New Year, New Laws: Tax Changes in the 2021 Consolidated Appropriations Act

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On December 27, 2020, President Trump signed into law the Consolidated Appropriations Act, 2021 (CAA). It combines various relief measures for the pandemic with a slew of other legislative changes—including changes to the tax laws, many of which became effective January 1, 2021. Below is a high-level summary of the tax law changes included in the CAA.

COVID-Related Tax Relief Act Of 2020

Many of the tax measures in the CAA expand or clarify the tax treatment of relief measures enacted in 2020 as part of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") and other legislation.

- **Additional Recovery Rebates for Individuals**. Eligible individuals will receive a $600 ($1,200 for married jointly filing taxpayers) refundable 2020 tax credit, which, similar to the stimulus payments made under the CARES Act, Treasury is authorized to issue as advance payments. Taxpayers will receive an additional $600 for each "qualifying child" within the meaning of Internal Revenue Code Section ("Section") 24(c). The credit is based on 2019 modified adjusted gross income and phases out at a rate of $5 per every $100 of income above $75,000 of modified adjusted gross income ($112,500 for heads of household and $150,000 for married jointly filing taxpayers). A taxpayer receiving a credit based on 2019 income will not have to repay the credit (or recognize income) if 2020 income exceeds the phaseout limitation. A taxpayer who did not receive an advance payment based on 2019 income, however, may apply the $600 credit to their 2020 tax return if the taxpayer would qualify based on the taxpayer's 2020 income.
- **Amendments to Recovery Rebates Under the CARES Act**. The increased income limitation of $150,000 for taxpayers filing joint returns is also applied to taxpayers who are filing as "surviving spouses" within the meaning of Section 2(a). Additionally, Section 6428 is amended to include the provision that any payment made to a representative or fiduciary must either be provided to the individual who is entitled to the payment or used for their benefit. For an overview of such CARES Act recovery rebates, see our article here.
- **Extension of Certain Deferred Payroll Taxes**. President Trump's executive order, later outlined in IRS Notice 2020-65, permitted employers to postpone the withholding of payroll taxes on employee wages paid through 2020—provided that any payroll taxes deferred in such a manner were subsequently repaid by April 30, 2021. The CAA extends the time period over which employers may remit any such deferred payroll tax obligations from April 30, 2021 to December 31, 2021.
- **Regulations or Guidance Clarifying Application of Educator Expense Tax Deduction.** The Treasury is required to issue regulations or other guidance clarifying that eligible educators may deduct the cost of personal protective equipment, disinfectant, and other supplies used for the prevention of the spread of COVID-19 under Section 62(a)(2)(d)(iii).
- **Tax Treatment of Forgiven PPP loans.** The immensely popular Paycheck Protection Program (PPP) was enacted as part of the CARES Act with the aim of infusing capital into small and midsize business to help them survive the pandemic. PPP loans were forgivable (and, significantly, were tax-free income) to the extent they were used to fund certain expenses—

mainly payroll. A tax issue that quickly became apparent with respect to forgiven PPP loans was whether otherwise tax-deductible business expenses paid with such loans could be deducted. The IRS ultimately ruled that expenses paid with PPP loans were *not* deductible, arguing that to hold otherwise would permit taxpayers to effectively "double-dip" by receiving tax-free income and receiving a tax deduction on top of that. The CAA, however, supersedes the position previously taken by the IRS and clarifies that (i) expenses paid with proceeds from forgiven PPP loans are deductible, (ii) a basis increase is permitted with respect to forgiven loans, and (iii) tax attributes may not be reduced as a result of such loan forgiveness. It is not clear whether the basis increase referenced in the CAA includes outside basis in a flow-through entity such as a partnership or S corporation; the IRS may issue guidance on this point in the future. In Revenue Ruling 2021-2, the IRS subsequently abandoned its prior position and adopted the position taken in the CAA.

