Current Federal Tax Developments

Week of June 29, 2020

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ACCOUNTING
CONTINUING EDUCATION

KAPLAN

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF JUNE 29, 2020
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Current Federal Tax Developments

Kaplan Financial Education

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SECTION: ERC
ADDITIONAL EXAMPLES AND OTHER GUIDANCE ADDED TO EMPLOYER RETENTION CREDIT FAQS

Citation: "FAQs: Employee Retention Credit under the CARES Act," IRS website, 6/19/20

The IRS has revised the FAQ related to the Employee Retention Credit under the CARES Act,[1] adding information on when employers qualify for the credit among other items. The Employee Retention Credit (ERC) is a refundable credit employers claim against payroll taxes due on Form 941, equal to ½ of eligible wages paid during specified periods.

Employers need to meet one of two tests to be eligible for the credit for certain wages paid after March 12, 2020 and before January 1, 2021:

- Fully or partially suspend operation during 2020 due to government orders limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19; or

- Experience a significant decline in revenues (revenues for a quarter in 2020 less than 50% of the same quarter in 2019).

The CARES Act limited qualification for the credit to employers that did not receive a PPP loan. Later SBA and IRS guidance clarified that those entities that returned the funds received in their entirety to the lender by May 18, 2020 will not be barred from claiming the ERC.

A summary of the major changes is provided below.

Governmental Orders

The IRS has updated Question 28 to clarify which government orders qualify an employer for the ERC credit.

The Question reads:

> **28. What "orders from an appropriate governmental authority" may be taken into account for purposes of the Employee Retention Credit? (updated June 19, 2020)**
>
> Orders, proclamations, or decrees from the Federal government, or any State or local government are considered "orders from an

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[1] "FAQs: Employee Retention Credit under the CARES Act," IRS website, June 19, 2020, https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act (retrieved June 26, 2020)

appropriate governmental authority" if they limit commerce, travel, or group meetings due to COVID-19 in a manner that affects an employer's operation of its trade or business, including orders that limit hours of operation and, if they are from a State or local government, they are from a State or local government that has jurisdiction over the employer's operations (referred to as a "governmental order").

Statements from a governmental official, including comments made during press conferences or in interviews with the media, do not rise to the level of a governmental order for purposes of the Employee Retention Credit. Additionally, the declaration of a state of emergency by a governmental authority is not sufficient to rise to the level of a governmental order if it does not limit commerce, travel, or group meetings in any manner. Further, such a declaration that limits commerce, travel, or group meetings, but does so in a manner that does not affect the employer's operation of its trade or business does not rise to the level of a governmental order.

A governmental order allows employers to qualify as Eligible Employers for purposes of claiming the Employee Retention Credit without regard to the level of enforcement of the governmental order.

Governmental orders include:

- An order from the city's mayor stating that all non-essential businesses must close for a specified period;
- A State's emergency proclamation that residents must shelter in place for a specified period, other than residents who are employed by an essential business and who may travel to and work at the workplace location;
- An order from a local official imposing a curfew on residents that impacts the operating hours of a trade or business for a specified period;
- An order from a local health department mandating a workplace closure for cleaning and disinfecting.

Whether the operations of a trade or business are considered essential or non-essential will often vary from jurisdiction to jurisdiction. An employer should determine whether it is an essential or non-essential business by referring to the governmental order affecting the employer's operation of its trade or business. For more information on when a business's operations are considered to be fully or partially suspended due to a governmental order, see "Determining When an

> Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order."[2]

Question 28 then provides the following three examples.

EXAMPLE 1:

Governor of State Y issues an order that all non-essential businesses must close from March 20, 2020 until April 30, 2020. The order provides a list of non-essential businesses, including gyms, spas, nightclubs, barber shops, hair salons, tattoo parlors, physical therapy offices, waxing salons, fitness centers, bowling alleys, arcades, racetracks, indoor children's play areas, theaters, chiropractors, planetariums, museums, and performing arts centers. Employers that provide essential services may remain open. The governor's order is a governmental order limiting the operations of non-essential businesses, entitling employers with non-essential businesses to claim the Employee Retention Credit for qualified wages.

EXAMPLE 2:

Mayor of City Y holds a press conference in which she encourages residents to practice social distancing to prevent the spread of COVID-19. The statement during the press conference is not an order limiting commerce, travel, or group meetings. Accordingly, the mayor's statement would not be a governmental order for purposes of the Employee Retention Credit.

EXAMPLE 3:

A restaurant is ordered by a local health department to close due to a health code violation. Since the order is unrelated to COVID-19, it would not be considered a governmental order for purposes of the Employee Retention Credit.[3]

Full or Partial Suspension Due to a Government Order

Assuming that a qualified government order described above is in existence, Questions 30, 33, 34 and 36 have been updated to provide additional information about what does and does not constitute a full or partial shutdown in response to a qualifying order.

Question 30 provides:

> **30. If a governmental order requires non-essential businesses to suspend operations but allows essential businesses to continue**

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[2] "COVID-19-Related Employee Retention Credits: Determining What Types of Governmental Orders May be Taken into Account for Purposes of the Employee Retention Credit FAQs," IRS website, June 19, 2020, https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-what-types-of-governmental-orders-may-be-taken-into-account-for-purposes-of-the-employee-retention-credit-faqs (retrieved June 26, 2020)

[3] "COVID-19-Related Employee Retention Credits: Determining What Types of Governmental Orders May be Taken into Account for Purposes of the Employee Retention Credit FAQs," IRS website, June 19, 2020

operations, is the essential business considered to have a full or partial suspension of operations? (updated June 19, 2020)

An employer that operates an essential business is not considered to have a full or partial suspension of operations if the governmental order allows the employer's operations to remain open. However, an employer that operates an essential business may be considered to have a partial suspension of operations if, under the facts and circumstances, more than a nominal portion of its business operations are suspended by a governmental order. For example, an employer that maintains both essential and non-essential business operations, each of which are more than nominal portions of the business operations, may be considered to have a partial suspension of its operations if a governmental order restricts the operations of the non-essential portion of the business, even if the essential portion of the business is unaffected. In addition, an essential business that is permitted to continue its operations may, nonetheless, be considered to have a partial suspension of its operations if a governmental order requires the business to close for a period of time during normal working hours.

For more information regarding employers whose business operations may continue for certain purposes, but not others, see " If a governmental order causes the suppliers to an essential business to suspend their operations, is the essential business considered to have a suspension of operations?"

For more information regarding the application of the full and partial suspension rules if the essential business' suppliers are required to close due to a governmental order, see "If a governmental order causes the suppliers to an essential business to suspend their operations, is the essential business considered to have a suspension of operations?"

For more information regarding the application of the full and partial suspension rules if the essential business's operating hours are affected by a governmental order, see Are an employer's operations considered to be partially suspended for purposes of the Employee Retention Credit if the employer is required to reduce its operating hours by a governmental order?

Even if an employer's operations are not considered to have been fully or partially suspended as a consequence of a governmental order, the employer may be considered an Eligible Employer and may be eligible for the Employee Retention Credit if it experiences a significant decline in gross receipts. For more information on what constitutes a significant decline in gross receipts, see Determining When an

> Employer is Considered to have a Significant Decline in Gross Receipts.[4]

Question 33 deals with the issue of whether a business that is required to change its operations (say close its office) but is able to continue its operations via telework by employees is eligible for the credit:

> **33. If a governmental order requires an employer to close its workplace, but the employer is able to continue operations comparable to its operations prior to the closure by requiring employees to telework, is the employer considered to have a suspension of operations? (updated June 19, 2020)**
>
> If an employer's workplace is closed by a governmental order, but the employer is able to continue operations comparable to its operations prior to the closure by requiring its employees to telework, the employer's operations are not considered to have been fully or partially suspended as a consequence of a governmental order.
>
> However, if the closure of the workplace causes the employer to suspend business operations for certain purposes, but not others, it may be considered to have a partial suspension of operations due to the governmental order. For more information regarding employers whose business operations may continue for certain purposes, but not others, see "If a governmental order requires an employer to close its workplace for certain purposes, but the workplace may remain operational for limited purposes, is the employer considered to have a suspension of operations?"
>
> Even if an employer's operations are not considered to have been fully or partially suspended as a consequence of a governmental order, the employer may be considered an Eligible Employer and may be eligible for the Employee Retention Credit if it experiences a significant decline in gross receipts. For more information on what constitutes a significant decline in gross receipts, see Determining When an Employer is Considered to have a Significant Decline in Gross Receipts.[5]

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[4] "COVID-19-Related Employee Retention Credits: Determining When an Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order FAQs," IRS website, June 19, 2020, https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-when-an-employers-trade-or-business-operations-are-considered-to-be-fully-or-partially-suspended-due-to-a-governmental-order-faqs (retrieved June 26, 2020)

[5] "COVID-19-Related Employee Retention Credits: Determining When an Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order FAQs," IRS website, June 19, 2020

The question ends with three examples.

EXAMPLE 1:

Employer C, a software development company maintains an office in a city where the mayor has ordered that only essential businesses may operate. Employer C's business is not essential under the mayor's order which requires Employer C to close its office. Prior to the governmental order, all employees at the company teleworked once or twice per week, and business meetings were held at various locations. Following the governmental order, the company ordered mandatory telework for all employees and limited client meetings to telephone or video conferences. Employer C's business operations are not considered to be fully or partially suspended by the governmental order because its business operations may continue in a comparable manner.

EXAMPLE 2:

Employer D operates a physical therapy facility in a city where the mayor has ordered that only essential businesses may operate. Employer D's business is not considered essential under the mayor's order, which requires Employer D to close its workplace. Prior to the governmental order, none of Employer D's employees provided services through telework and all appointments, administration, and other duties were carried out at Employer D's workplace. Following the governmental order, Employer D moves to an online format and is able to serve some clients remotely, but employees cannot access specific equipment or tools that they typically use in therapy and not all clients can be served remotely. Employer D's business operations are considered to be partially suspended by the governmental order because Employer D's workplace, including access to physical therapy equipment, is central to its operations, and the business operations cannot continue in a comparable manner.

EXAMPLE 3:

Employer E, a scientific research company with facilities in a state in which the governor has ordered that only essential businesses may operate, conducts research in a laboratory setting and through the use of computer modeling. Employer E's business is not essential under the governor's order, which requires Employer E to close its workplace. Prior to the governmental order, Employer E's laboratory-based research operations could not be conducted remotely (other than certain related administrative tasks) and employees involved in laboratory-based research worked on-site; however, Employer E's computer modeling research operations could be conducted remotely and employees engaged in this portion of the business often teleworked. Following the governmental order, all employees engaged in computer modeling research are directed to telework, and those business operations are able to continue in a comparable manner. In contrast, the employees engaged in the laboratory-based research cannot perform their work while the facility is closed and are limited to performing administrative tasks during the closure. Employer E's business operations are considered to be partially suspended by the governmental order

because Employer E's laboratory-based research business operations cannot continue in a comparable manner.[6]

Question 34 looks at the situation where the workplace is closed for some, but not all, purposes.

> **34. If a governmental order requires an employer to close its workplace for certain purposes, but the workplace may remain operational for limited purposes, is the employer considered to have a suspension of operations? (updated June 19, 2020)**
>
> Yes. If an employer's workplace is closed by a governmental order for certain purposes, but the employer's workplace may remain open for other purposes or the employer is able to continue certain operations remotely, the employer's operations would be considered to be partially suspended. However, if all of an employer's business operations may continue, even if subject to modification (for example, to satisfy distancing requirements), such a modification of operations is not considered to be a partial suspension of business operations due to a governmental order, unless the modification required by the governmental order has more than a nominal effect on the business operations under the facts and circumstances.[7]

Again, the IRS provides a series of examples to apply these provisions.

EXAMPLE 1:

Employer F, a restaurant business, must close its restaurant to on-site dining due to a governmental order closing all restaurants, bars, and similar establishments for sit-down service. Employer F is allowed to continue food or beverage sales to the public on a carry-out, drive-through, or delivery basis. Employer F's business operations are considered to be partially suspended because a portion of its business operations – its indoor and outdoor dining service – is closed due to the governmental order.

EXAMPLE 2:

Same facts as Example 1, except that two months later, under a subsequent governmental order, Employer F is permitted to offer sit-down service in its outdoor space, but its indoor dining service continues to be closed. During the period in which Employer F is allowed to operate only its outdoor sit-down and carry-out service in accordance with the order, Employer F's business operations are considered to be partially suspended because, under the facts and circumstances, a more than nominal portion of its business operations – its indoor dining service—is closed due to a governmental order. The following month, under a

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[6] "COVID-19-Related Employee Retention Credits: Determining When an Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order FAQs," IRS website, June 19, 2020

[7] "COVID-19-Related Employee Retention Credits: Determining When an Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order FAQs," IRS website, June 19, 2020

further governmental order, Employer F is permitted to offer indoor dining service, in addition to outdoor sit-down and carry-out service, provided that all tables in the indoor dining room must be spaced at least six feet apart. Under the facts and circumstances, the governmental order restricting the spacing of tables limits Employer F's indoor dining service capacity and has more than a nominal effect on its business operations. During this period, Employer F's business operations continue to be considered to be partially suspended because the governmental order restricting its indoor dining service has more than a nominal effect on its operations.

EXAMPLE 3:

Employer G, a retail business, must close its retail storefront locations due to a governmental order. The retail business also maintains a website through which it continues to fulfill online orders; the retailer's online ordering and fulfillment system is unaffected by the governmental order. Employer G's business operations are considered to have been partially suspended due to the governmental order requiring it to close its retail store locations.

EXAMPLE 4:

Employer H, a hospital, is considered to be operating an essential business under a governmental order with respect to its emergency department, intensive care, and other services for conditions requiring urgent medical care. However, the governmental order treats Employer H's elective and non-urgent medical procedures as non-essential business operations and prevents Employer H from performing these services. Employer H suspends operations related to elective and non-urgent medical procedures. Although Employer H is an essential business, Employer H is considered to have a partial suspension of operations due to the governmental order that prevents Employer H from performing elective and non-urgent medical procedures.

EXAMPLE 5:

Employer I, a grocery store, is considered to be operating an essential business under a governmental order. However, the governmental order requires grocery stores to discontinue their self-serve offerings, such as salad bars, though they may offer prepared or prepackaged food. Employer I modifies its operations to close its salad bar and other self-serve offerings and instead offers prepackaged salads and other items. The governmental order requiring Employer I to discontinue its self-serve offerings does not have more than a nominal effect on Employer I's business operations under the facts and circumstances, even though Employer I was required to modify its business operations. Employer I's business operations are not considered to be partially suspended because the governmental order requiring closure of self-serve offerings does not have more than a nominal effect on its business operations.

