The Connection

In This Issue

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Excess Employment Tax Credit Recapture under Families First Act and CARES Act

The Treasury and the IRS have issued temporary and proposed regulations to reconcile advance payments of refundable employment tax credits provided under the Families First Coronavirus Response Act (P.L. 116-127) and the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) and to recapture the benefit of the credits when necessary.

The text of the temporary regulations serves as the text of the proposed regulations (T.D. 9904; NPRM REG-111879-20).

Background

Under the Families First Act, many employers with fewer than 500 employees must provide paid leave to employees due to circumstances related to COVID-19. Certain employers must provide an employee with up to 80 hours of paid sick leave if the employee cannot work or telework due to specific reasons related to COVID-19. The Families First Act also amends the Family and Medical Leave Act of 1993 so employers must provide expanded paid family and medical leave to employees who cannot work or telework for certain reasons related to COVID-19.

Eligible employers may receive a refundable payroll credit for required qualified sick or family leave wages paid to an employee, plus allocable qualified health plan expenses. The credits are allowed against the taxes imposed on employers by Code Sec. 3111(a) (Social Security tax), reduced by any credits claimed under Code Sec. 3111(e) and (f), and Code Sec. 3221(a) (railroad retirement tier I tax), on all wages and compensation paid to all employees. The credits are increased by the employer's share of Medicare tax on qualified leave wages.

The paid leave credits have per-day and maximum dollar limits for each employee. They apply to qualified leave wages paid for the period beginning April 1, 2020, and ending Dec. 31, 2020.

The CARES Act provides an employee retention credit for certain employers that experience economic hardship related to COVID-19 and pay qualified wages to their employees. Employers eligible for the credit carry on a trade or business during calendar year 2020. Also eligible are tax-exempt organizations that experience either a full or partial COVID-related

suspension of operations during any calendar quarter in 2020 due to an order from an appropriate governmental authority limiting commerce, travel or group meetings (for commercial, social, religious or other purposes), or a significant decline in gross receipts during the calendar quarter.

Qualified wages are those paid by an employer to some or all employees after March 12, 2020, and before Jan. 1, 2021, and include the employer's qualified health plan expenses that are properly allocable to such wages or compensation. Qualified wages differ depending on whether the employer averaged more than 100 full-time employees during 2019.

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The employee retention credit is a fully refundable tax credit for employers equal to 50% of qualified wages. The maximum for qualified wages paid to any employee by an eligible employer is $5,000. The credit is allowed against taxes imposed on employers by Code Sec. 3111(a), reduced by any credits allowed under Code Sec. 3111(e) and (f), the paid leave credits described above, and taxes imposed under Code Sec. 3221(a) that are attributable to the Code Sec. 3111(a) rate in effect, reduced by any paid leave credits allowed, on all wages and compensation paid to all employees.

The same wages or compensation cannot be counted for both the Families First Act leave credits and the CARES Act employee retention credit.

Refundability of Credits

If the amount of paid sick and family leave credits is more than the taxes imposed by Code Sec. 3111(a) or Code Sec. 3221(a) for any calendar quarter, the excess is treated as an overpayment that must be refunded under Code Sec. 6402(a) and Code Sec. 6413(b). A similar refund is required for the employee retention credit.

The IRS has revised Form 941, *Employer's Quarterly Federal Tax Return*, and is revising the other employment tax returns, so employers can use these returns to claim the paid sick and family leave credits and the employee retention credit.

The revised returns will provide for any credits exceeding the employment taxes described above to be credited against other employment taxes, and then for any remaining balance to be refunded to the employer.

Advance Payment of Credits and Erroneous Refunds

In anticipation of the paid sick and family leave credits, including any refundable portions, these credits may be advanced as provided by IRS forms and instructions, up to the total allowable amount and subject to applicable limits for the calendar quarter.

The IRS has created Form 7200, *Advance Payment of Employer Credits Due To COVID-19*, which employers can use to request an advance of the paid sick or family leave credits, the employee retention credit, or two or more credits. Employers must reconcile any advance payments claimed on Form 7200 with total credits claimed and total taxes due on their employment tax returns. A refund, a credit or an advance of any portion of these credits to a taxpayer over the amount to which the taxpayer is entitled is an erroneous refund for which the IRS must seek repayment.

