Tax & Weath Planning

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House Democrats Propose Additional Tax Relief and Reform Measures in HEROES Act

On May 12, the House Democrats introduced an aspirational tax package within the Health and Economic Recovery Omnibus Emergency Solutions Act (the "HEROES Act"), which lays out their starting point in negotiations with the Senate and provides insight into the top Democratic legislative tax priorities.

Download the HEROES Act Legislative Text.

> Although the HEROES Act tax provisions represent a bid by one party caucus on tax policy, it is a useful index on where House Democrats are as they shape tax policy. This legislation is aspirational but has practical implications: some of these ideas may become law, now or even in the next Congress. Embedded in political messages, corrections and consensus opportunities are a few key ideas. The net operating loss provision will open a contentious debate on how to target and simplify efforts to get liquidity back to impacted firms. The temporary lifting of the cap on SALT deductions is a clever and targeted (if regressive) bid to reverse a key policy change in the Trump tax regime on behalf of swing voters in high tax, affluent communities. We can expect to hear more about both.
>
> **– Hon. Phil English, former Ways and Means Committee member**

Business Tax Provisions

Deductibility of PPP Loan Proceeds Expenditures

In our May 1 client alert, we explained that an IRS notice barred the deductibility for U.S. federal income tax purposes of some expenses incurred in a taxpayer's trade or business when the taxpayer receives a loan through the Paycheck Protection Program ("PPP") under the CARES Act. In that client alert, we summarized the IRS notice but highlighted that the IRS's conclusion may contradict Congress's intent when it contemplated the PPP

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under the CARES Act. Under the IRS guidance, no deduction is allowed under the Internal Revenue Code (the "Code") for an expense that is otherwise deductible if the payment of the expense results in forgiveness of a covered loan under the CARES Act and if the income associated with the forgiveness is excluded from gross income. The HEROES Act overrides the IRS position on this issue. Under the HEROES Act, a taxpayer may deduct expenses paid or incurred in the taxpayer's trade or business when the taxpayer receives a PPP loan under the CARES Act even if the payment of the expense results in forgiveness of the loan.

Modifications to Employee Retention Credit

The HEROES Act would expand on the refundable Employee Retention Credit introduced by the CARES Act. In our April 1 client alert, we discussed that pursuant to the CARES Act, Eligible Employers are allowed a credit against the employer's share of Social Security taxes for each calendar quarter equal to 50 percent of qualified wages paid to each employee for that quarter (for up to $10,000 aggregate wages per employee across all calendar quarters). The HEROES Act would increase the credit amount from 50 percent to 80 percent of qualified wages paid to each employee. The proposed legislation would also dramatically increase the maximum credit from $10,000 in wages for each employee for all quarters, to $15,000 per employee per calendar quarter (and $45,000 per employee for all calendar quarters). These changes would result in an increase of the maximum credit from 50 percent of $10,000, or a $5,000 maximum credit per employee, to 80 percent of $45,000, or a $36,000 maximum credit per employee. In addition to increasing the credit amount, the HEROES Act would also modify the manner in which the credit is calculated for many employers, allowing eligible employers that are subject to partial or total suspension of operations as a result of a governmental order, and that have 1,500 or fewer full-time employees during the 2019 calendar year and whose gross receipts during the calendar year did not exceed $41.5 million dollars, to be eligible for the Employee Retention Credit with respect to all employees (and not solely those employees who are unable to work as a result of a government order).

Finally, the bill would provide for more generous application of the credit for employers that are not subject to a total or partial suspension of operations as a result of a governmental order, but who have suffered a reduction in gross receipts as a result of COVID-19 interruptions. Whereas the CARES Act would permit the credit for such employers only if there has been a 50 percent or greater reduction in gross receipts, based on a comparison of the quarterly gross receipts to the prior year quarterly gross receipts, the HEROES Act would allow for a partial credit if there is a 10 percent or greater reduction in gross receipts, with a phase-in of the available credit where the decline is between 10 percent and 50 percent.

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Revision to Payroll Tax Deferral Provisions Under CARES Act

The HEROES Act would see a controversial provision of the CARES Act reversed. The CARES Act permits employers to defer payment of the employer portion of Social Security taxes otherwise due between March 27 and the end of 2020 until December 31, 2021 (one-half of such deferred taxes) and December 31, 2022 (the other half of such deferred taxes). The CARES Act provides, however, that the deferral provision will not apply to any taxpayer if such taxpayer has obtained a PPP loan that is forgiven pursuant to the terms of the CARES Act. As discussed in our April 13 client alert, the IRS has indicated in informal guidance that deferral will be permitted through the date the lender issues a decision to forgive the loan in accordance with the CARES Act. The bill has taken the relief further by eliminating the loan forgiveness carveout contained in the CARES Act, thereby permitting payroll tax deferral to recipients of PPP loans that are forgiven.

