



SOME GOOD NEWS: HOW BUSINESSES BENEFIT FROM THE RECENT STIMULUS LEGISLATION

By Daniel L. Rudnick

The COVID-19 outbreak has caused disruption to the entire economy. As a result, the Federal Government has taken action to aid businesses. This article will summarize many of these changes.

Change to Tax Date

On March 13th, President Trump issued an emergency declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act in response to the ongoing COVID-19 pandemic, and instructed the IRS to delay the April 15th tax deadline. The IRS interpreted this order as constituting a federally declared disaster, which allowed the IRS to push the deadline for payment and filing of 2019 tax returns and payments that would otherwise have been due on April 15th to July 15th, 2020. On March 18th, the State of California Franchise Tax Board followed the IRS.

The Families First Coronavirus Response Act (FFCRA)

As we previously reported, Congress passed the Families First Coronavirus Response Act ("FFCRA"), which provides protection for employees impacted by COVID-19 by requiring employers to pay sick leave and expanded family and medical leave for certain periods and up to certain amounts. The bill helps fund these additional payments by offering employers a tax credit against payroll taxes. More can be found in our article on the subject, which can be found at <https://bit.ly/2Jg3skL>. In addition, the Department of Labor continues to provide updates, which can be found at <https://www.dol.gov/agencies/whd/pandemic/ffcra-employer-paid-leave>.

The CARES Act

Most recently, Congress enacted, and the President signed, the CARES Act, which makes nearly \$350 billion in government-guaranteed loans available to small businesses while also making a number of favorable changes to the tax law.

A. Highlights of the CARES Act

The \$2.2 Trillion dollar relief bill has several provisions that may help small businesses survive the crisis so they can come back and fight another day. The relief is mainly tax deferral and loans that can be forgiven. The bill is supposed to tide Americans over for the next four to six weeks. The government will be offering a variety of loans to companies in an effort to tide them over.

B. SBA Loans and Grants

Businesses interested in these loans should approach a bank or other lender that makes loans guaranteed by the Small Business Administration (“SBA”). As enacted, provided a borrower meets certain conditions, repayment of part of the loans will be forgiven and converted into a grant. The amount forgiven is equivalent to the payroll costs, mortgage interest, rent and utilities the borrower has to pay during the first eight weeks after the loan is made. The amount forgiven will be subject to reduction if employee wages are cut by more than 25% and by the percentage reduction in the average monthly “full-time equivalent” employee headcount during the eight-week period. Normally when repayment of a loan is forgiven, the borrower must report the amount as taxable income. For these loans, however, no income will have to be reported.

There are limitations to what the funds can be used for. They are to be used to pay payroll costs, mortgage interest, rent, utilities and interest on other debt that was outstanding before January 31, 2020. The loan will be limited to 2.5 times average monthly payroll costs during the year leading up to March 22, 2020, with a maximum of \$10 million.

The loans are nonrecourse and do not require collateral. No personal guarantees are required. The interest rate cannot exceed 4%. Payment of interest and principal will be deferred for the first six months to a year.

C. Payroll Tax Relief

Payroll tax relief is also provided. Payment of the 6.2% employer share of social security taxes on employee wages for the period starting March 27, 2020, through the end of this year will be delayed and can be paid half at the end of 2021 and half at the end of 2022.

Some companies will not have to pay the employer share of social security taxes at all during some calendar quarters this year and may receive payments from the federal government instead. Companies can fit into this category in one of two ways, namely:

1. During quarters when their business activities are “fully or partially suspended” by a government order limiting “commerce, travel or group meetings” due to coronavirus.
2. If the business suffers more than a 50% drop in gross receipts in a quarter this year compared to the same quarter last year. The relief in that case lasts through the first quarter when gross receipts recover to more than 80% of gross receipts during the same quarter in 2019.

Companies falling into either category will get a tax credit of up to \$5,000 per employee. If the credit exceeds the employer share of social security taxes they would otherwise owe for a quarter, the government will send a check for the excess. The credit is 50% of wages paid to employees during covered quarters.

The total credit for all covered quarters is capped at \$5,000 per employee. Wages include premiums paid by employers for group medical insurance. Companies that had an average payroll during 2019 of 100 or fewer employees can claim a credit on wages paid to all employees only on wages paid after March 12, 2020.