Temporary Regulations

The temporary regulations provide that erroneous refunds of the credits are treated as underpayments of the taxes imposed under Code Sec. 3111(a) or Code Sec. 3221(a), and authorize the IRS to assess any portion of the credits erroneously credited, paid or refunded above the amount allowed as if those amounts were tax liabilities subject to assessment and administrative collection procedures. This allows the IRS to efficiently recover the amounts, while also preserving administrative protections enabling taxpayers to contest their tax liabilities under the Code and avoid unnecessary costs and burdens associated with litigation. These procedures will apply in the normal course of processing employment tax returns that report advances exceeding claimed credits, and in examining returns for excess claimed credits.

The temporary regulations also provide that employers against whom an erroneous refund of credits can be assessed as an underpayment include persons treated as the employer under

Code Sec. 3401(d), Code Sec. 3504 and Code Sec. 3511, consistent with their liability for the employment taxes against which the credit applied.

The temporary regulations apply to all paid leave credit refunds advanced or paid on or after April 1, 2020, and all employee retention credit refunds advanced or paid on or after March 13, 2020. Further, the temporary regulations apply to all paid leave credits (including any increases in the credits) refunded on or after April 1, 2020, including advanced refunds, as well as all employee retention credits refunded on or after March 13, 2020, including advanced refunds.

Applicability Date

The temporary regulations are effective July 29, 2020, the date they are scheduled to be published in the Federal Register. ◆

IRS Amends 199A Regulations on Suspended Losses and RICs

The IRS amended final regulations with guidance on the Code Sec. 199A deduction for suspended losses and shareholders of regulated investment companies (RICs) (T.D. 9899; IR-2020-128). The amendments address the treatment of suspended losses included in qualified business income (QBI), the deduction allowed to shareholders in RICs, and additional rules related to trusts and estates. The IRS had previously issued final and proposed regulations addressing these issues (NPRM REG-134652-18).

Background

Code Sec. 199A provides a deduction of up to 20% of QBI from a U.S. trade or business operated as a sole proprietorship, or through a partnership, S corporation, trust or estate. If the taxpayer's taxable income exceeds the threshold amount in Code Sec. 199A(e)(2), the deduction may be limited. Statutory limitations are subject to phase-in rules. Code Sec. 199A also provides individuals and some trusts and estates a deduction of up to 20% of their combined qualified real estate investment trust (REIT) dividends and publicly traded partnership (PTP) income.

461(l) Losses

Under Reg. §1.199A-3(b)(1)(iv), previously disallowed losses or deductions allowed in the tax year are generally taken into account for computing QBI, except to the extent the losses or deductions were disallowed, suspended, limited or carried over from tax years ending before Jan. 1, 2018. The final regulations amend Reg. §1.199A-3(b)(1)(iv)(A) to specifically reference excess business losses disallowed by Code Sec. 461(l) and treated as a net operating loss (NOL) carryover for the tax year for determining any NOL carryover in subsequent tax years. The IRS notes that the list of statutes in the regulation is not exhaustive.

Phase-in Rules for SSTB Losses

The amendments also clarify how the phase-in rules apply when a taxpayer has a suspended or disallowed loss or deduction from a specified service trade or business (SSTB). 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 is treated as QBI from a separate trade or business in the later tax year in which the loss is allowed. If the individual's taxable income is within the phase-in range, only a percentage of the disallowed loss or deduction is taken into account in the later tax year. If the individual's taxable income exceeds the phase-in range, the loss or deduction is not included in QBI.

Conduit Treatment

The final regulations provide conduit treatment for qualified REIT dividends earned by RICs. Conduit treatment happens when RICs treat dividends paid to a shareholder in the same or similar manner as the shareholder would treat the underlying item of income or gain if the shareholder realized it directly. The Treasury Department and IRS continue to consider comments on whether to provide conduit treatment for qualified PTP income and for RIC income from an activity that would generate QBI if conducted by a partnership or S corporation.

Separate Share Rule

The separate share applies for a trust or estate described in Code Sec. 663(c) with substantially separate and independent shares for multiple beneficiaries. Under the final regulations, the trust or estate will be treated as a single trust or estate for determining taxable income, net capital gain, net QBI, W-2 wages, unadjusted basis immediately after acquisition (UBIA) of qualified property, qualified REIT dividends and qualified PTP income for each trade or business of the trust or estate, as well as for computing the W-2 wage and UBIA of qualified property limitations.