Reversal of Suspension to Excess Business Loss Limitation for Non-Corporate Taxpayers

As discussed in our April 1 client alert, the CARES Act modified loss limitation rules for non-corporate taxpayers such as individuals, trusts, and estates. The 2017 Tax Cuts and Jobs Act ("TCJA") limited non-corporate taxpayers' ability to deduct excess business losses—the excess of the aggregate business gross deductions over aggregate business gross income. Under the TCJA, deduction of excess business losses by non-corporate taxpayers was limited to $250,000 per year (or $500,000 for joint filers), with unused excess business losses carried forward as net operating losses. Under the CARES Act, however, the application of the excess business loss limitation is delayed until 2021. The HEROES Act would reverse course on these changes, restoring and making permanent the excess business loss limitation of a taxpayer other than a corporation.

Net Operating Loss Carrybacks

The CARES Act had amended the Code to permit taxpayers that generate net operating losses ("NOLs") in tax years beginning after December 31, 2017, and before January 1, 2021 (*e.g.*, for calendar year taxpayers, 2018, 2019 and 2020) to carry those losses back to the five prior years and thereby obtain a refund of taxes paid in those prior years. The HEROES Act would prevent such loss from being carried back to any taxable year beginning before January 1, 2018, meaning that the net operating loss could not be applied against income in taxable year 2017 (*i.e.*, before the reduction in the corporate tax rate). As a result, any carryback could only apply against post-TCJA taxable income (resulting in a smaller refund to affected taxpayers). The bill also disallows the carryback for certain specified corporations.

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Business Interruption Credit for Certain Self-Employed Individuals

The bill creates a refundable tax credit for eligible self-employed individuals for the taxpayer's first taxable year beginning in 2020 in an amount equal to 90 percent of the eligible self-employed individual's qualified self-employment income. The amount of self-employment income with respect to any eligible self-employed individual that may be taken into account is capped at $45,000, and the credit amount is reduced by 50 percent of the taxpayer's modified adjusted gross income in excess of $60,0000 ($120,000 in the case of a joint return) for the taxpayer's first taxable year beginning in 2020. Qualified self-employment income will be reduced by the qualified sick leave equivalent amount for which a credit is allowed under the Families First Coronavirus Response Act ("FFCRA") and the qualified wages for which a credit is allowed under the CARES Act.

Modifications to the Families First Coronavirus Response Act (FFCRA)

The HEROES Act proposes to modify several provisions of the FFCRA. The bill extends the applicable period with respect to the payroll tax credits for paid sick leave and paid family and medical leave under the FFCRA by one year. It also increases the $10,000 limitation on credits for paid family leave wages to $12,000 and makes other technical improvements to the FFCRA.

Payroll Tax Credit for Certain Pandemic Related Employee-Benefit Expenses Paid by Employers

The bill introduced a new payroll tax credit for certain "qualified pandemic-related employee benefit expenses" paid after March 12, 2020 and before January 1, 2021. A refundable credit would be available each calendar quarter for employers to take against the employer's share of Social Security taxes for that calendar quarter. The amount of the payroll tax credit is equal to the "applicable percentage" (*i.e.*, 50 percent in the case of an "essential employee" and 30 percent in all other cases) of the "qualified pandemic-related employee benefit expenses" paid by the employer with respect to each quarter. The total amount of qualified pandemic-related employee benefit expenses that may be taken into account with respect to any employee is capped at $5,000 per calendar quarter.

A qualified pandemic-related employee benefit expense is any amount paid to or for the benefit of an employee if the amount is (i) excludible from the employee's gross income by reason of being a disaster relief payment and (ii) the employer elects to treat it as a qualified pandemic-related employee benefit expense. The qualified pandemic-related employee benefit expenses taken into account by any employer must be reduced by any amounts provided by any federal, state, or local government grants that had been provided to the employer for purposes of making or reimbursing such expenses. The credit is not permitted for any agency or instrumentality of

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the federal government except for tax-exempt nonprofit organizations.

As with other credits available under the FFCRA and the CARES Act, any amount of the credit in excess of an employer's liability for Social Security tax for the quarter is treated as an overpayment that is refundable to the employer.