EXAMPLE 6:

Employer J, a large retailer, is required to close its storefront location due to a governmental order, but is permitted to provide customers with curbside service to pick up items ordered online or by phone. During this period, Employer J's business operations are considered to have been partially suspended due to the governmental order requiring it to close its storefront location. Two months later, under a subsequent governmental order, Employer J is permitted to reopen its storefront location. Under the subsequent governmental order, however, Employer J must enforce social distancing guidelines that require Employer J to admit only a specified number of customers into the store per 1,000 square feet. While the

governmental order results in customers waiting in line for a short period of time to enter the store during certain busy times of the week, the size of Employer J's storefront location is large enough that it is able to accommodate all of its customers after these short waits outside the store. The governmental order requiring Employer J to enforce social distancing guidelines does not have more than a nominal effect on Employer J's business operations under the facts and circumstances, even though Employer J is required to modify its business operations. During this period, Employer J's business operations are not considered to be partially suspended because the governmental order requiring enforcement of social distancing guidelines does not have more than a nominal effect on its operations.[8]

Question 35 deals with orders that require an employer to reduce operating hours:

> **35. Are an employer's operations considered to be partially suspended for purposes of the Employee Retention Credit if the employer is required to reduce its operating hours by a governmental order? (updated June 19, 2020)**
>
> Yes. An employer that reduces its operating hours due to a governmental order is considered to have partially suspended its operations since the employer's operations have been limited by a governmental order.
>
> The employer may also be an Eligible Employer if it experiences a significant decline in gross receipts. For more information on what constitutes a significant decline in gross receipts, see Determining When an Employer is Considered to have a Significant Decline in Gross Receipts.[9]

Question 35 comes with a single example:

EXAMPLE:

Employer K operates a food processing facility that normally operates 24 hours a day. A governmental order issued by the local health department requires all food processing businesses to deep clean their workplaces once every 24 hours in order to reduce the risk of COVID-19 exposure. In order to comply with the governmental order, Employer K reduces its daily operating hours by five hours per day so that a deep cleaning may be conducted within

[8] "COVID-19-Related Employee Retention Credits: Determining When an Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order FAQs," IRS website, June 19, 2020

[9] "COVID-19-Related Employee Retention Credits: Determining When an Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order FAQs," IRS website, June 19, 2020

its workplace once every 24 hours. Employer K is considered to have partially suspended its operations due to the governmental order requiring it to reduce its hours of operation.[10]

Significant Decline in Gross Receipts

In the section of the FAQs dealing with a substantial decline in gross receipts, the IRS's changes only involved a single question. Question 46 deals with tax-exempt employers:

> **46. What are "gross receipts" for a tax-exempt employer? (updated June 19, 2020)**
>
> Solely for purposes of determining eligibility for the Employee Retention Credit, gross receipts for a tax-exempt employer include gross receipts from all operations, not only from activities that constitute unrelated trades or businesses. For example, gross receipts for this purpose include amounts received by the organization from total sales (net of returns and allowances) and all amounts received for services, whether or not those sales or services are substantially related to the organization's exercise or performance of the exempt purpose or function constituting the basis for its exemption. Gross receipts also include the organization's investment income, including from dividends, rents, and royalties, as well as the gross amount received as contributions, gifts, grants, and similar amounts, and the gross amount received as dues or assessments from members or affiliated organizations.
>
> To determine whether there has been a significant decline in gross receipts, a tax-exempt employer computes its gross receipts received from all of its operations during the calendar quarter and compares those gross receipts to the same gross receipts received for the same calendar quarter in 2019.[11]

Qualified Wages

In the FAQ dealing with qualified wages, the IRS revised guidance related to employees who are exempt from social security and Medicare taxes. Question 58 provides:

> **58. If an amount an Eligible Employer pays to an employee is exempt from social security and Medicare taxes, can the Eligible**

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[10] "COVID-19-Related Employee Retention Credits: Determining When an Employer's Trade or Business Operations are Considered to be Fully or Partially Suspended Due to a Governmental Order FAQs," IRS website, June 19, 2020

[11] "COVID-19-Related Employee Retention Credits: Determining When an Employer is Considered to have a Significant Decline in Gross Receipts and Maximum Amount of an Eligible Employer's Employee Retention Credit FAQs," IRS website, June 19, 2020

> **Employer still claim the Employee Retention Credit on the amount paid to that employee? (updated June 19, 2020)**
>
> No. The Employee Retention Credit is allowed on qualified wages paid to employees; an amount must constitute wages within the meaning of section 3121(a) of the Internal Revenue Code (the "Code") (or must constitute qualified health plan expenses allocable to such wages) in order to fall within the definition of qualified wages.[12]

The question illustrates the application of this rule with three examples.

EXAMPLE 1:

A church in State X employs an ordained minister; the minister is a common law employee of the church. The governor of State X issues an executive order limiting gatherings of more than 10 people. As a result, the church suspends Sunday worship services, but continues to pay the minister's salary and parsonage allowance. The minister's salary and parsonage allowance do not constitute wages within the meaning of section 3121(a) of the Code and therefore are not qualified wages for purposes of the Employee Retention Credit.

EXAMPLE 2:

A group of licensed real estate agents at Real Estate Brokerage Firm Y receive substantially all their payments for services directly related to home sales and perform services under a written contract providing that they will not be treated as employees for federal tax purposes. Therefore, the licensed real estate agents at Real Estate Brokerage Firm Y are treated as statutory nonemployees under the Code. Amounts paid to the licensed real estate agents at Real Estate Brokerage Firm Y do not constitute wages within the meaning of section 3121(a) of the Code and therefore are not qualified wages for purposes of the Employee Retention Credit.

EXAMPLE 3:

Employer Z offers its employees various benefits that provide for pre-tax salary reduction contributions, including a qualified 401(k) plan, a fully-insured group health plan, a dependent care assistance program satisfying the requirements of section 129 of the Internal Revenue Code (Code), and qualified transportation benefits satisfying the requirements of section 132(f) of the Code. Employer Z also makes matching and nonelective contributions to the qualified 401(k) plan and pays the portion of the cost of maintaining the group health plan remaining after the employees' share.

Employer Z may treat as qualified wages the amounts its employees contribute as pre-tax salary reduction contributions to the qualified 401(k) plan because those amounts are wages within the meaning of section 3121(a) of the Code.

Employer Z may also treat all amounts paid toward maintaining the group health plan (including any employee pre-tax salary reduction contribution) as qualified health plan expenses that may be allocated to wages. See "Does the amount of qualified health plan

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[12] "COVID-19-Related Employee Retention Credits: Determining Qualified Wages FAQs," IRS website, June 19, 2020, https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-determining-qualified-wages-faqs (retrieved June 26, 2020)

expenses include both the portion of the cost paid by the Eligible Employer and the portion of the cost paid by the employee?"

Employer Z may not treat as qualified wages the amounts Employer Z contributes as matching or nonelective contributions to the qualified 401(k) plan, nor may it treat as qualified wages any employee pre-tax salary reduction contributions toward the dependent care assistance program or qualified transportation benefits. These amounts do not constitute wages within the meaning of section 3121(a) of the Code and therefore are not qualified wages for purposes of the Employee Retention Credit.[13]

Use of Third-Party Payors

The IRS has issued revised guidance regarding the use of third-party payors in the June 19 FAQ revisions. Question 88 deals with the handling of Form 7200 by a third-party payor on behalf of a client:

> **88. May a payroll reporting agent sign and submit Form 7200 on behalf of a client? (updated June 19, 2020)**
>
> A payroll reporting agent (RA) may sign Form 7200, Advance Payment of Employer Credits Due to COVID-19, for a client for which it has the authority, via Form 8655, Reporting Agent Authorization, to sign and file the employment tax return (e.g., Form 941, Employer's Quarterly Federal Tax Return). The signatory must be the Principal or Responsible Official listed on the RA's e-file application. The signatory may sign with ink on paper or may use the alternative signature method (rubber stamp, mechanical device, or computer software program; for details and required documentation, see Rev. Proc. 2005-39, 2005-28 I.R.B. 82). Consistent with Rev. Proc. 2005-39, an alternative signature must be in the form of a facsimile signature. The RA will submit the form via fax to 855-248-0552.
>
> The RA must obtain written authorization from the client (paper, fax, or e-mail) to perform these actions regarding the Form 7200. The RA need not submit that authorization to the IRS, but should retain it in its files so that the RA can furnish it to the IRS upon request. For a client for which a third party does not have a Reporting Agent Authorization, it may complete and print the form, or it may provide the client a means to complete and print the form, but the client will have to sign it.
>
> The signatory for the RA must sign, date, and print his or her name in the relevant boxes on Form 7200. In the box, "Printed Title," the signatory must include the RA company name or name of business as it appeared on line 9 of the Form 8655. If the RA company name or

[13] "COVID-19-Related Employee Retention Credits: Determining Qualified Wages FAQs," IRS website, June 19, 2020

> name of business from the Form 8655 is missing, the Form 7200 cannot be processed.[14]

Question 90 discusses the extent to which a third-party payor can rely on information provided by a client in handling the ERC:

> **90. May third party payers rely on client employer information regarding the Employee Retention Credit? (updated June 19, 2020)**
>
> If a third party payer is claiming the Employee Retention Credit on behalf of the client employer, the third party payer may rely on the client employer's information regarding the client employer's eligibility to claim the Employee Retention Credit, and the client employer may maintain all records which substantiate the client's eligibility for the Employee Retention Credit.
>
> However, upon request by the IRS, the third party payer must obtain from the client employer and provide to the IRS records that substantiate the client's eligibility for the Employee Retention Credit. The client employer and the third party payer will each be liable for employment taxes that are due as a result of any improper claim of Employee Retention Credits that are improperly claimed in accordance with their liability under the Internal Revenue Code and applicable regulations for the employment taxes reported on the employment tax return filed by the third party payer on which the credit was claimed.[15]

The final new third-party payor guidance looks at avoiding claiming a "double benefit" for these wages by also claiming a credit under IRC §46S:

> **92. Are client employers responsible for avoiding a "double benefit" with respect to the Employee Retention Credit and the credit under section 45S of the Internal Revenue Code? (updated June 19, 2020)**
>
> Yes. The client employer is responsible for avoiding a "double benefit" with respect to the Employee Retention Credit and the credit under section 45S of the Internal Revenue Code. The client employer cannot use wages that were used to claim the Employee Retention

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[14] "COVID-19-Related Employee Retention Credits: Special Issues for Employers FAQs," IRS website, June 19, 2020, https://www.irs.gov/newsroom/covid-19-related-employee-retention-credits-special-issues-for-employers-faqs#income-and-deduction (retrieved June 26, 2020)

[15] "COVID-19-Related Employee Retention Credits: Special Issues for Employers FAQs," IRS website, June 19, 2020

Credit, and reported by the third-party payer on the client employer's behalf, to claim the 45S credit on its income tax return.[16]

SECTION: PPP LOAN
SBA UPDATES FORGIVENESS RULES FOR PPPFA, CLARIFIES LIMITS ON OWNER PAYROLL COSTS

Citation: RIN 1505-AC70, "Business Loan Program Temporary Changes; Paycheck Protection Program – Revisions to Loan Forgiveness Interim Final Rule and SBA Loan Review Procedures Interim Final Rule," Small Business Administration, 6/22/20

The Small Business Administration has issued another Interim Final Rule (IFR)[17] to take into account changes made in the PPP program due to the passage of the Paycheck Protection Program Flexibility Act (PPPFA). This IFR makes additions and revisions to guidance related to loan forgiveness and review of the application for forgiveness.

Some of the provisions of interest found in the new IFR include the following.

Payroll Costs – Owner-Employees and Self-Employed Individuals

The IFR contains revisions and clarifications to the new limitation on payroll costs incurred for owner-employees and self-employed individuals. Part III.3.c of the First Loan Forgiveness Rule (85 FR 33004, 33006) now reads as follows:

> *c. Are there caps on the amount of loan forgiveness available for owneremployees and self-employed individuals' own payroll compensation?*
>
> Yes. For borrowers that received a PPP loan before June 5, 2020 and elect to use an eight-week covered period, the amount of loan forgiveness requested for owner-employees and self-employed individuals' payroll compensation is capped at eight weeks' worth (8/52) of 2019 compensation (i.e., approximately 15.38 percent of

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[16] "COVID-19-Related Employee Retention Credits: Special Issues for Employers FAQs," IRS website, June 19, 2020

[17] RIN 1505-AC70, "Business Loan Program Temporary Changes; Paycheck Protection Program – Revisions to Loan Forgiveness Interim Final Rule and SBA Loan Review Procedures Interim Final Rule," Small Business Administration, June 22, 2020, https://home.treasury.gov/system/files/136/PPP--IFR--Revisions-to-Loan-Forgiveness-Interim-Final-Rule-and-SBA-Loan-Review-Procedures-Interim-Final-Rule.pdf (retrieved June 23, 2020)

2019 compensation) or $15,385 per individual, whichever is less, in total across all businesses. For all other borrowers, the amount of loan forgiveness requested for owner-employees and self-employed individuals' payroll compensation is capped at 2.5 months' worth (2.5/12) of 2019 compensation (i.e., approximately 20.83 percent of 2019 compensation) or $20,833 per individual, whichever is less, in total across all businesses.

In particular, C-corporation owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement and health insurance contributions made on their behalf. S-corporation owner-employees are capped by the amount of their 2019 employee cash compensation and employer retirement contributions made on their behalf, but employer health insurance contributions made on their behalf cannot be separately added because those payments are already included in their employee cash compensation. (emphasis added) Schedule C or F filers are capped by the amount of their owner compensation replacement, calculated based on 2019 net profit. General partners are capped by the amount of their 2019 net earnings from self-employment (reduced by claimed section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) multiplied by 0.9235. For self-employed individuals, including Schedule C or F filers and general partners, retirement and health insurance contributions are included in their net self-employment income and therefore cannot be separately added to their payroll calculation.

The Administrator, in consultation with the Secretary, determined that it is appropriate to limit the forgiveness of owner compensation to either eight weeks' worth (8/52) of their 2019 compensation (up to $15,385) for an eight-week covered period or 2.5 months' worth (2.5/12) of their 2019 compensation (up to $20,833) for a 24-week covered period per owner in total across all businesses. This approach is consistent with the structure of the CARES Act and its overarching focus on keeping workers paid, and will prevent windfalls that Congress did not intend. Specifically, Congress determined that the maximum loan amount is generally based on 2.5 months of a borrower's average monthly payroll costs during the one-year period preceding the loan. 15 U.S.C. 636(a)(36)(E). For example, a borrower with one other employee would receive a maximum loan amount equal to 5 months of payroll (2.5 months of payroll for the owner plus 2.5 months of payroll for the employee). If the owner laid off the employee and availed itself of the exemption in the Paycheck Protection Program Flexibility Act of 2020 (Flexibility Act) related to reductions in business activity described in e. below, the owner could treat the entire amount of the PPP loan as payroll, with the entire loan being forgiven. This would not only result in a windfall for the owner, by providing the owner with five months of payroll instead of 2.5 months, but also defeat the purpose of the CARES Act of protecting the paycheck of the employee. For owners with no employees, this

> limitation will have no effect, because the maximum loan amount for such borrowers already includes only 2.5 months of their payroll.[18]

The highlighted portion is an added clarification paragraph that indicates two things:

- "Owner-employees" is a class that includes shareholders in any corporation (C or S). Some advisers had continued to try and stake out a position from prior guidance that such individuals were not owner-employees under this guidance. The position had become far more tenuous over time as more guidance was published, and this appears to remove any argument that the SBA's rules don't' view these individuals as owner-employees.

- The covered fringe benefits for shareholders that aren't included in the cash compensation are apparently still limited by overall caps (8/52 of 2019 earnings or $20,833/$15,385). Prior guidance wasn't clear if such amounts were covered by the caps, or if the caps were limited to cash compensation. Some may still see some room for interpretation here, but the discussion seems to link all types of owner compensation into one testing basket.

Payroll Costs Eligible for Forgiveness – When Must They Be Incurred?

Due to the expansion of the covered period, the SBA has revised the guidance on when payroll costs must be incurred to qualify for forgiveness. Part III.3.a of the First Loan Forgiveness Rule (85 FR 33004, 33006) now reads as follows:

> *a. When must payroll costs be incurred and/or paid to be eligible for forgiveness?*
>
> In general, payroll costs paid or incurred during the covered period are eligible for forgiveness. For purposes of loan forgiveness, the covered period is the 24-week period beginning on the date the lender disburses the PPP loan. Alternatively, a borrower that received a PPP loan before June 5, 2020 may elect for the covered period to end eight weeks after the date of disbursement of the PPP loan.
>
> Borrowers may seek forgiveness for payroll costs for the applicable covered period beginning on either:
>
> > i. the date of disbursement of the borrower's PPP loan proceeds from the Lender (i.e., the start of the covered period); or
> >
> > ii. the first day of the first payroll cycle in the covered period (the "alternative payroll covered period").
>
> Payroll costs are considered paid on the day that paychecks are distributed or the borrower originates an ACH credit transaction. Payroll costs incurred during the borrower's last pay period of the

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[18] RIN 1505-AC70, section 1d

covered period or the alternative payroll covered period are eligible for forgiveness if paid on or before the next regular payroll date; otherwise, payroll costs must be paid during the covered period (or alternative payroll covered period) to be eligible for forgiveness. Payroll costs are generally incurred on the day the employee's pay is earned (i.e., on the day the employee worked). For employees who are not performing work but are still on the borrower's payroll, payroll costs are incurred based on the schedule established by the borrower (typically, each day that the employee would have performed work).

