as a result of being quarantined, furloughed, laid off, who experiences reduced work hours, who is unable to work due to lack of childcare, or who suffers from the closing or reduced hours from a business whose owner has tested positive for COVID-19; or
4. Other factors as determined by the Treasury.

In the case of a distribution from a qualified retirement plan, the employer may rely on an employee's certification that they have met the conditions outlined above. However, proceed with caution when discussing this new provision, as further guidance is needed to determine how a taxpayer will self-certify that they have experienced "adverse consequences." Visit the IRS website for the most up-to-date guidance on the CARES Act and COVID-19-related tax guidance. Coronavirus-related distributions will also automatically be considered as an eligible distribution event, regardless of whether the plan has been amended to allow for such distributions.

Increased Limits in Qualified Plan Loans

Plan loans from qualified retirement plans are generally limited to the lesser of 50% of the vested account balance or $50,000. The CARES Act temporarily increases the loan limits to 100% of the vested account value or $100,000, whichever is less, on loans originated within 180 days of enactment (March 27, 2020). Any outstanding loan as of enactment, for which the re-payment is scheduled to occur between March 27, 2020, and December 31, 2020, may be delayed by one year without interest accrual.[6]

Practical Implications

This provision is designed to enable individuals to have greater access to qualified plan balances through plan loans to offset financial strain due to the pandemic, without triggering a taxable event at the time the loan is taken, unlike a non-pandemic-related distribution, which generally would be taxable. If a loan is requested more than 180 days after March 27, 2020, the regular limits described above will apply.

Temporary Waiver of RMDs for 2020

Required minimum distributions (RMDs) for the 2020 calendar year are waived for all defined contribution plans and IRAs, including inherited IRAs and inherited Roth IRAs. The waiver also applies to individuals whose first RMD for 2019 has not yet been taken. Individuals who have already taken an RMD for calendar year 2020 have the option of returning the distribution.[7]

Practical Implications

The waiver may be particularly useful for individuals whose 2019 year-end balances, on which the 2020 RMD is calculated, was substantially higher than what the value of the plan is now, allowing them to avoid withdrawing from a plan that may have been severely impacted by the market downturn.

Other Provisions for Individuals

Partial Above-the-Line Deduction for Charitable Contributions

Beginning for tax years after December 31, 2019, an individual who does not itemize deductions may take a maximum above-the-line deduction of $300 if the contribution is made to a qualified charitable organization in cash. Contributions to private foundations and donor-advised funds are ineligible.[8]

Increase in Charitable Contribution Limits

In 2020, the 50% of AGI charitable cash contribution limit is temporarily suspended. For corporations, the limit is increased from 10% to 25%, and the deduction for contributions of food inventory is increased from 15% to 25%. To the extent that the aggregate amount of the contribution exceeds the limit, the excess may be carried over for five years. Contributions to donor-advised funds and private foundations are specifically excluded.[9]

Practical Implications

This provision is intended to help increase donations to charitable organizations during the crisis by waiving or increasing the cap on charitable donations. Charitable giving took a hit after the Tax Cuts and Jobs Act of 2017 doubled the standard deduction and put limits on many itemized deductions. Many who continued to donate despite the changes were unlikely to see a positive tax benefit if their total deductions didn't exceed the standard deduction. These changes will make it easier for individuals to optimize charitable contributions without lumping them into alternating tax years (a strategy that became popular after the 2017 Act), in order to exceed the standard deduction. The $300 above-the-line deduction, while small, provides a dollar-for-dollar reduction to AGI.

Temporary Relief for Student Loan Borrowers

Students with federally-backed student loans may defer payments, including interest, for up to six months through September 30, 2020, without penalty. The deferment period will be automatically applied to any eligible federal student loan. For a detailed Q and A related to federal student loans under the Act, visit the Department of Education's Student Aid division at www.studentaid.gov/announcements-events/coronavirus#borrower-questions.

Broader Access to Telehealth Options

In the case of plan years beginning on or before December 31, 2021, high-deductible health plans with a health savings account (HSA) will permit the coverage of telehealth services, prior to reaching the plan's deductible. This will provide greater access for individuals who may have COVID-19, while protecting others from exposure.[10] Visit IRS Notice 2020-15 for more information: www.irs.gov/pub/irs-drop/n-20-15.pdf.

Medicare has also temporarily expanded access to telehealth services in response to the current public health emergency allowing individuals, especially those who are at-risk, to gain access to a variety of services, including access to doctors, nurse practitioners, mental health counseling, and licensed clinical social workers.[11] For more information as it relates to coronavirus and Medicare, visit www.medicare.gov/medicare-coronavirus#500.