Payroll Credit for Certain Fixed Expenses of Employers Subject to Closure by Reason of COVID-19

The HEROES Act creates another new payroll credit for certain fixed expenses of employers who were subject to closure due to COVID-19. This is a refundable credit that would allow employers to utilize some of the expenses that the employer continued to incur despite the employer's inability to operate during the pandemic. Qualified expenses are defined in the bill to include payment or accrual in the ordinary course of the eligible employer's trade or business, of any covered mortgage obligation, covered rent obligation, or covered utility payment. They do not include the prepayment of any obligations that are not customarily due in advance.

Eligible employers may take as a credit against the employer's share of Social Security taxes for each quarter an amount equal to 50 percent of the qualified fixed expenses paid or incurred by such employer during such calendar quarter. The amount of qualified fixed expenses that may be taken into account is the lesser of:

1. The qualified expenses paid by the eligible employer in the same calendar quarter of calendar year 2019;
2. $50,000; or
3. The greater of (i) 25 percent of the wages paid with respect to the employment of all the employees of the eligible employer for such calendar quarter or (ii) 6.25 percent of the gross receipts of the eligible employer for calendar year 2019.

To be eligible for this credit, the employer must have employed 1,500 or fewer full-time employees during the 2019 calendar year, had gross receipts during the 2019 calendar year that did not exceed $41.5 million dollars, and had operations that were fully or partially suspended during the calendar quarter due to the pandemic. Tax-exempt organizations may also be eligible for this credit, and there is a phase-in of the credit where the business is no longer suspended and the reduction in the gross receipts for the calendar quarter is less than 50 percent, meaning there is no longer a significant decline in the gross receipts from the same quarter in the previous year.

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Individual Tax Provisions

Temporary Removal of SALT Deduction Cap

The TCJA introduced a $10,000 cap on the amount of state and local taxes ("SALT") that are deductible in calculating U.S. federal taxable income. The SALT deduction allows taxpayers who itemize their deductions to deduct the amounts they paid in certain state and local taxes, including real estate, personal property taxes, and income taxes or general sales taxes. The SALT deduction cap particularly affects taxpayers in high tax states and states and localities with high property taxes, as well as high-income taxpayers generally.

The proposed legislation would temporarily abolish the $10,000 SALT deduction cap for the 2020 and 2021 tax years, thereby reducing the tax burden for taxpayers who itemize deductions on their U.S. federal income tax returns who would otherwise exceed the limit.

Additional Recovery Rebates to Individuals

The CARES Act provided for stimulus checks of $1,200 to individuals and $2,400 for married couples, plus $500 per qualified child (for up to three children). The HEROES Act would double down on those stimulus checks and provide additional rebates to individuals and families in an additional amount of $1,200 for an individual (and $2,400 for a married couple), plus $1,200 per dependent (which could include non-child dependents, such as college-student children) for up to three dependents, resulting in stimulus checks of up to $6,000 for a family of five. As was the case with the CARES Act recovery rebate checks, the amount of the rebate will be subject to income-based phaseout.

Expansion of Child Tax Credit

The HEROES Act would temporarily expand the child tax credit under existing law from $2,000 to $3,000 per child ($3,600 in the case of a qualifying child who has not attained the age of 6) for 2020. In addition, the child tax credit would be expanded for 2020 to cover children who are younger than 18 years old at the end of 2020 (rather than children who are younger than 17 years old under existing law).

Enhancement of Earned Income Tax Credit

The bill further aims to offer relief to taxpayers by strengthening the earned income tax credit for individuals with no qualifying children by reducing the minimum age required for the credit from age 25 to age 19 (other than in the case of a full-time student) and increasing the maximum age for the credit from age 65 to age 66. The bill would also increase the income phaseout levels under existing law.

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Retirement Plan Required Minimum Distribution

The CARES Act provided special rules for the use of retirement funds for reasons related to COVID-19 and enabled individuals to withdraw retirement funds for coronavirus-related distributions, without incurring the 10 percent early withdrawal penalty they would otherwise incur. The HEROES Act would extend that relief to 2019 for defined contribution plans and individual retirement accounts. Required Minimum Distributions made in 2019 and Required Minimum Distributions made in 2020 could be rolled back to a plan or IRA without regard to the normal 60-day requirement if the rollover is made by November 30, 2020.

Other Individual Relief Measures

The bill provides various other individual relief measures, including the following:

- Increased exclusion for employer provided dependent care assistance and increased limits for contributions to dependent care flexible spending accounts.
- 12-month grace period extension for use of unused benefits or contributions in health flexible spending arrangements and dependent care flexible spending arrangements.
- Increased "above-the-line" deduction for elementary school and secondary school teachers of certain classroom expenses.
- "Above-the-line" deduction for first responders and COVID-19 frontline employees for costs of uniforms, professional development expenses, supplies and equipment.
- Exclusions from income for emergency financial grants made to students.