The Administrator of the Small Business Administration (Administrator), in consultation with the Secretary of the Treasury (Secretary), recognizes that the covered period will not always align with a borrower's payroll cycle. For administrative convenience of the borrower, a borrower with a bi-weekly (or more frequent) payroll cycle may elect to use an alternative payroll covered period that begins on the first day of the first payroll cycle in the covered period and continues for either (a) eight weeks, in the case of a borrower that received its PPP loan before June 5, 2020 and elects to use an eight-week covered period, or (b) 24 weeks, in the case of all other borrowers. If payroll costs are incurred during this alternative payroll covered period, but paid after the end of the alternative payroll covered period, such payroll costs will be eligible for forgiveness if they are paid no later than the first regular payroll date thereafter. The Administrator, in consultation with the Secretary, determined that this alternative computational method for payroll costs is justified by considerations of administrative feasibility for borrowers, as it will reduce burdens on borrowers and their payroll agents while achieving the paycheck protection purposes manifest throughout the CARES Act, including section 1102. Because this alternative computational method is limited to payroll cycles that are bi-weekly or more frequent, this computational method will yield a calculation that the Administrator does not expect to materially differ from the actual covered period, while avoiding unnecessary administrative burdens and enhancing auditability.

Example: A borrower that received a PPP loan before June 5, 2020 and elects to use an eight-week covered period has a bi-weekly payroll schedule (with payments made every other week). The borrower's eight-week covered period begins on June 1 and ends on July 26. The first day of the borrower's first payroll cycle that starts in the covered period is June 7. The borrower may elect an alternative payroll covered period for payroll cost purposes that starts on June 7 and ends 55 days later (for a total of 56 days), on August 1. Payroll costs paid during this alternative payroll covered period are eligible for forgiveness. In addition, payroll costs incurred during this alternative payroll covered period are eligible for forgiveness if they are paid on or before the first regular payroll date occurring after August 1. Payroll costs that were

> both paid and incurred during the covered period (or alternative payroll covered period) may only be counted once.[19]

In a footnote to this revision, the SBA reminds borrowers that "the loan forgiveness covered period of any borrower will end no later than December 31, 2020."[20]

Non-Payroll Costs

The IFR makes changes to Part III.4.a of the First Loan Forgiveness Rule (85 FR 33004, 33007) to take into account the longer 24-week covered period:

> *a. When must nonpayroll costs be incurred and/or paid to be eligible for forgiveness?*
>
> A nonpayroll cost is eligible for forgiveness if it was:
>
> > i. paid during the covered period; or
> >
> > ii. incurred during the covered period and paid on or before the next regular billing date, even if the billing date is after the covered period.
>
> Example: A borrower that received a loan before June 5, 2020 uses a 24-week covered period that begins on June 1 and ends on November 15. The borrower pays its electricity bills for June through October during the covered period and pays its November electricity bill on December 10, which is the next regular billing date. The borrower may seek loan forgiveness for its June through October electricity bills, because they were paid during the covered period. In addition, the borrower may seek loan forgiveness for the portion of its November electricity bill through November 15 (the end of the covered period), because it was incurred during the covered period and paid on the next regular billing date.
>
> The Administrator, in consultation with the Secretary, has determined that this interpretation provides an appropriate degree of borrower flexibility while remaining consistent with the text of section 1106(b). The Administrator believes that this simplified approach to calculation of forgivable nonpayroll costs is also supported by considerations of administrative convenience for borrowers, and the Administrator notes that the 40 percent cap on nonpayroll costs as a portion of the total loan forgiveness amount will avoid excessive inclusion of nonpayroll costs.[21]

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[19] RIN 1505-AC70, section 1d

[20] RIN 1505-AC70, section 1d

[21] RIN 1505-AC70, section 1e

Reductions to Loan Forgiveness Amounts – Prior Guidance

The extension of the covered period, along with other changes, made by the PPPFA required certain changes to be made to guidance related to the reduction in loan forgiveness guidance in Part III.5 of the First Loan Forgiveness Rule. The introductory paragraph in Part III.5 of the First Loan Forgiveness Rule (85 FR 33004, 33007) now reads:

> *5. Reductions to Loan Forgiveness Amount*
>
> Section 1106 of the CARES Act, as amended by Section 3(b)(2) of the Flexibility Act, specifically requires certain reductions in a borrower's loan forgiveness amount based on reductions in full-time equivalent employees or in employee salary and wages, subject to an important statutory exemption for borrowers that have eliminated the reduction on or before December 31, 2020. Section 3(b)(2) of the Flexibility Act also adds exemptions from reductions in loan forgiveness amounts based on employee availability and business activity. In addition, SBA and Treasury have adopted a regulatory exemption to the reduction rules for borrowers that have offered to restore employee hours at the same salary or wages, even if the employees have not accepted. The instructions to the loan forgiveness applications and the guidance below explains how the statutory forgiveness reduction formulas work.[22]

The examples in Part III.5.e of the First Loan Forgiveness Rule (85 FR 33004, 33008) are revised and now read:

> Example: A borrower is using a 24-week covered period. This borrower reduced a full-time employee's weekly salary from $1,000 per week during the reference period to $700 per week during the covered period. The employee continued to work on a full-time basis during the covered period, with an FTE of 1.0. In this case, the first $250 (25 percent of $1,000) is exempted from the loan forgiveness reduction. The borrower seeking forgiveness would list $1,200 as the salary/hourly wage reduction for that employee (the extra $50 weekly reduction multiplied by 24 weeks). If the borrower applies for forgiveness before the end of the covered period, it must account for the salary reduction for the full 24-week covered period (totaling $1,200).
>
> Example: A borrower that received a PPP loan before June 5, 2020 has elected to use an eight-week covered period. This borrower reduced a full-time employee's weekly salary from $1,000 per week during the reference period to $700 per week during the covered period. The employee continued to work on a full-time basis during the covered period, with an FTE of 1.0. In this case, the first $250 (25 percent of $1,000) is exempted from the loan forgiveness reduction.

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[22] RIN 1505-AC70, section 1f

The borrower seeking forgiveness would list $400 as the salary/hourly wage reduction for that employee (the extra $50 weekly reduction multiplied by eight weeks).[23]

Reductions to Loan Forgiveness – New PPPFA Provisions

The PPPFA added a pair of new exceptions to the reduction in loan forgiveness. As the IFR notes:

> …[S]ection 3(b)(2)(B) of the Flexibility Act established two new exemptions based on employee availability and business activity, respectively, that would eliminate a reduction in the loan forgiveness amount that would otherwise be required due to a reduction in full-time equivalent (FTE) employees. Specifically, that section of the Flexibility Act states that the amount of loan forgiveness "shall be determined without regard to a proportional reduction in the number of full-time equivalent employees" if an eligible recipient, in good faith, (A) is able to document (i) an inability to rehire individuals who were employees of the eligible recipient on February 15, 2020; and (ii) an inability to hire similarly qualified employees for unfilled positions on or before December 31, 2020; or (B) is able to document an inability to return to the same level of business activity as such business was operating at before February 15, 2020, due to compliance with requirements established or guidance issued by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration during the period beginning on March 1, 2020, and ending December 31, 2020, related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID–19.[24]

The SBA had already provided a rule that covered the situation where an employee refused an offer of employment, which would seem similar to the "inability to rehire" provision in PPPFA, but the SBA decided to retain portions of the original rule as well as add guidance for the new one. The IFR states:

> The new exemption pertaining to individuals who refuse an offer to be rehired is very similar, but not identical, to a de minimis exemption that was provided in the First Loan Forgiveness Rule; therefore, the Administrator and the Secretary have determined that this new statutory exemption should supersede the previous de minimis exemption relating to reductions in FTE employees. However, a related de minimis exemption in the First Loan Forgiveness Rule for borrowers that have reduced the hours of an employee and offered to

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[23] RIN 1505-AC70, section 1f

[24] RIN 1505-AC70, section 1f

> restore the reduction in hours, but the employee declined the offer, is not addressed in the Flexibility Act and is therefore being retained. [25]

Thus, Part III.5.a of the First Loan Forgiveness Rule (85 FR 33004, 33007) now reads:

> *a. Will a borrower's loan forgiveness amount be reduced if the borrower reduced the hours of an employee, then offered to restore the reduction in hours, but the employee declined the offer?*
>
> No. In calculating the loan forgiveness amount, a borrower may exclude any reduction in full-time equivalent employee headcount that is attributable to an individual employee if:
>
> > i. The borrower made a good faith, written offer to restore the reduced hours of such employee;
> >
> > ii. the offer was for the same salary or wages and same number of hours as earned by such employee in the last pay period prior to the reduction in hours;
> >
> > iii. the offer was rejected by such employee; and
> >
> > iv. the borrower has maintained records documenting the offer and its rejection.
>
> The Administrator and the Secretary determined that this exemption is an appropriate exercise of their joint rulemaking authority to grant a de minimis exemption under section 1106(d)(6). Section 1106(d)(2) of the CARES Act reduces the amount of the PPP loan that may be forgiven if the borrower reduces full-time equivalent employees during the covered period as compared to a base period selected by the borrower. Section 1106(d)(5) of the CARES Act waives this reduction in the forgiveness amount if the borrower eliminates the reduction in full-time equivalent employees occurring during a different statutory reference period by not later than December 31, 2020. The Administrator and the Secretary believe that the additional exemption set forth above is consistent with the purposes of the CARES Act and provides borrowers appropriate flexibility in the current economic climate. The Administrator, in consultation with the Secretary, has determined that the exemption is de minimis for two reasons. First, it is reasonable to anticipate that most employees will accept the offer of restored hours in light of current labor market conditions. Second, to the extent this exemption allows employers to cure FTE reductions attributable to reductions in hours that occurred before February 15, 2020 (the start of the statutory FTE reduction safe harbor period), it is reasonable to anticipate those reductions will represent a relatively

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[25] RIN 1505-AC70, section 1f

> small portion of aggregate employees given the historically strong labor market conditions before the COVID–19 emergency. [26]

The IFR also revises Part III.5.b of the First Loan Forgiveness Rule (85 FR 33004, 33007-08) by adding the following to theh end:

> Borrowers are exempted from the loan forgiveness reduction arising from a proportional reduction in FTE employees during the covered period if the borrower is able to document in good faith the following: (1) an inability to rehire individuals who were employees of the borrower on February 15, 2020; and (2) an inability to hire similarly qualified individuals for unfilled positions on or before December 31, 2020. Borrowers are required to inform the applicable state unemployment insurance office of any employee's rejected rehire offer within 30 days of the employee's rejection of the offer. The documents that borrowers should maintain to show compliance with this exemption include, but are not limited to, the written offer to rehire an individual, a written record of the offer's rejection, and a written record of efforts to hire a similarly qualified individual. Borrowers are also exempted from the loan forgiveness reduction arising from a reduction in the number of FTE employees during the covered period if the borrower is able to document in good faith an inability to return to the same level of business activity as the borrower was operating at before February 15, 2020, due to compliance with requirements established or guidance issued between March 1, 2020 and December 31, 2020 by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention (CDC), or the Occupational Safety and Health Administration related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19 (COVID Requirements or Guidance). Specifically, borrowers that can certify that they have documented in good faith that their reduction in business activity during the covered period stems directly or indirectly from compliance with such COVID Requirements or Guidance are exempt from any reduction in their forgiveness amount stemming from a reduction in FTE employees during the covered period. Such documentation must include copies of applicable COVID Requirements or Guidance for each business location and relevant borrower financial records.
>
> The Administrator, in consultation with the Secretary, is interpreting the above statutory exemption to include both direct and indirect compliance with COVID Requirements or Guidance, because a significant amount of the reduction in business activity stemming from COVID Requirements or Guidance is the result of state and local government shutdown orders that are based in part on guidance from the three federal agencies.

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[26] RIN 1505-AC70, section 1f

> Example: A PPP borrower is in the business of selling beauty products both online and at its physical store. During the covered period, the local government where the borrower's store is located orders all non-essential businesses, including the borrower's business, to shut down their stores, based in part on COVID-19 guidance issued by the CDC in March 2020. Because the borrower's business activity during the covered period was reduced compared to its activity before February 15, 2020 due to compliance with COVID Requirements or Guidance, the borrower satisfies the Flexibility Act's exemption and will not have its forgiveness amount reduced because of a reduction in FTEs during the covered period, if the borrower in good faith maintains records regarding the reduction in business activity and the local government's shutdown orders that reference a COVID Requirement or Guidance as described above. [27]

Of particular interest is the fact that if an employer is covered by an order to close their business, that does count as an action that serves to reduce the need to maintain FTEs.

General Process for Loan Forgiveness

The IFR revises the guidance found at Part III.2 of the First Loan Forgiveness Rule (85 FR 33004, 33005) to read as follows:

> *a. What is the general process to obtain loan forgiveness?*
>
> To receive loan forgiveness, a borrower must complete and submit the Loan Forgiveness Application (SBA Form 3508, 3508EZ, or lender equivalent) to its lender (or the lender servicing its loan). As a general matter, the lender will review the application and make a decision regarding loan forgiveness. The lender has 60 days from receipt of a complete application to issue a decision to SBA. If the lender determines that the borrower is entitled to forgiveness of some or all of the amount applied for under the statute and applicable regulations, the lender must request payment from SBA at the time the lender issues its decision to SBA. SBA will, subject to any SBA review of the loan or loan application, remit the appropriate forgiveness amount to the lender, plus any interest accrued through the date of payment, not later than 90 days after the lender issues its decision to SBA. If applicable, SBA will deduct EIDL Advance Amounts from the forgiveness amount remitted to the Lender as required by section 1110(e)(6) of the CARES Act. If SBA determines in the course of its review that the borrower was ineligible for the PPP loan based on the provisions of the CARES Act, SBA rules or guidance available at the time of the borrower's loan application, or the terms of the borrower's PPP loan application (for example, because the borrower lacked an adequate basis for the certifications that it made in its PPP loan application), the loan will not be eligible for loan forgiveness. The lender is responsible for notifying the borrower of the forgiveness

[27] RIN 1505-AC70, section 1f

> amount. If only a portion of the loan is forgiven, or if the forgiveness request is denied, any remaining balance due on the loan must be repaid by the borrower on or before the maturity date of the loan. The lender is responsible for notifying the borrower of remittance by SBA of the loan forgiveness amount (or that SBA determined that no amount of the loan is eligible for forgiveness) and the date on which the borrower's first payment is due, if applicable. If SBA determines that the full amount of the loan is eligible for forgiveness and remits the full amount of the loan to the lender, the lender must mark the PPP loan note as "paid in full" and report the status of the loan as "paid in full" on the next monthly 1502 report filed by the lender.
>
> The general loan forgiveness process described above applies only to loan forgiveness applications that are not reviewed by SBA prior to the lender's decision on the forgiveness application. A separate interim final rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities describes SBA's procedures for reviewing PPP loan applications and loan forgiveness applications.[28]

The changes in this provision are mainly to conform the regulations to new deferral period and to take into account the new Form 3805EZ the SBA has issued.