- **Tax Treatment of Other Loan and Grant Programs**. The favorable tax treatment described above for forgiven PPP loans has been extended to certain other Small Business Administration (SBA) loans and advances previously enacted under the CARES Act and similar legislation and to the newly enacted grants for shuttered venue operators introduced in the CAA. For more information on shuttered venue operator grants and the second round of PPP loans, see our article here.
- **Authority to Waive Certain Information Reporting Requirements**. The CAA gives Treasury discretion to waive information reporting requirements with respect to forgiven covered loans (e.g., PPP loans and other SBA loans) that are excluded from taxable income by virtue of the CARES Act or the CAA. It remains to be seen whether Treasury will issue any formal guidance adopting this position.
- **Emergency Financial Aid Grants**. Qualified emergency financial aid grants that may be awarded to students under the CARES Act are excluded from taxable income. Any grant money received that represents a payment for teaching, research, or other services as a condition for receiving such a grant, however, is not excludable.
- **Special Rules for Money Purchase Pension Plans**. The CARES Act provided favorable tax treatment to qualified individuals receiving coronavirus-related distributions from eligible retirement plans. Specifically, individuals were permitted to make penalty-free withdrawals and pay the tax liability on such withdrawals over a three-year period or roll the distributions back into the eligible retirement plan without creating a taxable event. The CAA expands the scope of this rule to distributions from money purchase pension plans, effective retroactively as of the enactment date of the CARES Act. It should be noted that the December 31, 2020 deadline to make coronavirus-related distributions from retirement plans under the CARES Act remains in effect.
- **Election to Waive Application of Certain Modifications to Farming Losses**. The CARES Act allowed a five-year carryback for net operating losses (NOLs) arising in the 2018, 2019, and 2020 tax years. Previously, NOL carrybacks had been unavailable to all taxpayers except farmers, who were allowed a two-year carryback. The CAA reconciles these rules and allows farmers to elect to retain a two-year carryback under the old regime rather than electing a five-year carryback under the CARES Act.
- **Election to Terminate the Transfer Period for Qualified Pension Plan Transfers**. The CAA provides relief for sponsors of overfunded defined-benefit pension plans who make qualified transfers under Section 420 to retiree health benefit accounts or retiree life insurance accounts. More specifically, transfers of excess pension assets to retiree health accounts under Section 420 are modified to allow employers to make a one-time election to end any transfers. Such election must be made in either 2020 or 2021.
- **Extension of Credits for Paid Sick and Family Leave.** Employers may receive a tax credit with respect to payroll taxes withheld from wages paid to employees on sick or family leave. Under the Families First Coronavirus Response Act

(FFCRA), eligible employers were entitled to receive a credit against any payroll taxes withheld with respect to qualified sick leave wages and qualified family leave wages paid during the period beginning April 1, 2020 and ending December 31, 2020. This rule has been extended to qualified wages paid through March 2021.

- **Election to Use Prior Year Net Earnings from Self-Employment.** For purposes of calculating paid sick and family leave credits, self-employed taxpayers are permitted to use their daily average net earnings from 2019 instead of 2020. This provides for a greater potential credit for self-employed taxpayers who may have been financially impacted by the pandemic.
- **Technical Improvements to Credits for Paid Sick and Family Leave**. For purposes of the paid sick and family leave credit, the definition of "qualified wages" is modified to reflect how it is generally defined in the Internal Revenue Code, presumably for the sake of consistency.
- **Employee Retention Credit**
  - Employers may be eligible for a tax credit with respect to Social Security tax withholding on certain wages paid in the first half of 2021. This credit was previously enacted earlier in 2020 as part of the CARES Act, but was set to expire at the end of 2020. Now the credit is available with respect to qualified wages paid through June 30, 2021, and other requirements and thresholds with respect to the credit have also been modified. Employers are eligible for this credit if, in any calendar quarter, they experienced (a) a full or partial suspension of their trade or business as a result of government restrictions in response to COVID-19 or (b) a significant decline (at least 20% when compared to last year) in gross receipts.
  - The credit is equal to 70% of "qualified wages" paid to employees, subject to a limit of $10,000 per employee per quarter. Thus, the maximum amount of the credit in 2021 is $14,000 per employee. Qualified wages generally include any wages paid by a business with 500 or fewer employees. Under the CARES Act, employers receiving a PPP loan could not claim the Employee Retention Credit. However, under the CAA, employers that received PPP loans are retroactively eligible for the credit with respect to any wages that were not paid with proceeds from forgiven PPP loans. For an overview of the employee retention credit as initially enacted under the CARES Act, see our article here.