Business-Related Provisions

Employee Retention Credit for Businesses Subject to Closure Due to COVID-19

A refundable payroll tax credit of 50% of wages is available to employers who paid employees during the COVID-19 crisis. The credit is available to employers whose businesses were fully or partially suspended due to a related shut down order or gross receipts declined by more than 50%, compared to the same quarter in the prior year. For purposes of the credit, wages per employee may not exceed $10,000 per quarter. The credit applies to wages paid between March 13, 2020, and December 31, 2020.[12]

Delay of Payment of Payroll Taxes

This provision allows employers, including self-employed individuals, to defer payment of the employer share of the Social Security Tax (6.2%) that they would otherwise pay between March 27, 2020, and December 31, 2020. The deferred employment tax may be paid over the following two years, with 50% of the amount required to be paid by December 31, 2021, and the other 50% to be paid by December 31, 2022.[13]

Modification to Net Operating Losses

The CARES Act relaxes the limitations on a company's use of losses. Net operating losses are currently subject to a taxable income limitation and cannot be carried back to reduce income in a prior year. The Act allows for net operating losses incurred in tax years 2018 to 2020 to be carried back for five years and temporarily removes the taxable income limitation, allowing net operating losses to fully offset income.[14]

Limitation on Business Interest Increases

For tax years beginning in 2019 or 2020, the amount of interest expense that businesses may deduct is increased from 30% to 50%.[15]

Practical Implications

The changes outlined above, while they may require an amendment of a prior tax return, can provide critical cash flow to businesses hit hard by the pandemic.

Business-Related Provisions to Keep Americans Working

Paycheck Protection Program

The CARES Act provides authority to the Small Business Administration to make loans to small businesses of 500 employees or less, including eligible non-profit organizations, veterans organizations, and business tribes. Loans are also available to eligible sole proprietors, independent contractors, and other self-employed individuals. The government guarantee of loans is increased to 100% through December 31, 2020. The covered loan period runs from February 15, 2020, through June 30, 2020.[16]

The maximum loan amount is capped at $10 million through December 31, 2020, and provides a formula for determining the loan amount tied to payroll costs during the covered loan period. The proceeds from the loan may be used for payroll support, insurance premiums, mortgage, rent, and utilities.

Eligibility qualifications are based upon whether a business was operating as of February 15, 2020, and had employees for whom it paid salaries, payroll taxes, or an independent contractor. Borrowers must make a good faith certification that the loan is necessary due to the current economic conditions and the monies will be used to support the retention of employees. Borrower and lender fees are waived under this program.

Loan Forgiveness

The Act establishes that the borrower may be eligible for loan forgiveness equal to the amount spent by the borrower during an eight-week period after the origination of the loan on payroll costs, interest payments, or on mortgages incurred prior to February 15, 2020.[17] Amounts forgiven may not exceed the principal amount of the loan.

The amount forgiven will be reduced by any reduction in employees retained, compared to the prior year or proportionately to a reduction of pay to an employee greater than 25%, as compared to their prior year compensation. Any amounts forgiven will not be treated as taxable income. Any loan amounts not forgiven at the end of one year is carried forward as an ongoing loan, with a maximum term of 10 years and an interest rate not to exceed 4%.

Summary

To obtain more detailed guidance on the Paycheck Protection Program, Loan Forgiveness, or any other work-related provisions within the CARES Act, visit the Small Business Administration's website page outlining specifics of coronavirus-related issues here: www.sba.gov/page/coronavirus-covid-19-small-business-guidance-loan-resources.

To reiterate, the public health emergency is an evolving crisis that has prompted lawmakers to act swiftly to help mitigate the health and economic challenges that our country faces. With that in mind, the largest stimulus package in our nation's history is bound to need more analysis and guidance in the days ahead. Use this summary as such and understand that not all legislative changes under the Act are detailed here. Always encourage your clients to seek counsel from tax and legal advisors.

[1]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, March 27, 2020.

[2]www.npr.com What's Inside the Senate's $2Trillion Coronavirus Aid Package? March 2020.

[3]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II, Subtitle B, Sec 2201 March 27, 2020.

[4]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II, Subtitle A, Sec 2102 March 27, 2020.

[5]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II, Subtitle A, Sec 2014 March 27, 2020.

[6]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II Subtitle B, Sec 2202 March 27, 2020.

[7]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II Subtitle B, Sec 2203 March 27, 2020

[8]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II Subtitle B, Sec 2204 March 27, 2020

[9]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II Subtitle B, Sec 2205 March 27, 2020

[10]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title III Subtitle D, Sec 3701 March 27, 2020

[11]www.medicare.gov/medicare-coronavirus, Telehealth and Related Services.

[12]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II Subtitle C, Sec 2301 March 27, 2020.

[13]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II Subtitle C, Sec 2302 March 27, 2020.

[14]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II Subtitle C, Sec 2303 March 27, 2020.

[15]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title II Subtitle C, Sec 2306 March 27, 2020.

[16]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title I, Sec 1102 March 27, 2020.

[17]H.R. 748 Coronavirus Aid, Relief, and Economic Security Act, Title I Sec 1106 March 27, 2020.