Deferral Period and Forgiveness

The PPPFA extended the deferral period generally until the borrower receives a decision on forgiveness but added a provision that if the borrower does not apply for forgiveness within 10 months of the end of the covered period the deferral period ends. Part III.2 of the First Loan Forgiveness Rule (85 FR 33004) is revised to add the following new paragraph b at the end of the Part:

> *b. When must a borrower apply for loan forgiveness or start making payments on a loan?*
>
> A borrower may submit a loan forgiveness application any time on or before the maturity date of the loan – including before the end of the covered period – if the borrower has used all of the loan proceeds for which the borrower is requesting forgiveness. If the borrower applies for forgiveness before the end of the covered period and has reduced any employee's salaries or wages in excess of 25 percent, the borrower must account for the excess salary reduction for the full 8-week or 24-week covered period, as described in Part III.5. If the borrower does not apply for loan forgiveness within 10 months after the last day of the covered period, or if SBA determines that the loan is not eligible for forgiveness (in whole or in part), the PPP loan is no longer deferred and the borrower must begin paying principal and interest. If this occurs, the lender must notify the borrower of the date the first payment is due. The lender must report that the loan is no longer

[28] RIN 1505-AC70, section 1b

> deferred to SBA on the next monthly SBA Form 1502 report filed by the lender.[29]

Note that, for the first time, the SBA makes it clear that a borrower can apply for forgiveness at any time after the borrower has expended all of the funds, even if that is before the end of the appropriate covered period.

SECTION: 199A
NEW §199A FINAL REGULATIONS DEAL WITH DISALLOWED LOSSES, MUTUAL FUNDS AND TRUSTS

Citation: TD 9899, 6/24/20

Although many have forgotten about it by now, the IRS had not yet finalized all of the regulations under IRC §199A. In TD 9899[30] the IRS has now issued additional final regulations dealing with the qualified business income deduction under IRC §199A.

The new regulations deal with the following issues:

- Treatment of previously suspended losses included in QBI;
- Registered investment companies (RICs) with interests in publicly traded partnerships (PTPs) and real estate investment trusts (REITs); and
- Special rules for trusts and estates related to separate shares and charitable remainder trusts.

While the regulations will generally be effective first for calendar year 2021 year tax returns, taxpayers are allowed to rely upon these regulations for preparing returns for earlier years so long as the rules are applied consistently.

Treatment of Previously Suspended Losses – General Rules

While the IRS had dealt with the issue of previously suspended losses in the original final regulations at Reg. §1.199A-3(b)(1)(iv), the IRS proposed to expand the guidance as discussed below in the preamble to the final regulations:

> Section 1.199A-3(b)(1)(iv) of the February 2019 Final Regulations provides that previously disallowed losses or deductions (including under sections 465, 469, 704(d), and 1366(d)) allowed in the taxable year are generally taken into account for purposes of computing QBI,

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[29] RIN 1505-AC70, section 1c

[30] TD 9899, 6/24/20 (scheduled for publication in the *Federal Register* on June 25, 2020), https://s3.amazonaws.com/public-inspection.federalregister.gov/2020-11832.pdf?utm_medium=email&utm_campaign=pi+subscription+mailing+list&utm_source=federalregister.gov (retrieved June 24, 2020)

> except to the extent the losses or deductions were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018. These losses are used, for purposes of section 199A, in order from the oldest to the most recent on a first-in, first-out (FIFO) basis. The February 2019 Proposed Regulations expanded this rule to provide that previously disallowed losses or deductions are treated as losses from a separate trade or business in the year they are taken into account in determining taxable income. Further, the attributes of the previously disallowed losses or deductions, including whether they are attributable to a trade or business and whether they would otherwise be included in QBI, are determined in the year the loss or deduction is incurred.[31]

The IRS notes that some individuals had expressed concern that §461(l) was not listed in the original final regulations. In these new final regulations, the IRS expands the list and clarifies that the list is not all inclusive:

> Previously disallowed losses or deductions allowed in the taxable year generally are taken into account for purposes of computing QBI to the extent the disallowed loss or deduction is otherwise allowed by section 199A. These previously disallowed losses include, but are not limited to losses disallowed under sections 461(l), 465, 469, 704(d), and 1366(d). These losses are used for purposes of section 199A and this section in order from the oldest to the most recent on a first-in, first-out (FIFO) basis and are treated as losses from a separate trade or business. To the extent such losses relate to a PTP, they must be treated as a loss from a separate PTP in the taxable year the losses are taken into account. However, losses or deductions that were disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018 (including under sections 465, 469, 704(d), and 1366(d)), are not taken into account in a subsequent taxable year for purposes of computing QBI.[32]

The regulations also clarify the treatment of a partial disallowance of a deduction that relates to QBI:

> If a loss or deduction attributable to a trade or business is only partially allowed during the taxable year in which incurred, only the portion of the allowed loss or deduction that is attributable to QBI will be considered in determining QBI from the trade or business in the year the loss or deduction is incurred. The portion of the allowed loss or deduction attributable to QBI is determined by multiplying the total amount of the allowed loss by a fraction, the numerator of which is the portion of the total loss incurred during the taxable year that is

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[31] TD 9899, SUPPLEMENTARY INFORMATION, Summary of Comments and Explanation of Revisions, Section I

[32] Reg. §1.199A-3(b)(1)(iv)(A)

> attributable to QBI and the denominator of which is the amount of the total loss incurred during the taxable year.[33]

EXAMPLE 1, REG. §1.199A-3(B)(1)(IV)(D)

A is an unmarried individual and a 50% owner of LLC, an entity classified as a partnership for Federal income tax purposes. In 2018, A's allocable share of loss from LLC is $100,000 of which $80,000 is negative QBI. Under section 465, $60,000 of the allocable loss is allowed in determining A's taxable income. A has no other previously disallowed losses under section 465 or any other provision of the Code for 2018 or prior years. Because 80% of A's allocable loss is attributable to QBI ($80,000/$100,000), A will reduce the amount A takes into account in determining QBI proportionately. Thus, A will include $48,000 of the allowed loss in negative QBI (80% of $60,000) in determining A's section 199A deduction in 2018. The remaining $32,000 of negative QBI is treated as negative QBI from a separate trade or business for purposes of computing the section 199A deduction in the year the loss is taken into account in determining taxable income as described in §1.199A-1(d)(2)(iii).

The regulations on disallowed losses are effective for tax years beginning after August 24, 2020, based on the scheduled publication date in the *Federal Register*.[34]

Disallowed Losses from a Specified Service Trade or Business (SSTB)

The regulations also deal with the issue of how to handle a disallowed loss from a specified service trade or business (SSTB). The regulation provides that, in general, "[w]hether a disallowed loss or deduction is attributable to a trade or business, and otherwise meets the requirements of this section, is determined in the year the loss is incurred."[35]

The IRS uses this rule to decide that the impact of the limitations on inclusion of QBI items from an SSTB has to be determined in the year the loss is incurred. The regulations provide:

> If a disallowed loss or deduction is attributable to a specified service trade or business (SSTB), whether an individual has taxable income at or below the threshold amount as defined in §1.199A-1(b)(12), within the phase-in range as defined in §1.199A-1(b)(4), or in excess of the phase-in range is determined in the year the loss or deduction is incurred. If the individual's taxable income is at or below the threshold amount in the year the loss or deduction is incurred, the entire disallowed loss or deduction must be taken into account when applying paragraph (b)(1)(iv)(A) of this section. If the individual's taxable income is within the phase-in range, then only the applicable percentage, as defined in §1.199A-1(b)(2), of the disallowed loss or deduction is taken into account when applying paragraph (b)(1)(iv)(A)

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[33] Reg. §1.199A-3(b)(1)(iv)(B)

[34] Reg. §1.199A-3(e)(2)(iii)

[35] Reg. §1.199A-3(b)(1)(iv)(C)(1)

> of this section. If the individual's taxable income exceeds the phase-in range, none of the disallowed loss or deduction will be taken into account in applying paragraph (b)(1)(iv)(A) of this section.[36]

EXAMPLE 2, REG. §1.199A-3(B)(1)(IV)(D)

B is an unmarried individual and a 50% owner of LLC, an entity classified as a partnership for Federal income tax purposes. After allowable deductions other than the section 199A deduction, B's taxable income for 2018 is $177,500. In 2018, LLC has a single trade or business that is an SSTB. B's allocable share of loss is $100,000, all of which is suspended under section 465. B's allocable share of negative QBI is also $100,000. B has no other previously disallowed losses under section 465 or any other provision of the Code for 2018 or prior years. Because the entire loss is suspended, none of the negative QBI is taken into account in determining B's section 199A deduction for 2018. Further, because the negative QBI is from an SSTB and B's taxable income before the section 199A deduction is within the phase-in range, B must determine the applicable percentage of the negative QBI that must be taken into account in the year that the loss is taken into account in determining taxable income. B's applicable percentage is 100% reduced by 40% (the percentage equal to the amount that B's taxable income for the taxable year exceeds B's threshold amount ($20,000=$177,500-$157,500) over $50,000). Thus, B's applicable percentage is 60%. Therefore, B will have $60,000 (60% of $100,000) of negative QBI from a separate trade or business to be applied proportionately to QBI in the year(s) the loss is taken into account in determining taxable income, regardless of the amount of taxable income and how rules under §1.199A-5 apply in the year the loss is taken into account in determining taxable income.

These regulations impacting SSTB disallowed losses are effective for tax years beginning after August 24, 2020, based on the scheduled publication date in the *Federal Register*. [37]

Dividends Paid by a Registered Investment Company (RIC)

The regulations also give details on the treatment of dividends paid by a regulated investment company (RIC), more commonly referred to as a mutual fund.

In addition to giving detailed rules the mutual fund will use to compute the amount of the §199A dividends reported to shareholders[38] that will primarily be of interest to those who handle tax reporting for such funds (and is beyond the scope of this article's more general audience), the regulations give details on reporting of such dividends by shareholders that will be of more general interest.

The final regulations note that a shareholder of the fund who receives a §199A dividend from the fund treats the dividend as a qualified REIT dividend under the rules for

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[36] Reg. §1.199A-3(b)(1)(iv)(C)(2)

[37] Reg. §1.199A-3(e)(2)(iii)

[38] Reg. §1.199A-3(d)(2)

§199A.[39] However, the regulations note that in the following cases the shareholder is *not* allowed to treat the dividend as a §199A REIT dividend:

- The RIC stock is held by the shareholder for 45 days or less (taking into account the principles of section 246(c)(3) and (4)) during the 91-day period beginning on the date which is 45 days before the date on which the share becomes ex-dividend with respect to such dividend; or

- To the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.[40]

The regulations impacting RICs are effective for tax years beginning after August 24, 2020, based on the scheduled publication date in the *Federal Register*. [41]

Separate Shares in Trusts or Estates

The regulations clarify the treatment of a trust or estate if the trust or estate has separate shares for tax purposes as defined at IRC §663(c). The new regulations provide:

> In the case of a trust or estate described in section 663(c) with substantially separate and independent shares for multiple beneficiaries, such trust or estate will be treated as a single trust or estate for purposes of determining whether the taxable income of the trust or estate exceeds the threshold amount; determining taxable income, net capital gain, net QBI, W-2 wages, UBIA of qualified property, qualified REIT dividends, and qualified PTP income for each trade or business of the trust and estate; and computing the W-2 wage and UBIA of qualified property limitations. The allocation of these items to the separate shares of a trust or estate will be governed by the rules under §§1.663(c)-1 through 1.663(c)-5, as they may be adjusted or clarified by publication in the Internal Revenue Bulletin (see §601.601(d)(2)(ii)(b) of this chapter).[42]

The regulations impacting separate shares are effective for tax years beginning after August 24, 2020, based on the scheduled publication date in the *Federal Register*.[43]

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[39] Reg. §1.199A-3(d)(4)(i)

[40] Reg. §1.199A-3(d)(4)(ii)

[41] Reg. §1.199A-3(e)(2)(iv)

[42] Reg. §1.199A-6(d)(3)(iii)

[43] Reg. §1.199A-6(e)(2)(iii)

Charitable Remainder Trusts

While the charitable remainder trust does not itself qualify to claim a deduction under §199A, the regulations provide that a taxable recipient of a unitrust or annuity amount may qualify for a deduction.

The regulations provide:

> A charitable remainder trust described in section 664 is not entitled to and does not calculate a section 199A deduction, and the threshold amount described in section 199A(e)(2) does not apply to the trust. However, any taxable recipient of a unitrust or annuity amount from the trust must determine and apply the recipient's own threshold amount for purposes of section 199A taking into account any annuity or unitrust amounts received from the trust. A recipient of a unitrust or annuity amount from a trust may take into account QBI, qualified REIT dividends, or qualified PTP income for purposes of determining the recipient's section 199A deduction for the taxable year to the extent that the unitrust or annuity amount distributed to such recipient consists of such section 199A items under §1.664-1(d).[44]

The regulation illustrates the application of this provision as follows:

> For example, if a charitable remainder trust has investment income of $500, qualified dividend income of $200, and qualified REIT dividends of $1,000, and distributes $1,000 to the recipient, the trust would be treated as having income in two classes within the category of income, described in §1.664-1(d)(1)(i)(a)(1), for purposes of §1.664-1(d)(1)(ii)(b). Because the annuity amount first carries out income in the class subject to the highest income tax rate, the entire annuity payment comes from the class with the investment income and qualified REIT dividends. Thus, the charitable remainder trust would be treated as distributing a proportionate amount of the investment income ($500/(1,000+500)*1,000 = $333) and qualified REIT dividends ($1000/(1,000+500)*1000 = $667) because the investment income and qualified REIT dividends are taxed at the same rate and within the same class, which is higher than the rate of tax for the qualified dividend income in a separate class. The charitable remainder trust in this example would not be treated as distributing any of the qualified dividend income until it distributed all the investment income and qualified REIT dividends (more than $1,500 in total) to the recipient.[45]

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[44] Reg. §1.199A-6(d)(3)(v)

[45] Reg. §1.199A-6(d)(3)(v)

If more than one individual receives such a distribution during the year, there is a proportionate allocation of affected amounts:

> To the extent that a trust is treated as distributing QBI, qualified REIT dividends, or qualified PTP income to more than one unitrust or annuity recipient in the taxable year, the distribution of such income will be treated as made to the recipients proportionately, based on their respective shares of total QBI, qualified REIT dividends, or qualified PTP income distributed for that year. The trust allocates and reports any W-2 wages or UBIA of qualified property to the taxable recipient of the annuity or unitrust interest based on each recipient's share of the trust's total QBI (whether or not distributed) for that taxable year.[46]

Again, the regulation provides an illustration of such an allocation:

> Accordingly, if 10 percent of the QBI of a charitable remainder trust is distributed to the recipient and 90 percent of the QBI is retained by the trust, 10 percent of the W-2 wages and UBIA of qualified property is allocated and reported to the recipient and 90 percent of the W-2 wages and UBIA of qualified property is treated as retained by the trust. However, any W-2 wages retained by the trust cannot be used to compute W-2 wages in a subsequent taxable year for section 199A purposes.[47]

The regulation also notes that such a trust with QBI may also run into issues with unrelated business taxable income:

> Any QBI, qualified REIT dividends, or qualified PTP income of the trust that is unrelated business taxable income is subject to excise tax and that tax must be allocated to the corpus of the trust under §1.664-1(c).[48]

The regulations impacting charitable remainder trusts are effective for tax years beginning after August 24, 2020, based on the scheduled publication date in the *Federal Register*.[49]

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[46] Reg. §1.199A-6(d)(3)(v)

[47] Reg. §1.199A-6(d)(3)(v)

[48] Reg. §1.199A-6(d)(3)(v)

[49] Reg. §1.199A-6(e)(2)(iv)

SECTION: 274
REMEMBER THE PARKING LOT TAX? IRS ISSUES PROPOSED REGULATIONS ON POST-TCJA QUALIFIED TRANSPORTATION EXPENSES

Citation: REG-119307-19, 6/19/20

The IRS has returned to the issue of qualified transportation fringes, including more detailed guidance on the implementation of the "parking lot tax," in proposed regulations.[50] The parking lot tax portion of the regulations build on the safe harbor calculation the IRS provided in Notice 2018-99, adding two additional simplified computations for disallowed parking costs.