Disaster Tax Relief

In addition to the various measures in the CAA to help taxpayers affected by the pandemic, the CAA also creates a carveout for disaster relief provisions for disasters *other than* the pandemic (Qualified Disasters). In many cases, these provisions provide parity to taxpayers affected by Qualified Disasters (i.e., they extend to such taxpayers the same benefits as provided to individuals affected by the pandemic). The following measures are available to taxpayers affected by Qualified Disasters.

- **Special Disaster-Related Rules for Use of Retirement Funds**. Taxpayers who live in areas affected by Qualified Disasters may make penalty-free withdrawals up to $100,000 from qualifying retirement accounts. The tax on any such withdrawal may be paid over a three-year period, or, alternatively, the amounts withdrawn may be recontributed to such qualifying retirement accounts.
- **Employee Retention Credit for Employers Affected by Qualified Disasters.** An employee retention credit of 40% of a qualifying wage, subject to an annual limit of $6,000 per employee, is made available to employers carrying on a trade or business in an area affected by a Qualified Disaster.

- **Other Disaster-Related Tax Relief Provisions.** Corporations are permitted a 100% charitable contribution deduction for any qualifying contributions made to support relief efforts in areas affected by a Qualified Disaster. This is an expansion of the charitable contribution deduction for corporations previously enacted in the CARES Act. Individuals are also permitted to include net disaster losses, calculated under the Section 165(h) casualty loss rules (but with a $500 floor rather than $100), as part of their standard deduction.

- **Low-Income Housing Tax Credit.** The state housing credit ceiling under Section 42 is increased for 2021 and 2022 by $3.50 per resident of an area affected by a Qualifying Disaster.

Additional Tax Provisions

- **Full Deduction for Business Meals Provided by Restaurants.** The 50% deduction for business meals is increased to 100% for expenses incurred from January 1, 2021 through December 31, 2022 for food and beverages provided by a restaurant.

- **Education Expenses**. The deduction for qualified tuition and related expenses under Section 222 is repealed. Income limitations for phaseout of the Lifetime Learning Credit under Section 25A are increased to match the limitations on the American Opportunity Tax Credit.

- **Low-Income Housing Credit.** A 4% floor was established for the applicable percentage used in calculating the low-income housing credit under Section 42.

- **Alternative Depreciation System.** The 30-year alternative depreciation system for electing real property trades or businesses is extended to property placed in service before January 1, 2018, whereas, under the 2017 Tax Act, this applied only to property placed in service *after* January 1, 2018.

- **Waste Energy Recovery Property Credit.** For tax years 2021 through 2023, the Section 48 investment tax credit is expanded to cover waste energy recovery property, which generates electricity from heat from buildings or equipment.

- **Offshore Wind Facilities Credit.** The Section 48 investment tax credit is extended for electing offshore wind facilities for facilities that begin construction before January 1, 2026.

- **Life Insurance Contracts Minimum Rate Determinations.** The fixed interest rate under Section 7702 is updated such that, going forward, the rate will be tied to certain benchmark interest rates that will be periodically updated.

- **Minimum Age for Pension Distributions During Working Retirement**. The minimum age required under Section 401(a) for certain qualified pension plan distributions to workers and certain construction and building trade workers is lowered to 59 and a half and 55, respectively.

- **Temporary Rule Preventing Partial Pension Plan Termination.** Qualified plans will not be treated as having a partial termination under Section 411(d)(3) during any plan year that includes the period from March 13, 2020 through March 31, 2021, as long as the number of active participants covered by the plan on March 31, 2021, is 80% or more of the number covered on March 13, 2020.