Qualified Employer Disaster Relief Payments to Employees are Tax Free

Lost among all the recent legislation, however, is an existing provision of the tax law that, thankfully, has been little-used since its enactment in 2002, but that is very important in a time like this. Specifically, Section 139, added to the Code after the September 11th attacks of 2001, allows employers to make “qualified disaster relief payments” to employees to assist the employees in managing the COVID-19 crisis. The payments are tax-free to the employees, but fully deductible to the employer.

Section 139, however, provides that in the worst of circumstances, an employer can make a tax-free payment to an employee. In addition to contemplating the type of terrorist attack for which it was originally designed, Section 139 also applies to any “federally declared disaster.” The IRS has already determined that the President’s emergency declaration delaying the filing of returns and payment of taxes from April 15th to July 15th constituted a federally declared disaster for purposes of Section 165. Thus, the COVID-19 pandemic satisfies the requirement in Section 139 of a federally declared disaster.

As a result, beginning immediately, employers may provide tax-free payments to employees — while still claiming a full deduction for the payments — provided the payment is to reimburse or pay the employee for “reasonable and necessary personal, family, living, or funeral expenses” incurred as a result of COVID-19. Payments are **NOT**, however, covered by Section 139 if they compensate employees for expenses that are otherwise compensated for by insurance or that are intended to replace lost income. Thus, payments of sick pay or family medical leave remain fully taxable to the employee.

It is important to understand Section 139 has never been utilized for a national pandemic. As a result, there is some guesswork involved in identifying the types of expenses that will meet the definition of “qualified disaster relief payments.” A reasonable interpretation of the statute, however, shows that, at a minimum, the following payments from employer to employee should be treated as deductible to the employer and tax-free to the employee, provided the expenses relate to the COVID-19 pandemic:

- Medical expenses of the employee that are not compensated for by insurance (for example, the employees deductible and out-of-pocket expenses);
- The cost of over-the-counter medications and hand sanitizer;
- Funeral costs of an employee or a member of an employee’s family;

- The costs associated with enabling an employee to work from home throughout the pandemic, including the cost of a computer, cell phone, printer, supplies, and even increased utility costs of the employee; and,
- The cost of an employee's child care or tutoring for family members that are not permitted to attend school throughout the pandemic.

Interestingly, Section 139 does not require that employees achieve a certain period of service before being eligible to receive tax-free payments under the provision, nor is any formal plan or documentation required to be maintained by the employer. For example, in Revenue Ruling 2003-12, the IRS recognized that given the “extraordinary circumstances surrounding a qualified disaster, it is anticipated that individuals will not be required to account for actual expenses in order to qualify the Section 139 exclusion, provided that the amount of the payments can be reasonably expected to be commensurate with the expenses incurred.”

Despite the informality permitted by the IRS, it would be extremely wise for employers to document their intention to make payments covered by Section 139, as well as the following:

- The amounts paid and to whom;
- The start and end date of any Section 139 program;
- A general listing of the expenses that will be paid or reimbursed on behalf of the employee; and,
- Any maximum amount per-employee or in the aggregate that the employer will pay.

Aside from allowing a deduction for any amounts paid, Section 139 does not provide any additional tax relief directly to employers. But, by allowing employers to assist employees in their time of need with tax-free payments, the hope is that the physical health and financial well-being of an organization can be maintained.

Section 139 was designed for the worst of moments. On a national scale, we have not needed it since 2002, and hopefully it will lay dormant for another twenty years after COVID-19 is under control. In the interim, however, employers should take advantage of the disaster relief provisions and do what they can to see their employees through these uncertain times.

Conclusion

Experts agree another economic stimulus bill will be needed if the economy sinks more than 10%. With the Senate in recess until April 20th and the House out for an indefinite period, another bill is unlikely before May.

The truth is there is a huge challenge ahead once the US moves into economic recovery. How will small businesses climb out from under all the debt and deferred taxes that the relief measures will pile on? The only hope is that revenue lost during the coronavirus downturn is merely deferred revenue that pent-up consumer demand will help restore later.

There is certainly more to follow. We will continue with our efforts to keep you informed. If you have any questions, please feel free to contact the author at (661) 325-1300 or drudnick@ch-law.com.



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