The regulations cover any *qualified transportation fringe* which is defined as any of the following:

- Transportation in a commuter highway vehicle if such transportation is in connection with travel between the employee's residence and place of employment (as described in sections 132(f)(1)(A) and 132(f)(5)(B));
- Any transit pass (as described in sections 132(f)(1)(B) and 132(f)(5)(A)); or
- Qualified parking (as described in sections 132(f)(1)(C) and 132(f)(5)(C))[51]

Under §274(a)(4), enacted as part of the Tax Cuts and Jobs Act, no income tax deduction is allowed "for the expense of any qualified transportation fringe (as defined in section 132(f)) provided to an employee of the taxpayer."

Determining the amount of the denied expense deduction is the purpose of these proposed regulations. Proposed Reg. §1.274-13 deals primarily with qualified parking expenses, while Proposed Reg. §1.274-14 deals with other transportation and commuting expenses.

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[50] REG-119307-19, June 19, 2020, https://s3.amazonaws.com/public-inspection.federalregister.gov/2020-13506.pdf?utm_medium=email&utm_campaign=pi+subscription+mailing+list&utm_source=federalregister.gov (retrieved June 19, 2020)

[51] Proposed Reg. §1.274-13(b)(1)

Effective Date

Although these regulations would only mandatorily apply to taxable years beginning on or after the date the rules are published as final in the *Federal Register*, the preamble provides that, pending issuance of final regulations:

> … a taxpayer may rely on these proposed regulations for QTF expenses and transportation and commuting expenses, as applicable, that are paid or incurred in taxable years beginning after December 31, 2017. Alternatively, a taxpayer may choose to rely on the guidance in Notice 2018-99 until these proposed regulations are finalized.[52]

Definitions

The proposed regulations start with the following key definitions that apply generally for parking QTFs, with key portions highlighted:

- **Employee** - The term employee means a common law employee or other statutory employee, such as an officer of a corporation, who is currently employed by the taxpayer. *Partners, 2-percent shareholders of S corporations, sole proprietors, and independent contractors are not employees of the taxpayer for purposes of this section.*[53]

- **Parking facility** - The term parking facility includes indoor and outdoor garages and other structures, as well as parking lots and other areas, where a taxpayer provides qualified parking to one or more of its employees. The term parking facility may include one or more parking facilities but does not include parking spaces on or near property used by an employee for residential purposes.[54]

- **Total parking expenses** - The term total parking expenses means all expenses of the taxpayer related to total parking spaces in a parking facility including, but not limited to, repairs, maintenance, utility costs, insurance, property taxes, interest, snow and ice removal, leaf removal, trash removal, cleaning, landscape costs, parking lot attendant expenses, security, and rent or lease payments or a *portion of a rent or lease payment (if not broken out separately). A deduction for an allowance for depreciation on a parking facility owned by a taxpayer and used for parking by the taxpayer's employees is an allowance for the exhaustion, wear and tear, and obsolescence of property, and not included in total parking expenses for purposes of this section.* Expenses paid or incurred for nonparking facility property, including items related to property next to the parking facility, such as landscaping or lighting, also are not included in total parking expenses.[55]

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[52] Preamble to REG-119307-19, SUPPLEMENTARY INFORMATION, Proposed Applicability Date

[53] Proposed Reg. §1.274-13(b)(2)

[54] Proposed Reg. §1.274-13(b)(4)

[55] Proposed Reg. §1.274-13(b)(12)

Qualified Transportation Fringe (QTF) Parking Expenses General Special Rules

Either or both of the following special rules can be used when computing total parking expenses and total parking spaces under either the *Primary Use Methodology* or *Cost per Space Methodology* for computing disallowed QTF parking expenses under IRC §274(e). The aggregation of spaces by geographic location special rule can also be used under the *General Rule* for computing disallowed QTF parking expense.[56]

Calculation of Mixed Parking Expenses

One of the key questions that often came up when dealing with the safe harbor found in Notice 2018-99 was how a taxpayer was supposed to separate out costs that weren't separately stated when leasing a building with a parking lot, or the taxpayer simply owned the building and parking lot and paid various expenses related to the overall property.

The term *mixed parking expense* means a single expense amount paid or incurred by a taxpayer that includes both parking facility and nonparking facility expenses for a property that a taxpayer owns or leases.[57]

The proposed regulations provide two options for determining how much of the mixed costs represent the parking facility's portion of the mixed facility expenses:

- A taxpayer may use a reasonable methodology to allocate the applicable portion of mixed parking expenses to a parking facility.
- A taxpayer may choose to allocate 5 percent of the following mixed parking expenses to a parking facility:
  - Lease or rental agreement expenses,
  - Property taxes,
  - Interest expense, and
  - Expenses for utilities and insurance.[58]

The second method is simple to use and likely will be what many taxpayers gravitate to, since the overall impact may not be material. However, a taxpayer can use another method so long as it is reasonable.

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[56] Proposed Reg. §1.274-13(c)

[57] Proposed Reg. §1.274-13(b)(13)

[58] Proposed Reg. §1.274-13(c)(1)

Aggregation of Spaces for Multiple Facilities in a Single Geographic Location

If two parking facilities meet the test described below for being located in a single *geographic location*, a taxpayer may aggregate the number of spaces in those facilities for purposes of calculating the disallowance of deductions for QTF parking expenses.[59]

The term geographic location means contiguous tracts or parcels of land owned or leased by the taxpayer. Two or more tracts or parcels of land are contiguous if they share common boundaries or would share common boundaries but for the interposition of a road, street, railroad, stream, or similar property. Tracts or parcels of land which touch only at a common corner are not contiguous.[60]

The proposed regulations provide:

> For example, parking spaces at an office park or an industrial complex in the geographic location may be aggregated. However, a taxpayer may not aggregate parking spaces in parking facilities that are in different geographic locations.[61]

Methods for Calculating Disallowed QTF Parking Expenses

The proposed regulations provide five different methods for computing the disallowed portion of QTF parking expenses:

- A method that must be used if the taxpayer pays a third party for the parking QTF
- Four methods from which a taxpayer may select if the taxpayer owns or leases a parking facility at which it provides the parking QTF:
  - General rule;
  - Qualified parking limit methodology;
  - Primary use methodology (very similar to the Notice 2018-99 safe harbor method);
  - Cost per space methodology.[62]

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[59] Proposed Reg. §1.274-13(c)(2)

[60] Proposed Reg. §1.274-13(b)(5)

[61] Proposed Reg. §1.274-13(c)(2)

[62] Proposed Reg. §1.274-13(d)

If the taxpayer owns or leases parking facilities, the taxpayer can select the general rule or any of the other methodologies for each taxable year and for each parking facility.[63]

Third-Party Paid for Parking QTF

If the employer pays a third party for the parking QTF (such as paying for use of spaces by employees in a public parking garage), the disallowance "generally is calculated as the taxpayer's total annual cost of employee parking qualified transportation fringes paid to the third party."[64]

EXAMPLE 1, PROPOSED REG. §1.274-13(F)

Taxpayer A pays B, a third party who owns a parking garage adjacent to A's place of business, $100 per month per parking space for each of A's 10 employees to park in B's garage, or $12,000 for parking in 2020 (($100 x 10) x 12 = $12,000). The $100 per month paid for each of A's 10 employees for parking is excludible under section 132(a)(5), and none of the exceptions in section 274(e) or paragraph (e) of this section are applicable. Thus, the entire $12,000 is subject to the section 274(a)(4) disallowance under paragraphs (a) and (d)(1) of this section.

EXAMPLE 2, PROPOSED REG. §1.274-13(F)

Assume the same facts as in paragraph (f)(1) of this section (Example 1), except A pays B $300 per month for each parking space, or $36,000 for parking for 2020 (($300 x 10) x 12 = $36,000). Of the $300 per month paid for parking for each of 10 employees, $270 is excludible under section 132(a)(5) for 2020 and none of the exceptions in section 274(e) or paragraph (e) of this section are applicable to this amount. A properly treats the excess amount of $30 ($300 - $270) per employee per month as compensation and wages. Thus, $32,400 (($270 x 10) x 12 = $32,400) is subject to the section 274(a)(4) disallowance under paragraphs (a) and (d)(1) of this section.

The excess amount of $30 per employee per month is not excludible under section 132(a)(5). As a result, the exceptions in section 274(e)(2) and paragraph (e)(2)(i) of this section are applicable to this amount. Thus, $3,600 ($36,000 - $32,400 = $3,600) is not subject to the section 274(a)(4) disallowance and remains deductible.

General Rule for Owned or Leased Parking Facilities

The general rule provides that the taxpayer must compute the disallowed QTF parking expense under IRC §274(a)(4) for each employee using a reasonable method. The taxpayer can use the aggregation of spaces special rule described earlier as part of its general rule computation, but is not allowed to use the special mixed cost rule.[65]

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[63] Proposed Reg. §1.247-13(d)(2)

[64] Proposed Reg. §1.274-13(d)(1)

[65] Proposed Reg. §1.274-13(d)(2)(i)

While this appears to give the taxpayer a lot of freedom to choose a method, the IRS does provide certain restrictions in developing an acceptable reasonable method:

- A taxpayer must not use value to determine expense. A taxpayer may not use the value of employee parking to determine expenses allocable to employee parking that is either owned or leased by the taxpayer because section 274(a)(4) disallows a deduction for the expense of providing a qualified transportation fringe, regardless of its value.[66]

- A taxpayer must not deduct expenses related to reserved employee spaces. A taxpayer must determine the allocable portion of total parking expenses that relate to any reserved employee spaces. No deduction is allowed for the parking expenses that relate to reserved employee spaces.[67]

- A taxpayer must not improperly apply the exception for qualified parking made available to the public. A taxpayer must not improperly apply the exception in section 274(e)(7) or paragraph (e)(2)(ii) of this section to parking facilities, for example, by treating a parking facility regularly used by employees as available to the general public merely because the general public has access to the parking facility.[68]

A taxpayer who owns or leases a parking facility may, in lieu of using the general method, use one of the three following simplified methodologies.

For all three methodologies, the *peak demand period* is a key concept that must be applied. The regulations define the term as follows:

> The term *peak demand period* refers to the period of time on a typical business day when the greatest number of the taxpayer's employees are utilizing parking spaces in the taxpayer's parking facility. If a taxpayer's employees work in shifts, the peak demand period would take into account the shift during which the largest number of employees park in the taxpayer's parking facility. However, a brief transition period during which two shifts overlap in their use of parking spaces, as one shift of employees is getting ready to leave and the next shift is reporting to work, may be disregarded. *Taxpayers may use any reasonable methodology to determine the total number of spaces used by employees during the peak demand period on a typical business day. A reasonable methodology may include periodic inspections or employee surveys*.[69]

[66] Proposed Reg. §1.274-13(d)(2)(i)(A)

[67] Proposed Reg. §1.274-13(d)(2)(i)(B)

[68] Proposed Reg. §1.274-13(d)(2)(i)(C)

[69] Proposed Reg. §1.274-13(b)(14)

Qualified Parking Limit Methodology

If a taxpayer elects to use the *qualified parking limit methodology*, the taxpayer must multiply:

- The total number of spaces used by employees during the peak demand period, or the total number of the taxpayer's employees,
- By the IRC §132(f)(2) monthly per employee limit on exclusion ($270[70] for 2020) for each month in the tax year

to determine the amount disallowed under IRC §274(a)(4).[71]

But there's a catch—the employer must determine the *value* of the parking QTF provided to each employee, and include the excess of that value over the monthly limit (if any) as wages for the employee and as compensation expense on the taxpayer's income tax return.[72]

The regulation also provides:

> In addition, the exception to the disallowance for amounts treated as employee compensation provided for in section 274(e)(2) and in paragraph (e)(2)(i) of this section cannot be applied to reduce a section 274(a)(4) disallowance calculated using this method.[73]

Essentially, if you use this method you can't simply add $270 to the employee's compensation each month subject to tax each month and then obtain a full deduction for the parking expense.

EXAMPLE 3, PROPOSED REG. §1.274-13(F)

Taxpayer C leases 200 parking spaces from a third party at a rate of $500 per space, per month in 2020. C's annual lease payment for the parking spaces is $1,200,000 ((200 x $500) x 12 = $1,200,000). The number of available parking spaces used by C's employees during the peak demand period is 200.

C uses the qualified parking limit methodology described in paragraph (d)(2)(ii)(A) of this section to determine the disallowance under section 274(a)(4). Under this methodology, the section 274(a)(4) disallowance is calculated by multiplying the number of available parking spaces used by employees during the peak demand period, 200, the section 132(f)(2) monthly per employee limitation on exclusion, $270, and 12, the number of months in the applicable taxable year. The amount subject to the section 274(a)(4) disallowance is $648,000 (200 x $270 x 12 = $648,000). This amount is excludible from C's employees' gross incomes under section 132(a)(5) and none of the exceptions in section 274(e) or paragraph (e) of this

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[70] Revenue Procedure 2019-44

[71] Proposed Reg. §1.274-13(d)(2)(ii)(A)

[72] Proposed Reg. §1.274-13(d)(2)(ii)(A)

[73] Proposed Reg. §1.274-13(d)(2)(ii)(A)

section are applicable to this amount. The excess $552,000 ($1,200,000 - $648,000) for which C is not disallowed a deduction under 274(a)(4) is included in C's employees' gross incomes because it exceeds the section 132(f)(2) monthly per employee limitation on exclusion.

Primary Use Methodology

The primary use methodology is very similar to the method first provided as a safe harbor in Notice 2018-99. A taxpayer uses a four-step calculation to compute the amount of disallowed deduction under §274(a)(4) for parking QTF expenses. As was true under Notice 2018-99, while the costs assigned to any reserved employee spaces must be treated as disallowed, if over ½ of the spaces are generally available for use by the general public, no additional disallowance is required.

- Step 1 - Calculate the disallowance for reserved employee spaces. A taxpayer must identify the total parking spaces in the parking facility, or the taxpayer's portion thereof, exclusively reserved for the taxpayer's employees. The taxpayer must then determine the percentage of reserved employee spaces in relation to total parking spaces and multiply that percentage by the taxpayer's total parking expenses for the parking facility. The product is the amount of the deduction for total parking expenses that is disallowed under section 274(a)(4) for reserved employee spaces. There is no disallowance for reserved employee spaces if the primary use (as defined in paragraphs (b)(11) and (d)(2)(ii)(B)(2) of this section) of the available parking spaces is to provide parking to the general public, and there are five or fewer reserved employee spaces in the parking facility and the reserved employee spaces are 5 percent or less of the total parking spaces.

- Step 2 - Determine the primary use of available parking spaces. A taxpayer must identify the available parking spaces in the parking facility and determine whether their primary use is to provide parking to the general public. If the primary use of the available parking spaces in the parking facility is to provide parking to the general public, then total parking expenses allocable to available parking spaces at the parking facility are excepted from the section 274(a)(4) disallowance by the general public exception under section 274(e)(7) and paragraph (e)(2)(ii) of this section. Primary use of available parking spaces is based on the number of available parking spaces used by employees during the peak demand period. Nonreserved parking spaces that are available to the general public but empty during normal business hours on a typical business day are treated as provided to the general public.