- **Special Rule for Determination of Earned Income**. Taxpayers may use earned income of the taxable year before the tax year beginning in 2020, if it is higher, when calculating the earned income tax credit under Section 32 and additional child tax credit under Section 24(d) for tax year 2020.

- **Health and Dependent Care Flexible Spending Arrangements**. Taxpayers can carry over unused benefits or contributions remaining in a flexible spending arrangement from 2020 to 2021 and from 2021 to 2022. Employers are also allowed to permit employees to make a 2021 midyear prospective modification in contributions amounts.
- **Charitable Contributions Limitations**. The above-the-line $300 charitable deduction ($600 if married filing jointly) for taxpayers who itemize deductions is extended through 2021. Additionally, for individuals who itemize and corporations, the rule increasing the limit for charitable contributions to 100% under the CARES Act is extended through 2021.

Extensions

The CAA provides for extensions of various tax provisions (such extensions being between one and five years), and some tax provisions that previously had a sunset date are made permanent.

Permanent

The following provisions are made permanent:

- **Unreimbursed Medical Expense Deduction.** The deduction floor for unreimbursed medical expenses under Section 213 is permanently adjusted to 7.5% of adjusted gross income (down from 10%).
- **Energy-Efficient Commercial Building Deduction.** The deduction for energy-efficient commercial buildings under Section 179D is made permanent. Furthermore, the standards for what constitutes an energy-efficient commercial building have been adjusted, including a special carveout for California standards. Finally, the maximum amount of the deduction will be adjusted for inflation.
- **First Responder Benefits.** The income exclusion for certain benefits provided to volunteer firefighters and emergency medical responders under Section 139B is made permanent.
- **Railroad Track Maintenance Credit.** The credit for certain qualified railroad track maintenance expenditures under Section 45G is reduced to 40% (from 50%) and made permanent. However, the 50% credit amount will remain with respect to any qualified expenditures incurred before January 1, 2023.
- **Beer, Wine, and Distilled Spirits**. Many provisions with respect to alcohol were made permanent. Federal excise tax rates on beer were reduced. Certain tax credits were enacted for wine. Tax rates for certain low-alcohol wines and meads were reduced. Additionally, the alcohol content level for the definition of "wine" was increased to 16% (from 14%) for purposes of determining the applicable excise tax rate.

Extended through 2025

The following provisions were extended through 2025:

- **CFC Look-Through Rule.** The controlled foreign corporation (CFC) look-through rule under Section 954(c)(6) is extended through 2025. Pursuant to the look-through rule, dividends, interest, rents, and royalties received or accrued by a CFC from a related CFC will not be treated as Subpart F income and, therefore, will not be currently includible as taxable income for U.S. shareholders—provided that the payment from the related CFC is not sourced from Subpart F or effectively connected income.
- **New Markets Tax Credit**. The $5 million limitation on the New Markets Tax Credit under Section 45D is extended through 2025. This credit provides incentives to invest in low-income communities.