Applicability

The amended regulations apply to tax years beginning 60 days after publication in the Federal Register. However, taxpayers may choose to apply the amendments before that date. Taxpayers who chose to rely on the proposed regulations issued in February 2019 may continue to do so until the date these amendments are published. ◆

IRS Encourages Abusive Conservation Easement Taxpayers to Settle

The IRS is calling on any taxpayers involved in syndicated conservation easement transactions who received a settlement offer from the agency to accept it soon. The IRS made this request in the wake of the Tax Court's recent striking down of four additional abusive syndicated conservation easement transactions (IR-2020-152).

Settlement Offers

Time-limited settlement offers, which the IRS announced on June 25 (IR-2020-130), are only being made to certain taxpayers with pending docketed Tax Court cases involving this type of abusive transaction. The IRS declared that these and other recent Tax Court decisions support the abusive nature of the underlying syndicated conservation easement deduction.

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Abusive Transactions

While recognizing the important role of legitimate conservation easement deductions in incentivizing land preservation for future generations, the IRS pointed out that abusive syndicated conservation easement transactions have been concerning for several years.

In listed syndicated conservation easement structures, promoters syndicate ownership interests in real property through partnerships, using promotional materials to suggest that prospective investors may be entitled to a share of a conservation easement contribution deduction that equals or exceeds 2.5 times the investment amount. The promoters obtain an appraisal that greatly inflates the value of the conservation easement, based on a fictional and unrealistic highest and best use of the property before it was encumbered with the easement. After the investors invest in the partnership, the partnership donates a conservation easement to a land trust. Investors in the partnership then claim a deduction based on the inflated value. According to the IRS, the investors typically claim charitable contribution deductions that grossly multiply their actual investment in the transaction and defy common sense.

The IRS is aware that some promoters of these abusive transactions have downplayed the significance of the string of recent court decisions holding in the government's favor, arguing that their cases are somehow different or that those decisions might be reversed on appeal. These promoters ignore common sense and argue that the real dispute is about value, neglecting to explain how the reporting of short-term appreciation, often exceeding many multiples of reality, could possibly withstand judicial scrutiny. ◆

Reporting COVID-19 Qualified Sick and Family Leave Wages

The IRS has issued guidance to employers on the requirement to report the amount of qualified sick and family leave wages paid to employees under the Families First Coronavirus Response Act (P.L. 116-127) (Notice 2020-54; IR-2020-144). This reporting provides employees who are also self-employed with information necessary to properly claim qualified sick leave equivalent or qualified family leave equivalent credits under the Families First Act.

Background

Under the Families First Act, many employers with fewer than 500 employees must provide paid leave to employees due to circumstances related to COVID-19. Certain employers must provide employees with up to 80 hours of paid sick leave if the employees cannot work or telework because they are:

1. Subject to a federal, state or local quarantine or isolation order related to COVID-19
2. Advised by a health care provider to self-quarantine due to concerns related to COVID-19
3. Experiencing symptoms of COVID-19 and seeking a medical diagnosis
4. Caring for an individual who is subject to a federal, state or local quarantine or isolation order related to COVID-19 or has been advised by a health care provider to self-quarantine due to COVID-related concerns
5. Caring for a son or daughter whose school or place of care has been closed, or whose child care provider is unavailable, due to COVID-19 precautions
6. Experiencing any other substantially similar condition specified by the Secretary of Health and Human Services in consultation with the Secretaries of the Treasury and Labor

Employees are entitled to paid sick leave at their regular pay rate (or if higher, the applicable federal, state or local minimum wage), up to:

- $511 per day ($5,110 aggregate) if they cannot work for reasons 1-3 above
- $200 per day ($2,000 aggregate) if they cannot work for reasons 4-6 above

The Families First Act also amends the Family and Medical Leave Act of 1993 so employers must provide expanded paid family and medical leave to employees who cannot work or telework for reasons related to COVID-19. Employees can receive up to 10 weeks of paid family and medical leave at two-thirds their regular rate of pay, up to $200 per day ($10,000 aggregate) if they cannot work because they are caring for a son or daughter whose school or place of care is closed, or whose child care provider is unavailable, for reasons related to COVID-19.