- Step 3 - Calculate the allowance for reserved nonemployee spaces. If the primary use of a taxpayer's available parking spaces is not to provide parking to the general public, the taxpayer must identify the number of available parking spaces in the parking facility, or the taxpayer's portion thereof, exclusively reserved for nonemployees. A taxpayer that has no reserved nonemployee spaces may proceed to Step 4 in paragraph (d)(2)(ii)(B)(4) of this section. If the taxpayer has reserved nonemployee spaces, it may determine the percentage of reserved nonemployee spaces in relation to remaining total parking spaces and multiply that percentage by the taxpayer's remaining total parking expenses. The product is the amount of the deduction for remaining total parking expenses that is not disallowed because the spaces are not available for employee parking.

- Step 4 - Determine remaining use of available parking spaces and allocable expenses. If a taxpayer completes Steps 1 - 3 in paragraph (d)(2)(ii)(B) of this section and has any remaining total parking expenses not specifically categorized as deductible or nondeductible, the taxpayer must reasonably allocate such expenses by determining the total number of available parking spaces used by employees during the peak demand period.[74]

The proposed regulations provide the following key definitions for applying this methodology:

- **General public** - The term general public includes, but is not limited to, customers, clients, visitors, individuals delivering goods or services to the taxpayer, students of an educational institution, and patients of a health care facility. *If a taxpayer owns or leases space in a multi-tenant building, the term general public includes employees, partners, 2-percent shareholders of S corporations, sole proprietors, independent contractors, clients, or customers of unrelated tenants in the building. The term general public does not include individuals that are employees, partners, 2-percent shareholders of S corporations, sole proprietors, or independent contractors of the taxpayer.* Also, an exclusive list of guests is not the general public.[75]

- **Total parking spaces** - The term total parking spaces means the total number of parking spaces, *or the taxpayer's portion thereof*, in the parking facility.[76]

- **Reserved employee spaces** - The term reserved employee spaces means the spaces in the parking facility, or the taxpayer's portion thereof, exclusively reserved for the taxpayer's employees. Employee spaces in the parking facility, or portion thereof, may be exclusively reserved for employees by a variety of methods, including, but not limited to, specific signage (for example, "Employee Parking Only") or a separate facility or portion of a facility segregated by a barrier to entry or limited by terms of access. Inventory/unusable spaces are not included in reserved employee spaces.[77]

- **Reserved nonemployee spaces** - The term reserved nonemployee spaces means the spaces in the parking facility, or the taxpayer's portion thereof, exclusively reserved for nonemployees. *For example, such parking spaces may include, but are not limited to, spaces reserved exclusively for visitors, customers, partners, sole proprietors, 2-percent shareholders of S corporations, vendor deliveries, and passenger loading/unloading.* Nonemployee spaces in the parking facility, or portion thereof, may be exclusively reserved for nonemployees by a variety of methods, including, but not limited to, specific signage (for example, "Customer Parking Only") or a separate facility, or

[74] Proposed Reg. §1.274-13(d)(1)(ii)(B)

[75] Proposed Reg. §1.274-13(b)(3)

[76] Proposed Reg. §1.274-13(b)(6)

[77] Proposed Reg. §1.274-13(b)(7)

portion of a facility, segregated by a barrier to entry or limited by terms of access. Inventory/unusable spaces are not included in reserved nonemployee spaces.[78]

- **Available parking spaces** - The term available parking spaces means the total parking spaces, less reserved employee spaces and less inventory/unusable spaces, that are available to employees and the general public.[79]

- **Inventory/unusable spaces** - The term inventory/unusable spaces means the spaces in the parking facility, or the taxpayer's portion thereof, exclusively used or reserved for inventoried vehicles, qualified nonpersonal use vehicles described in §1.274-5(k), or other fleet vehicles used in the taxpayer's business, or that are otherwise not usable for parking by employees. Examples of such parking spaces include, but are not limited to, parking spaces for vehicles that are intended to be sold or leased at a car dealership or car rental agency, parking spaces for vehicles owned by an electric utility used exclusively to maintain electric power lines, or parking spaces occupied by trash dumpsters (or similar property).[80]

- **Primary use** - The term primary use means greater than 50 percent of actual or estimated usage of the available parking spaces in the parking facility.[81]

EXAMPLE 4, PROPOSED REG. §1.274-13(F)

Facts. Taxpayer D, a big box retailer, owns a surface parking facility adjacent to its store. D incurs $10,000 of total parking expenses for its store in the 2020 taxable year. D's parking facility has 510 spaces that are used by its customers, employees, and its fleet vehicles. None of D's parking spaces are reserved. The number of available parking spaces used by D's employees during the peak demand period is 50. Approximately 30 nonreserved parking spaces are empty during normal business hours on a typical business day. D's fleet vehicles occupy 10 parking spaces.

Methodology. D uses the primary use methodology in paragraph (d)(2)(ii)(B) of this section to determine the amount of parking expenses that are disallowed under section 274(a)(4).

- Step 1. Because none of D's parking spaces are exclusively reserved for employees, there is no amount to be specifically allocated to reserved employee spaces under paragraph (d)(2)(ii)(B)(1) of this section.

- Step 2. D's number of available parking spaces is the total parking spaces reduced by the number of reserved employee spaces and inventory/unusable spaces or 500 (510 – 0 – 10 = 500). The number of available parking spaces used by D's employees during the peak demand period is 50. Of the 500 available parking spaces, 450 are used to provide parking to the general public, including the 30 empty nonreserved parking spaces that are treated as provided to the general public. The primary use of D's available parking spaces is to provide parking to the general public because 90% (450 / 500 = 90%) of the available parking spaces are used by the general public under paragraph (d)(2)(ii)(B)(2)

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[78] Proposed Reg. §1.274-13(b)(8)

[79] Proposed Reg. §1.274-13(b)(10)

[80] Proposed Reg. §1.274-13(b)(9)

[81] Proposed Reg. §1.274-13(b)(11)

of this section. Because the primary use of the available parking spaces is to provide parking to the general public, the exception in section 274(e)(7) and paragraph (e)(2)(ii) of this section applies and none of the $10,000 of total parking expenses is subject to the section 274(a)(4) disallowance.

EXAMPLE 5, PROPOSED REG. §1.274-13(F)

Facts. Taxpayer E, a manufacturer, owns a surface parking facility adjacent to its plant. E incurs $10,000 of total parking expenses in 2020. E's parking facility has 500 spaces that are used by its visitors and employees. E reserves 25 of these spaces for nonemployee visitors. The number of available parking spaces used by E's employees during the peak demand period is 400.

Methodology. E uses the primary use methodology in paragraph (d)(2)(ii)(B) of this section to determine the amount of parking expenses that are disallowed under section 274(a)(4).

- Step 1. Because none of E's parking spaces are exclusively reserved for employees, there is no amount to be specifically allocated to reserved employee spaces under paragraph (d)(2)(ii)(B)(1) of this section.
- Step 2. The primary use of E's parking facility is not to provide parking to the general public because 80% (400 / 500 = 80%) of the available parking spaces are used by its employees. Thus, expenses allocable to those spaces are not excepted from the section 274(a) disallowance by section 274(e)(7) and paragraph (e)(2)(ii) of this section under the primary use test in paragraph (d)(2)(ii)(B)(2) of this section.
- Step 3. Because 5% (25 / 500 = 5%) of E's available parking spaces are reserved nonemployee spaces, up to $9,500 ($10,000 x 95% = $9,500) of E's total parking expenses are subject to the section 274(a)(4) disallowance under this step as provided in paragraph (d)(2)(ii)(B)(3) of this section. The remaining $500 ($10,000 x 5% = $500) of expenses allocable to reserved nonemployee spaces is excepted from the section 274(a) disallowance and continues to be deductible.
- Step 4. E must reasonably determine the employee use of the remaining parking spaces by using the number of available parking spaces used by E's employees during the peak demand period and determine the expenses allocable to employee parking spaces under paragraph (d)(2)(ii)(B)(4) of this section.

EXAMPLE 6, PROPOSED REG. §1.274-13(F)

Facts. Taxpayer F, a manufacturer, owns a surface parking facility adjacent to its plant. F incurs $10,000 of total parking expenses in 2020. F's parking facility has 500 spaces that are used by its visitors and employees. F reserves 50 spaces for management. All other employees park in nonreserved spaces in F's parking facility; the number of available parking spaces used by F's employees during the peak demand period is 400. Additionally, F reserves 10 spaces for nonemployee visitors.

Methodology. F uses the primary use methodology in paragraph (d)(2)(ii)(B) of this section to determine the amount of parking expenses that are disallowed under section 274(a)(4).

- Step 1. Because F reserved 50 spaces for management, $1,000 ((50 / 500) x $10,000 = $1,000) is the amount of total parking expenses that is nondeductible for reserved employee spaces under section 274(a)(4) and paragraphs (a) and (d)(2)(ii)(B)(1) of this section. None of the exceptions in section 274(e) or paragraph (e) of this section are applicable to this amount.

- Step 2. The primary use of the remainder of F's parking facility is not to provide parking to the general public because 89% (400 / 450 = 89%) of the available parking spaces in the facility are used by its employees. Thus, expenses allocable to these spaces are not excepted from the section 274(a)(4) disallowance by section 274(e)(7) and paragraph (e)(2)(ii) of this section under the primary use test in paragraph (d)(2)(ii)(B)(2) of this section.
- Step 3. Because 2% (10 / 450 = 2.22%) of F's available parking spaces are reserved nonemployee spaces, the $180 allocable to those spaces (($10,000 - $1,000) x. 2%) is not subject to the section 274(a)(4) disallowance and continues to be deductible under paragraph (d)(2)(ii)(B)(3) of this section.
- Step 4. F must reasonably determine the employee use of the remaining parking spaces by using the number of available parking spaces used by F's employees during the peak demand period and determine the expenses allocable to employee parking spaces under paragraph (d)(2)(ii)(B)(4) of this section.

EXAMPLE 7, PROPOSED REG. §1.274-13(F)

Facts. Taxpayer G, a financial services institution, owns a multi-level parking garage adjacent to its office building. G incurs $10,000 of total parking expenses in 2020. G's parking garage has 1,000 spaces that are used by its visitors and employees. However, one floor of the parking garage is segregated by an electronic barrier that can only be accessed with a card provided by G to its employees. The segregated parking floor contains 100 spaces. The other floors of the parking garage are not used by employees for parking during the peak demand period.

Methodology. G uses the primary use methodology in paragraph (d)(2)(ii)(B) of this section to determine the amount of parking expenses that are disallowed under section 274(a)(4).

- Step 1. Because G has 100 reserved spaces for employees, $1,000 ((100 / 1,000) x $10,000 = $1,000) is the amount of total parking expenses that is nondeductible for reserved employee spaces under section 274(a)(4) and paragraph (d)(2)(ii)(B)(1) of this section. None of the exceptions in section 274(e) or paragraph (e) of this section are applicable to this amount.
- Step 2. The primary use of the available parking spaces in G's parking facility is to provide parking to the general public because 100% (900 / 900 = 100%) of the available parking spaces are used by the public. Thus, expenses allocable to those spaces, $9,000, are excepted from the section 274(a)(4) disallowance by section 274(e)(7) and paragraph (e)(2)(ii) of this section under the primary use test in paragraph (d)(2)(ii)(B)(2).

EXAMPLE 8, PROPOSED REG. §1.274-13(F)

Facts. Taxpayer H, an accounting firm, leases a parking facility adjacent to its office building. H incurs $10,000 of total parking expenses related to the lease payments in 2020. H's leased parking facility has 100 spaces that are used by its clients and employees. None of the parking spaces are reserved. The number of available parking spaces used by H's employees during the peak demand period is 60.

Methodology. H uses the primary use methodology in paragraph (d)(2)(ii)(B) of this section to determine the amount of parking expenses that are disallowed under section 274(a)(4).

- Step 1. Because none of H's leased parking spaces are exclusively reserved for employees, there is no amount to be specifically allocated to reserved employee spaces under paragraph (d)(2)(ii)(B)(1) of this section.

- Step 2. The primary use of H's leased parking facility under paragraph (d)(2)(ii)(B)(2) of this section is not to provide parking to the general public because 60% (60 / 100 = 60%) of the lot is used by its employees. Thus, H may not utilize the general public exception from the section 274(a)(4) disallowance provided by section 274(e)(7) and paragraph (e)(2)(ii) of this section.
- Step 3. Because none of H's parking spaces are exclusively reserved for nonemployees, there is no amount to be specifically allocated to reserved nonemployee spaces under paragraph (d)(2)(ii)(B)(3) of this section.
- Step 4. H must reasonably determine the use of the parking spaces and the related expenses allocable to employee parking. Because the number of available parking spaces used by H's employees during the peak demand period is 60, H reasonably determines that 60% (60 / 100 = 60%) of H's total parking expenses or $6,000 ($10,000 x 60% = $6,000) is subject to the section 274(a)(4) disallowance under paragraph (d)(2)(ii)(B)(4) of this section.

EXAMPLE 9, PROPOSED REG. §1.274-13(F)

Facts. Taxpayer I, a large manufacturer, owns multiple parking facilities adjacent to its manufacturing plant, warehouse, and office building at its complex in the city of X. All of I's tracts or parcels of land at its complex in city X are located in a single geographic location. I owns parking facilities in other cities. I incurs $50,000 of total parking expenses related to the parking facilities at its complex in city X in 2020. I's parking facilities at its complex in city X have 10,000 total parking spaces that are used by its visitors and employees of which 500 are reserved for management. All other spaces at parking facilities in I's complex in city X are nonreserved. The number of nonreserved spaces used by I's employees other than management during the peak demand period at I's parking facilities in city X is 8,000.

Methodology. I uses the primary use methodology in paragraph (d)(2)(ii)(B) of this section to determine the amount of parking expenses that are disallowed under section 274(a)(4). I chooses to apply the special rule in paragraph (c)(2) of this section to aggregate all parking facilities in the geographic location that comprises its complex in city X. However, I may not aggregate parking facilities in other cities with its parking facilities in city X because they are in different geographic locations.

- Step 1. Because 500 spaces are reserved for management, $2,500 ((500 / 10,000) x $50,000 = $2,500) is the amount of total parking expenses that is nondeductible for reserved employee spaces for I's parking facilities in city X under section 274(a)(4) and paragraphs (a) and (d)(2)(ii)(B)(1) of this section.
- Step 2. The primary use of the remainder of I's parking facility is not to provide parking to the general public because 84% (8,000 / 9,500 = 84%) of the available parking spaces in the facility are used by its employees. Thus, expenses allocable to these spaces are not excepted from the section 274(a)(4) disallowance by section 274(e)(7) or paragraph (e)(2)(ii) of this section under the primary use test in paragraph (d)(2)(ii)(B)(2) of this section.
- Step 3. Because none of I's parking spaces in its parking facilities in city X are exclusively reserved for nonemployees, there is no amount to be specifically allocated to reserved nonemployee spaces under paragraph (d)(2)(ii)(B)(3) of this section.
- Step 4. I must reasonably determine the use of the remaining parking spaces and the related expenses allocable to employee parking for its parking facilities in city X. Because the number of available parking spaces used by I's employees during the peak demand

period in city X during an average workday is 8,000, I reasonably determines that 84.2% (8,000 / 9,500 = 84.2%) of I's remaining parking expense or $39,900 (($50,000 - $2,500) x 84% = $39,900) is subject to the section 274(a)(4) disallowance under paragraph (d)(2)(ii)(B)(4) of this section.

Cost per Space Methodology

The final simplified method is the cost per space methodology. The taxpayer determines the cost per space in the lot and then computes the disallowed amount by "multiplying the cost per space by the total number of available parking spaces used by employees during the peak demand period."[82]

The regulation provides "a taxpayer may calculate cost per space by dividing total parking expenses by total parking spaces."[83]

This method simply eliminates the intermediate tests in the primary use methodology that might serve to reduce the disallowance of deductions for parking expenses. The taxpayer gains simplicity, but at the potential cost of a higher disallowance than would exist under the other method.