- **Work Opportunity Credit.** Wages paid through 2025 may be subject to the Section 51 Work Opportunity Credit, which provides a tax credit to employers for hiring individuals from certain targeted groups facing significant barriers to employment.
- **Discharge of Qualified Principal Residence Indebtedness.** The exclusion from gross income under Section 108(a)(1)(E) for discharge of qualified principal residence indebtedness (e.g., mortgages) is extended through 2025. The maximum amount of such indebtedness eligible for such an exclusion, however, is reduced to $750,000 (or $375,000 for a married taxpayer filing separately), down from $2 million (or $1 million for a married taxpayer filing separately).
- **Motorsports Entertainment Complex Cost Recovery.** The allowance for a 7-year cost recovery period for motorsports entertainment complexes (as defined in Section 168(i)(15)) is extended through 2025.
- **Expensing for Qualified Productions.** The allowance under Section 181 for the expensing of production costs associated with certain qualified film, television, and theatrical productions (subject to a limit of either $15 million or $20 million) is extended through 2025, which may help alleviate certain production company timing difference issues. For more information regarding timing issues with respect to production expenses, see Shane Nix's article here.
- **Oil Spill Liability Trust Fund Rate.** The Oil Spill Liability Trust Fund financing rate, used to calculate the tax imposed on crude oil and petroleum products under Section 4611, is extended through 2025.
- **Empowerment Zone Tax Incentives.** The tax credit under Section 1391 for hiring and retaining employees who live in empowerment zones is extended through 2025. The Section 179 increase for expensing equipment in empowerment zones and the deferral of capital gains with respect to such equipment are terminated.
- **Employer Credit for Medical and Family Leave.** The credit available to employers under Section 45S for wages paid to employees during any period in which such employees are on family and medical leave is extended through 2025.
- **Employer Payments of Student Loans.** The exclusion from employee gross income under Section 127 for certain expenses incurred by the employer for educational assistance to the employee is extended through 2025.
- **Carbon Oxide Sequestration Credit.** Tax credits available under Section 45Q for the capture of carbon oxide are extended through 2025.

Other Extensions

See the table below for a summary of other extended tax provisions:

Extension Provision	Code Section	Extension Period
Renewable Resource Credit. The credit for electricity produced from certain renewable resources.	45	Through 2021
Energy Credit. The investment tax credit incentivizing the implementation of solar energy, wind energy, and qualified fuel cells.	48	Through 2023
Qualified Residence Interest. The treatment of qualified mortgage insurance premiums as qualified residence interest.	163(h)(3)(E)	Through 2021
Health Insurance Credit. The credit for health insurance costs of eligible individuals.	35	Through 2021

Indian Employment Credit. The Indian Employment Credit.	45A	Through 2021
Mine Rescue Credit. The Mine Rescue Team Training Credit.	45N	Through 2021
Race Horse Cost Recovery. The classification of certain racehorses as three-year property for purposes of cost recovery.	168(e)(3)(A)	Through 2021
Indian Reservation Property. The allowance of cost recovery for certain qualified business property on Indian reservations.	168(j)(9)	Through 2021
American Samoa Economic Development Credit. Various extensions have been enacted for the American Samoa economic development credit as outlined in P.L. 109-432, as amended by P.L. 111-312.	N/A	
Biofuel Producer Credit. The Second Generation Biofuel Producer Credit.	40(b)(6)	Through 2021
Nonbusiness Energy Property. The allowance for a credit for qualified energy efficiency improvements and residential energy property expenditures.	25C	Through 2021
Qualified Fuel Cell Motor Vehicles. The allowance of a credit for the purchase of new qualified fuel cell motor vehicles.	30B	Through 2021
Alternative Fuel Refueling Property Credit. The credit for alternative fuel vehicle refueling property.	30C	Through 2021
2-Wheeled Plug-in Electric Vehicle Credit. The credit with respect to new qualified plug-in electric drive motor vehicles.	30D	Through 2021
Production Credit for Indian Coal Facilities. The credit for producers of Indian coal at an Indian coal production facility.	45(e)(10)	Through 2021
Energy Efficient Homes Credit. The availability of the energy efficient home credit to eligible contractors.	45L	Through 2021
Excise Tax Credits Relating to Alternative Fuels. The credit allowance against certain excise taxes to produce certain alternative fuels, including alcohol fuel and biodiesel.	6246	Through 2021
Black Lung Disability Trust Fund Excise Tax. The increased rates on the excise tax imposed on coal from U.S. mines.	4121	Through 2021

Future Legislation

It is likely that more tax legislation will be passed this year once President Biden takes office. President Biden has already announced a $1.9 trillion relief plan to combat the pandemic, which includes tax provisions such as an expansion of the Child Tax Credit and the Earned Income Credit. President Biden also announced a more comprehensive tax plan last year, as detailed in our article here. Whether such a tax plan will be passed remains to be seen.

Venable will continue to monitor any changes in the law and stands ready to advise.

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