Eligible employers may receive a refundable payroll credit for required qualified sick or family leave wages paid to an employee, plus allocable qualified health plan expenses. An equivalent credit is available to self-employed individuals carrying on a trade or business, provided the self-employed individuals would be entitled to receive paid leave if they were employees of an employer (other than themselves). The refundable credits apply to qualified leave wages paid for the period beginning April 1, 2020, and ending Dec. 31, 2020.

Reporting Qualified Leave Wages

In addition to reporting qualified sick and family leave wages paid in Boxes 1, 3 (up to the Social Security wage base) and 5 of Form W-2 (or, in the case of compensation subject to the Railroad Retirement Tax Act, in Boxes 1 and 14 of Form W-2), employers must report to the employee the total amounts of the following types of wages paid, with each amount separately reported either in Box 14 of Form W-2 or on a separate statement:

- Qualified sick leave wages paid for reasons 1-3 above, labeled as “sick leave wages subject to the $511 per day limit” or in similar language
- Qualified sick leave wages paid for reasons 4-6 above, labeled as “sick leave wages subject to the $200 per day limit” or in similar language
- Qualified family leave wages paid, labeled as “emergency family leave wages” or in similar language

If a separate statement is provided and the employee receives a paper Form W-2, the statement must be included with the Form W-2 provided to the employee. If the employee receives an electronic Form W-2, the statement must be provided in the same manner and at the same time.

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Self-employed Individuals

Self-employed individuals who claim qualified sick or family leave equivalent credits, and who are also eligible for qualified sick and family leave wages as employees, must report the qualified leave wage amounts described above on Form 7202, *Credits for Sick Leave and Family Leave for Certain Self-Employed Individuals*, included with their income tax returns. They also must reduce (but not below zero) any qualified sick or family leave equivalent credits by the amount of these qualified leave wages. ◆

Entities Denied Charitable Deductions for Conservation Easements

Four entities were not entitled to charitable deductions for conservation easements. The entities did not comply, strictly or substantially, with the regulatory reporting requirements. The taxpayers were limited liability companies treated as partnerships for federal tax purposes. The court ruled that the easement deeds failed to satisfy the "protected in perpetuity" requirement. The regulatory fraction used in the deeds was applied to the proceeds minus any increase in value after the date of the conservation easements attributable to improvements. Thus, the grantees' shares were improperly reduced on account of appreciation in the value of improvements existing when the easements were granted plus the fair market value of any improvements that the donors or their successors subsequently make to the properties.

Moreover, because the grantees' share of the proceeds was improperly reduced by carve-outs for both donor improvements and claims against the donors, the deeds' judicial extinguishment provisions did not satisfy the regulatory requirements. Further, the court observed that the taxpayers' failure to supply cost basis violated the essence of the statute. The taxpayers' refusal to report cost basis information was not an instance of inadvertent omission. Therefore, the court granted the IRS' motion for partial summary judgment. See *Village at Effingham, LLC*, TC Memo. 2020-102, Dec. 61,715(M); *Riverside Place, LLC*, TC Memo. 2020-103, Dec. 61,716(M); *Maple Landing, LLC*, TC Memo. 2020-104, Dec. 61,717(M); and *Englewood Place, LLC*, TC Memo. 2020-105, Dec. 61,718(M). ◆

CARES Act Waives RMDs for IRAs and Retirement Plans

The Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) waives required minimum distributions (RMDs) during 2020 for IRAs and retirement plans, including beneficiaries with inherited accounts (IR-2020-162). This waiver includes RMDs for individuals who turned age 70½ in 2019 and took their first RMD in 2020. Roth IRAs do not require withdrawals until after the death of the owner.

The IRS has reminded seniors and retirees that they are not required to take money out of their IRAs and workplace retirement plans in 2020. The CARES Act provisions apply to most retirement plans, including traditional IRAs, SEP IRAs, SIMPLE IRAs, 401(k) plans, 403(b) plans, 457(b) plans, profit sharing plans and other defined contribution plans. The RMD suspension does not apply to qualified defined benefit plans.

If an individual has already taken an RMD in 2020, including someone who turned 70½ during 2019, the individual will have the option of returning the distribution to their account or other qualified plan.

More information on the CARES Act and retirement plans, including FAQs, can be found at www.irs.gov/newsroom/coronavirus-related-relief-for-retirement-plans-and-iras-questions-and-answers. ◆

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