EXAMPLE 10, PROPOSED REG. §1.274-13(F)

Taxpayer J, a manufacturer, owns a parking facility and incurs mixed parking expenses along with other parking expenses. J uses the special rule in paragraph (c)(1) of this section to allocate 5% of certain mixed parking expenses to its parking facility. Applying the special rule, J determines that it incurred $100,000 of total parking expenses in 2020. J's parking facility has 500 spaces that are used by its visitors and employees. The number of available parking spaces used by J's employees during the peak demand period is 475.

J uses the cost per space methodology described in paragraph (d)(2)(ii)(C) of this section to determine the amount of parking expenses that are disallowed under section 274(a)(4). Under this methodology, J multiples the cost per space by the number of available parking spaces used by J's employees during the peak demand period. J calculates the cost per space by dividing total parking expenses by the number of parking spaces ($100,000 / 500 = $200). J determines that $95,000 ($200 x 475 = $95,000) of J's total parking expenses is subject to the section 274(a)(4) disallowance and none of the exceptions in section 274(e) or paragraph (e) of this section are applicable.

Expenses for Transportation in a Commuter Highway Vehicle or Transit Pass

The proposed regulation at Proposed Reg. §1.274-13(d)(3) provides that:

- If a taxpayer pays a third party an amount for its employees' commuter highway vehicle or a transit pass qualified transportation fringe, the section 274(a)(4) disallowance generally is equal to the taxpayer's total annual cost of employee

[82] Proposed Reg. §1.274-13(d)(1)(ii)(C)

[83] Proposed Reg. §1.274-13(d)(1)(ii)(C)

commuter highway vehicle or a transit pass qualified transportation fringes paid to the third party.

- If a taxpayer provides transportation in a commuter highway vehicle or transit pass qualified transportation fringes in kind directly to its employees, the taxpayer must calculate the disallowance of deductions for expenses for such fringes based on a reasonable interpretation of section 274(a)(4).[84]

The regulation bars the taxpayer from using the value of the transit pass to the employee, rather than the cost incurred by the employer, to compute the disallowed deduction under IRC §274(a)(4).[85]

Exceptions to Disallowance Under §274(a)(4)

If the expenditures listed below are otherwise deductible under the IRC, they are not treated as barred from deduction under IRC §274(a)(4).[86]

Certain QTF Expenses Treated as Compensation

Expenses otherwise paid for QTFs are not treated as disallowed for deduction by IRC §274(a)(4) if the expense is treated by the taxpayer:

- On the taxpayer's Federal income tax return as originally filed, as compensation paid to the employee; and
- As wages to the employee for purposes of withholding under chapter 24 (relating to collection of Federal income tax at source on wages).[87]

However, this exception is subject to the following limitation:

> The exception in section 274(e)(2) and paragraph (e)(2)(i) of this section does not apply to expenses paid or incurred for qualified transportation fringes the value of which (including a purported value of zero) is less than the sum of the amount, if any, paid by the employee for the fringe benefits and any amount excluded from gross income under section 132(a)(5). Thus, if an employer provides an employee with qualified transportation fringes the value of which is less than the applicable statutory monthly per employee limit under section 132(a)(5), the exception in section 274(e)(2) and paragraph

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[84] Proposed Reg. §1.274-13(d)(3)

[85] Proposed Reg. §1.274-13(d)(3)

[86] Proposed Reg. §1.274-13(e)(1)

[87] Proposed Reg. §1.274-13(e)(2)(i)(A)

> (e)(2)(i) of this section does not apply to expenses paid or incurred for the fringe benefits.[88]

The preamble provides the following explanation for this limitation:

> However, section 132(a)(5) excludes the value of QTFs from an employee's gross income subject to the limitations on exclusion provided by section 132(f)(2). Therefore, in determining whether the section 274(e)(2) exception for expenses treated as compensation applies, the proposed regulations provide that the exception in section 274(e)(2) does not apply to expenses paid or incurred for QTFs the value of which (including a purported value of zero) is excluded from an employee's gross income under section 132(a)(5).[89]

Similarly, the IRS provides the following special rule to shut down another potential loophole:

> The exception in section 274(e)(2) and paragraph (e)(2)(i) of this section does not apply to expenses paid or incurred for qualified transportation fringes for which the value that is included in gross income of the employee is less than the amount required to be included in gross income under §1.61-21. Similarly, if the amount required to be included in gross income under §1.61-21 is purportedly zero, the exception in section 274(e)(2) and paragraph (e)(2)(i) of this section does not apply.[90]

The employer must also follow the proper rules for inclusion of amounts in the employee's income to make use of the IRC § 274(e) exception to disallowance. Reg §1.274-13(e)(2)(i)(D) provides:

> The exception in section 274(e)(2) and paragraph (e)(2)(i) of this section applies to expenses paid or incurred for qualified transportation fringes the value of which exceeds the sum of the amount, if any, paid by the employee for the fringe benefits and any amount excluded from gross income under section 132(a)(5), if treated as compensation on the taxpayer's Federal income tax return as originally filed and as wages to the employee for purposes of withholding under chapter 24. Thus, assuming no other statutory exclusion applies, if an employer provides an employee with qualified transportation fringes the value of which exceeds the applicable statutory monthly limit and the employee does not make any payment, the value of the benefits provided in excess of the applicable statutory monthly limit must be included in the employee's wages for income and employment tax purposes in accordance with section 274(e)(2)

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88 Proposed Reg. §1.274-13(e)(2)(i)(B)

89 Preamble to REG-119307-19, Explanation of Provisions 1.E.i

90 Proposed Reg. §1.274-13(e)(2)(i)(C)

> and paragraph (e)(2)(i) of this section. See §1.61-21(b)(1) and §1.132-9(b), Q/A-8.[91]

As the preamble explains:

> As noted above, section 132(a)(5) excludes the value of QTFs from an employee's gross income subject to the monthly per employee limitations on exclusion provided by section 132(f)(2). Section 132(f)(2) provides that the amount of QTFs that can be excluded from gross income cannot exceed a maximum monthly dollar amount, adjusted for inflation. For taxable years beginning in 2020, the monthly per employee limitation under section 132(f)(2)(A) regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass is $270 per employee. The monthly limitation under section 132(f)(2)(B) regarding the fringe benefit exclusion amount for qualified parking is $270 per employee. Rev. Proc. 2019- 44, 2019-47 I.R.B. 1093. Therefore, if an employer provides an employee with QTFs, the value of which exceeds the sum of the amount, if any, paid by the employee for the fringe benefits and the applicable statutory monthly per employee limit, then the employer must include the value of the benefits provided in excess of the amount paid by the employee and the applicable statutory per employee monthly limit in the employee's wages for income and employment tax purposes. See §1.61–21(b)(1) and §1.132-9(b), Q/A-8. The proposed regulations provide that the employer must follow this treatment in order to rely on the exception in section 274(e)(2).[92]

Expenses for Transportation in a Commuter Highway Vehicle, Transit Pass or Parking Made Available to the Public

Another exception is found under IRC §274(e)(7) for transportation in a commuter highway vehicle, transit pass or parking made available to the public. As the regulation provides:

> Under section 274(e)(7) and this paragraph (e)(2)(ii), any expense paid or incurred by a taxpayer for transportation in a commuter highway vehicle, a transit pass, or parking that otherwise qualifies as a qualified transportation fringe and that is also made available to the general public, is not subject to the disallowance of deductions provided for in paragraph (a) of this section to the extent that such transportation, transit pass, or parking is made available to the general public. With respect to parking, this exception applies to the entire amount of the taxpayer's parking expense, less any expenses specifically attributable to employees (for example, expenses allocable to reserved employee spaces), if the primary use of the parking is by the general public. If the primary use of the parking is not by the general public, this exception

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[91] Proposed Reg. §1.274-13(e)(2)(i)(D)

[92] Preamble to REG-119307-19, Explanation of Provisions 1.E.i

> applies only to the costs attributable to the parking used by the general public.[93]

Expenses for Transportation in a Commuter Highway Vehicle, Transit Pass, or Parking Sold to Customers

Finally, no disallowance is required for expenses for transportation in a commuter highway vehicle, transit pass, or parking sold to customers. The regulation provides:

> Under section 274(e)(8) and this paragraph (e)(2)(iii), any expense paid or incurred by a taxpayer for transportation in a commuter highway vehicle, a transit pass, or parking that otherwise qualifies as a qualified transportation fringe to the extent such transportation, transit pass, or parking is sold to customers in a bona fide transaction for an adequate and full consideration in money or money's worth, is not subject to the disallowance of deductions provided for in paragraph (a) of this section. For purposes of this paragraph (e)(2)(iii), the term customer includes an employee of the taxpayer who purchases the transportation in a bona fide transaction for an adequate and full consideration in money or money's worth.[94]

Commuting Expense

Reg. §1.274-14 disallows most deductions for any commuting benefit expenditure to an employee. The general rule provides:

> Except as provided in this section, no deduction is allowed for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in connection with travel between the employee's residence, as defined in §1.121-1(b)(1), and place of employment. Travel between the employee's residence and place of employment includes travel that originates at a transportation hub near the employee's residence or place of employment. For example, an employee who commutes to work by airplane from an airport near the employee's residence to an airport near the employee's place of employment is traveling between the residence and place of employment. These transportation and commuting expenses do not include any expenditure of any qualified transportation fringe (as defined in section 132(f)) provided to an employee of the taxpayer. All qualified transportation fringe expenses are required to be analyzed under section 274(a)(4) and §1.274-13.[95]

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[93] Proposed Reg. §1.274-13(e)(2)(ii)

[94] Proposed Reg. §1.274-13(e)(2)(iii)

[95] Proposed Reg. §1.274-14(a)

However, the TCJA does allow an exception if such expenses are paid for the safety of the employee. The regulation provides:

> The disallowance for the deduction for expenses incurred for providing any transportation or commuting in paragraph (a) of this section does not apply if the transportation or commuting expense is necessary for ensuring the safety of the employee. The transportation or commuting expense is necessary for ensuring the safety of the employee if a bona fide business-oriented security concern, as described in §1.132-5(m), exists for the employee.[96]

SECTION: 401
EXTENDED ROLLOVER RELIEF AND OTHER GUIDANCE RELATED TO CARES ACT SUSPENSION OF RMD PERIOD FOR 2020 RELEASED BY IRS

Citation: Notice 2020-51, 6/23/20

Guidance has been issued by the IRS to deal with the removal of required minimum distributions from various retirement accounts added by Section 2203 of the CARES Act in Notice 2020-51.[97] The Notice indicates that it does the following:

- Permits rollovers of waived required minimum distributions (RMDs) and certain related payments, including an extension of the 60-day rollover period for certain distributions to August 31, 2020;
- Answers questions relating to the waiver of 2020 RMDs; and
- Provides a sample plan amendment that, if adopted, would provide participants a choice whether to receive waived RMDs and certain related payments.[98]

Rollover of Certain Distributions No Longer Treated as RMDs

The guidance provides relief for taxpayers that took amounts they believed were required minimum distributions for 2020 that, due to the CARES Act, were no longer required to be taken in 2020. The Notice provides that the following distributions from a plan *other than a defined benefit plan* may be rolled over, provided that all other rollover rules are satisfied:

- Distributions to a plan participant paid in 2020 (or paid in 2021 for the 2020 calendar year in the case of an employee who has a required beginning date of April

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[96] Proposed Reg. §1.274-14(b)

[97] Notice 2020-51, June 23, 2020, https://www.irs.gov/pub/irs-drop/n-20-51.pdf (retrieved June 23, 2020)

[98] Notice 2020-51, Section I

1, 2021) if the payments equal the amounts that would have been RMDs in 2020 (or for 2020), but for section 2203 of the CARES Act (2020 RMDs), or are one or more payments (that include the 2020 RMDs) in a series of substantially equal periodic payments made at least annually and expected to last for the life (or life expectancy) of the participant, the joint lives (or joint life expectancies) of the participant and the participant's designated beneficiary, or for a period of at least 10 years; and

- For a plan participant with a required beginning date of April 1, 2021, distributions that are paid in 2021 that would have been an RMD for 2021 but for section 2203 of the CARES Act (as described in Q&A-5 of section V of this notice).[99]

Q&A 5, referenced in the above bullet point, reads as follows:

> Q-5. How does § 401(a)(9)(I) impact an employee who has a required beginning date of April 1, 2021?
>
> A-5. Section 401(a)(9)(I) waives the RMD for 2020 regardless of whether the employee's required beginning date is April 1, 2021. Thus, for example, if an employee who is not a 5% owner attained age 70½ before January 1, 2020, and retires in the 2020 calendar year, that employee's required beginning date is April 1, 2021. Pursuant to § 401(a)(9)(I), the employee is not required to receive an RMD for 2020 before April 1, 2021, but must still receive the RMD for the 2021 calendar year by December 31, 2021. If the employee receives a distribution during 2021, then under the rules of § 1.402(c)-2, Q&A-7, that distribution is an RMD for the 2021 calendar year to the extent the total RMD for 2021 has not been satisfied even if the distribution is made on or before April 1, 2021, and accordingly, is not an eligible rollover distribution pursuant to § 402(c)(4)(B). However, to the extent the RMD for 2021 has been satisfied, subsequent amounts distributed in 2021 that would otherwise not be eligible rollover distributions pursuant to § 402(c)(4)(A) and § 1.402(c)-2, Q&A-5, may be rolled over consistent with the rollover guidance provided in section III.B.2 of this notice.[100]

The Notice first describes relief available to those receiving a covered distribution from an employer retirement plan:

> To assist plan participants who have already received distributions in 2020, the Treasury Department and the IRS, pursuant to § 402(c)(3)(B), are extending the 60-day rollover period for any payments described in section III.A and section III.B of this notice so that the deadline for rolling over such a payment will not be before August 31, 2020. For example, if a participant received a single-sum distribution in January 2020, part of which was treated as ineligible for rollover because it was considered an RMD, that participant will have

[99] Notice 2020-51, Section III.B

[100] Notice 2020-51, Section V

> until August 31, 2020, to roll over that part of the distribution. In addition, the Treasury Department and the IRS, pursuant to § 408(d)(3)(I), are extending the 60-day rollover period for IRA distributions in 2020 that would have been an RMD in 2020 but for section 2203 of the CARES Act or section 114 of the SECURE Act, so that the deadline for rolling over such distributions will not be before August 31, 2020.[101]

So long as a plan allows for rollover contributions, the amount can be rolled back into the same plan.[102]

The Notice continues to provide similar relief to IRA recipients and, most importantly for many who received monthly payments, gives relief from the one rollover per 12-month rule as well as allowing beneficiaries holding inherited IRAs to also return the funds:

> In the case of an IRA owner or beneficiary who has already received a distribution of an amount that would have been an RMD in 2020 but for section 2203 of the CARES Act or section 114 of the SECURE Act, the recipient may repay the distribution to the distributing IRA, even if the repayment is made more than 60 days after the distribution, provided the repayment is made no later than August 31, 2020. The repayment will be treated as a rollover for purposes of § 408(d)(3) of the Code, but will not be treated as a rollover for purposes of the one rollover per 12-month period limitation in § 408(d)(3)(B) and the restriction on rollovers for nonspousal beneficiaries in § 408(d)(3)(C).[103]

Sample Plan Amendment

The Notice provides a sample plan amendment that may be adopted to implement IRC §401(a)(9)(I) as added by the CARES Act. The amendment, along with employer adoption agreement options, is found in the Appendix at the end of the Notice.

The IRS sample amendment provides participants and beneficiaries a choice to receive or not receive what otherwise was going to be a required distribution. As the Notice describes the issue:

> The sample amendment provides participants and beneficiaries the choice between receiving and not receiving distributions described in section III.B of this notice. The sample plan amendment has no impact on other distribution provisions. For example, a 75-year-old retiree's request to have her remaining plan account balance distributed in 2020 in a lump sum, or in five approximately equal

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[101] Notice 2020-51, Section III.C

[102] Notice 2020-51, Section V, Q&A 8

[103] Notice 2020-51, Section III.D

> annual installments over a period that includes 2020, would not be affected by the amendment.[104]

While an employer is not required to use the sample language and can make other amendments, the IRS makes clear that employers will not be allowed to simply remove the ability to take an RMD for 2020:

> Employers may adopt other amendments pursuant to section 2203 of the CARES Act. However, the Treasury Department and the IRS are exercising their authority under section 2203(c) of the CARES Act to deny § 411(d)(6) relief for a plan amendment that eliminates an optional form of benefit. Thus, for example, if plan language provides for a distribution of amounts equal to the 2020 RMD to a participant or beneficiary without regard to § 401(a)(9)(I), then an amendment to eliminate the right to take that distribution would violate § 411(d)(6)(B). Similarly, if plan language automatically suspends a distribution of amounts equal to the 2020 RMD to a participant or beneficiary pursuant to § 401(a)(9)(I), then an amendment to eliminate the right to defer that distribution would also violate § 411(d)(6)(B). By contrast, an employer will not have eliminated an optional form of benefit in violation of § 411(d)(6)(B) merely because the plan's default for whether a distribution occurs in the absence of a participant's or beneficiary's election is different than the default for whether a distribution occurs in the absence of a plan amendment. [105]

The Notice describes the options made available to the employer when adopting the sample amendment:

> The format of the sample plan amendment generally follows the design of preapproved plans that employ a "basic plan document" and an "adoption agreement." Thus, the sample plan amendment includes language designed for inclusion in a basic plan document and language designed for inclusion in an adoption agreement to allow the employer to select among options related to the application of the basic plan document provision. Sponsors of plans that do not use an adoption agreement (including employers using individually designed plans) should modify the format of the amendment to incorporate the desired options in the terms of the amendment.
>
> The first option provides that the default that applies in the absence of a participant's or beneficiary's election is to pay out distributions that include 2020 RMDs, and the second option provides that the default that applies in the absence of a participant's or beneficiary's election is to suspend distributions that include 2020 RMDs. An employer may choose either option, regardless of current plan language. However, an employer must select one of these options and must include in the

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[104] Notice 2020-51, Section IV

[105] Notice 2020-51, Section IV

> adoption agreement the date as of which the plan begins operating in accordance with these terms.
>
> The sample plan amendment also provides an employer three options with respect to the availability of direct rollover choices for distributions in 2020, with the default being that the plan offers a direct rollover option only for pre-CARES Act eligible rollover distributions (that is, a direct rollover option is not offered for 2020 RMDs or for amounts that may be rolled over solely due to the rollover guidance provided in section III.B of this notice). The first option provides for the availability of a direct rollover of only 2020 RMDs. The second option provides for the availability of a direct rollover of 2020 RMDs and of other amounts that may be rolled over pursuant to the rollover guidance provided in section III.B of this notice (the latter amounts referred to as "Extended 2020 RMDs" in the sample amendment). The third option provides for the availability of a direct rollover of the entire amount of a distribution but only if the distribution consists of part or all of a 2020 RMD amount and an additional amount that is an eligible rollover distribution without regard to § 401(a)(9)(I). [106]

The Notice reminds plan sponsors of the deadline for adoption of such an amendment:

> Under section 2203(c) of the CARES Act, any plan amendment pursuant to section 2203 must be adopted no later than the last day of the first plan year beginning on or after January 1, 2022 (January 1, 2024, for governmental plans), and must reflect the operation of the plan beginning with the effective date of the plan amendment. The timely adoption of the amendment must be evidenced by a written document that is signed and dated by the employer (including an adopting employer of a pre-approved plan).[107]

IRAs do not need to be amended for the waiver of the RMD rules.[108]

Other Issues

The Notice ends with a series of Q&As that explain issues related to the suspension of the required distributions for 2020. Selected questions of interest are discussed below.

The Notice provides that the suspension of RMDs would serve to extend the time period for a beneficiary inheriting an interest to choose between a 5-year or life expectancy distribution:

> Q–2. For a plan that permits an employee or beneficiary to elect whether RMDs are determined using the 5-year rule in §

[106] Notice 2020-51, Section IV

[107] Notice 2020-51, Section IV

[108] Notice 2020-51, Section V, Q&A 1

> 401(a)(9)(B)(ii) or the life expectancy rule in § 401(a)(9)(B)(iii) and (iv), does § 401(a)(9)(I) extend the time for making the election?
>
> A–2. Yes, if a plan permits an employee or beneficiary to elect whether the 5-year rule or the life expectancy rule applies in determining RMDs, then the deadline for making that election typically would be the end of calendar year following the calendar year of the employee's death. For example, if a 50-year-old employee in a plan providing the election described in § 1.401(a)(9)–3, Q&A–4(c) died in 2019 with his sister as his designated beneficiary, the plan provision would require the election by the end of 2020. However, pursuant to § 401(a)(9)(I), that type of plan may be amended to permit the extension of the election deadline to the end of 2021.[109]

Similarly, the time period for a non-spouse beneficiary to make a direct rollover is also extended:

> Q–3. Does § 401(a)(9)(I) extend the time for making a direct rollover for a nonspouse designated beneficiary pursuant to § 402(c)(11)?
>
> A–3. Yes, § 401(a)(9)(I) extends the time for making a direct rollover for a nonspouse designated beneficiary if the participant died in 2019. The "special rule" at Q&A–17(c)(2) in Notice 2007–7, 2007–1 C.B. 395, provides that if the 5-year rule applies to a benefit under a plan, the nonspouse designated beneficiary may determine the amount that is not eligible for rollover because it is an RMD using the life expectancy rule in the case of a distribution made prior to the end of the year following the year of death. This special rule in Notice 2007–7 is hereby modified so that if the employee's death occurred in 2019, the nonspouse designated beneficiary has until the end of 2021 to make the direct rollover and use the life expectancy rule.[110]

Q&As 4 and 5 deal with the impact on an individual's required beginning date:

> Q-4. Does § 401(a)(9)(I) affect an individual's required beginning date?
>
> A-4. No, the waiver of 2020 RMDs under § 401(a)(9)(I) does not change an individual's required beginning date. Thus, for example, if an individual has a required beginning date of April 1, 2020, and dies after April 1, 2020, then that individual will be treated as having died after his or her required beginning date regardless of whether that individual had commenced receiving distributions or had delayed commencing distributions until 2021 pursuant to § 401(a)(9)(I).

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[109] Notice 2020-51, Section V, Q&A 2

[110] Notice 2020-51, Section V, Q&A 3

> Q-5. How does § 401(a)(9)(I) impact an employee who has a required beginning date of April 1, 2021?
>
> A-5. Section 401(a)(9)(I) waives the RMD for 2020 regardless of whether the employee's required beginning date is April 1, 2021. Thus, for example, if an employee who is not a 5% owner attained age 70½ before January 1, 2020, and retires in the 2020 calendar year, that employee's required beginning date is April 1, 2021. Pursuant to § 401(a)(9)(I), the employee is not required to receive an RMD for 2020 before April 1, 2021, but must still receive the RMD for the 2021 calendar year by December 31, 2021. If the employee receives a distribution during 2021, then under the rules of § 1.402(c)-2, Q&A-7, that distribution is an RMD for the 2021 calendar year to the extent the total RMD for 2021 has not been satisfied even if the distribution is made on or before April 1, 2021, and accordingly, is not an eligible rollover distribution pursuant to § 402(c)(4)(B). However, to the extent the RMD for 2021 has been satisfied, subsequent amounts distributed in 2021 that would otherwise not be eligible rollover distributions pursuant to § 402(c)(4)(A) and § 1.402(c)-2, Q&A-5, may be rolled over consistent with the rollover guidance provided in section III.B.2 of this notice.[111]

The relief provided in the Notice does not extend to all deadlines. Specifically, the Notice provides:

> Q–6. Besides the extensions provided in Q&A–2 and Q&A–3 of this notice and the rollover guidance provided in section III of this notice, are any other deadlines extended or rollover requirements modified in light of section 2203 of the CARES Act?
>
> A–6. No, section 2203 of the CARES Act and section III of this notice address only certain deadlines and rollover requirements. Thus, for example, there is no extension of the deadline of September 30 following the year of death in § 1.401(a)(9)–4, Q&A–4 (relating to the determination of designated beneficiaries); the October 31 deadline in § 1.401(a)(9)–4, Q&A–6(b) (relating to the date by which the trustee of a trust that is a plan's designated beneficiary must provide the plan administrator certain information); or the last-day-of-the-year deadline in § 1.401(a)(9)–8, Q&A–2(a)(2) (relating to the date by which separate accounts must be established). Similarly, if a participant or beneficiary dies in 2020, there is no extension of the 5-year period described in § 401(a)(9)(B)(ii) or the 10-year period described in § 401(a)(9)(H)(i) or § 401(a)(9)(H)(iii), as applicable.[112]

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[111] Notice 2020-51, Section V, Q&As 4, 5

[112] Notice 2020-51, Section V, Q&A 6

The interaction with spousal consents is described in the Notice:

> Q–7. For a plan subject to §§ 401(a)(11) and 417, is spousal consent required to suspend distributions that include 2020 RMDs and restart distributions in 2021?
>
> A–7. A plan subject to §§ 401(a)(11) and 417 may provide for either option described in Q&A–8 of Notice 97–75, 1997–2 C.B. 337, choosing whether or not to have a new annuity starting date when distributions restart. If the plan does not provide for a new annuity starting date, spousal consent is not required under most circumstances. If the plan provides that there is a new annuity starting date, spousal consent may be required for the suspension of distributions that include 2020 RMDs and the restart of distributions in 2021, depending on the form of distribution in each case.[113]

The Notice discusses how these rules interact with the mandatory withholding rules for rollover distributions:

> Q–9. Does a payor have the option of treating a 2020 RMD paid from a plan in 2020 as subject to the mandatory 20-percent withholding rate for eligible rollover distributions under § 3405(c)?
>
> A–9. No. Under the last sentence of § 402(c)(4), a 2020 RMD that is paid from a plan in 2020 is not treated as an eligible rollover distribution for purposes of the withholding rules under § 3405. For example, if a plan makes a distribution in 2020 to a retiree of his entire account balance under the plan and part of the distribution is a 2020 RMD, the portion of the distribution that is not a 2020 RMD is an eligible rollover distribution and is subject to the 20-percent mandatory withholding rules under § 3405(c), and the portion of the distribution that is a 2020 RMD is not an eligible rollover distribution for purposes of § 3405(c) and is subject to the 10-percent optional withholding rules under § 3405(b). On the other hand, if the retiree was receiving monthly distributions from the plan that exceeded his RMDs and that are expected to last for a period of at least 10 years, then the entire amount of each distribution is subject to the periodic-payment optional withholding rules under § 3405(a).[114]

The Notice also clarifies that the removal of the RMD requirement for 2020 does *not* provide relief for a taxpayer receiving substantially equal periodic payments to escape a premature distribution tax under IRC §72(t):

> Q–10. Does § 401(a)(9)(I) apply to payments that are part of a series of substantially equal periodic payments under the "RMD method" (a series of payments described in Notice 89–25 and Rev. Rul. 2002–62 that are designed to satisfy the § 72(t)(2)(A)(iv) exception to the 10-

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[113] Notice 2020-51, Section V, Q&A 7

[114] Notice 2020-51, Section V, Q&A 9

> percent additional tax under § 72(t)) so that the cessation of the payments for 2020 would not be considered a modification under § 72(t)(4)?
>
> A–10. No. Section 401(a)(9)(I) does not apply to these payments; accordingly, if they are stopped in 2020 (other than because of death or disability) prior to age 59½ (or prior to 5 years from the date of the first payment), the cessation of the payments is a modification under § 72(t)(4) so that all the payments made under the series are subject to a recapture tax under § 72(t)(4).[115]

As well, the Notice indicates this relief does not extend to defined benefit plans even if they are calculating RMDs as if the distributions were coming from an individual account plan:

> Q-12. Does the waiver of 2020 RMDs apply in the case of a distribution from a defined benefit plan that uses the rule in § 1.401(a)(9)-6 Q&A-1(d)(1) (under which the plan determines the portion of a single sum distribution that is an RMD as if the plan were an individual account plan)?
>
> A-12. No, the waiver of 2020 RMDs under § 401(a)(9)(I) does not apply to a defined benefit plan. This is the case even if the defined benefit plan is using the rule in § 1.401(a)(9)-6 Q&A-1(d)(1) to determine the portion of a single sum distribution that is an RMD.[116]

SECTION: 7508A
INTEREST WILL BE PAID ON REFUNDS FROM APRIL 15 TO JULY 15

Citation: "IRS statement on interest payments," IRS website, 6/24/20

The IRS has announced that the agency will be paying interest on refunds due to the filing deadline delay this year.[117] The statement on the IRS site provided that "[i]nterest on individual 2019 refunds reflected on returns filed by July 15, 2020 will generally be paid from April 15, 2020 until the date of the refund."

The reason the IRS is paying this interest is found in IRC §7508A, a provision that we've discussed before in the COVID-19 pandemic. This provision sets the rules

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[115] Notice 2020-51, Section V, Q&A 10

[116] Notice 2020-51, Section V, Q&A 12

[117] "IRS statement on interest payments," IRS website, June 24, 2020, https://www.irs.gov/newsroom/irs-statement-on-interest-payments (retrieved June 24, 2020)

under which the IRS can delay various due dates during a Presidentially declared disaster. IRC §7508A(c) provides:

> (c) Special rules for overpayments
>
> The rules of section 7508(b) shall apply for purposes of this section.

IRC §7508 provides special rules for extra time for performing certain acts for taxpayers in a combat zone. IRC §7508A borrows these rules for treatment of an overpayment of taxes. IRC §7508(b)(1) provides that "[s]ubsection (a) shall not apply for purposes of determining the amount of interest on any overpayment of tax." IRC §7508(a) is the provision that provides for the delay in payment for those in a combat zone. Thus, by extension, the government is now on the hook for interest during the period after the original due date until the taxpayer files the return under the relief provisions of IRC §7508A (that is, by July 15, 2020).

IRC §7508(b)(2) provides that "if an individual is entitled to the benefits of subsection (a) with respect to any return and such return is timely filed (determined after the application of such subsection), subsections (b)(3) and (e) of section 6611 shall not apply."

- IRC §6611(b)(3) is the rule that provides that interest on an overpayment does not begin to run until the date a return is first filed. Since we don't apply this rule, interest will begin running on the overpayment before the date the return is filed.

- IRC §6611(e)(1) provides the rule that no interest will be paid if the refund is paid by the the IRS within 45 days of the last date prescribed for filing the return. Again, this is barred by IRC §7508(b)(3), so the interest begins running immediately on April 15.[118]

The IRS statement notes that "[i]nterest payments may be received separately from the refund."

The rates in question per the IRS statement are:

- 5% per year, compounded daily, for the period through June 30, 2020; and

- 3% per year, compounded daily, for the period from July 1, 2020 through September 30, 2020.

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[118] The analysis above was contained in series of tweets from Richard Rubin of the *Wall Street Journal* posted on June 24, 2020 found at https://twitter.com/RichardRubinDC/status/1275893063215349761?s=20 (retrieved June 24, 2020). Richard gives credit to Bob Probasco of the Texas A&M Law School for leading him through this analysis.