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Final regulations released on small business simplified accounting rules

The IRS has released final regulations addressing the post-2017 simplified accounting rules for small businesses. The final regulations adopt and modify proposed regulations released in August 2020 (T.D. 9942).

Implementation of the rules

The Tax Cuts and Jobs Act (P.L. 115-97) put in place a single $25 million gross receipts test to determine whether certain taxpayers qualify as small taxpayers that can use the cash method of accounting, are not required to use inventories, are not required to apply the uniform capitalization rules and are not required to use the percentage of completion method for a small construction contract.

Highlights of changes in the final regulations

Annual syndicate election. The proposed regulations permit a taxpayer to use the allocated taxable income or loss of the immediately preceding tax year to determine whether the taxpayer is a syndicate under Code Sec. 448(d)(3) for the current tax year. Under the proposed regulations, a taxpayer that makes this election must apply the rule to all subsequent tax years, unless it receives IRS permission to revoke the election.

The final regulations provide additional relief by making the election annual. The election is valid only for the tax year for which it is made, and cannot be revoked once made. The IRS intends to issue procedural guidance to address the revocation of an election made under the proposed regulations due to the application of the final regulations.

Five-year written consent requirement relaxed. The proposed regulations require a taxpayer that meets the gross receipts test in the current tax year to obtain the written consent of the Commissioner before changing to the cash method if the taxpayer had previously changed its overall method from the cash method during any of the five tax years ending with the current one. The final regulations remove the five-year restriction on making automatic accounting method changes for certain situations.

Additional changes

To reduce confusion about the nature of property treated as non-incidental materials and supplies (NIMS) under Code Sec. 471(c)(1)(B)(i), the final regulations refer to the method under that provision as the "section 471(c) NIMS inventory method."

The final regulations provide that inventory costs includible in the section 471(c) NIMS inventory method are direct material costs of the property produced or the costs of property acquired for resale.

Examples clarify the principle that a taxpayer may not ignore its regular accounting procedures or portions of its books and records under the non-AFS section 471(c) inventory method.

The final regulations clarify how a taxpayer treats costs to acquire or produce tangible property that the taxpayer does not capitalize in its books and records.

Applicability date

The final regulations are applicable for tax years beginning on or after the date of publication in the Federal Register. However, a taxpayer may apply the final regulations under a particular Code provision for a tax year beginning after Dec. 31, 2017, if the taxpayer follows all the applicable rules in the regulations that relate to that Code provision for the tax year and all subsequent tax years, and follows the administrative procedures for filing a change in method of accounting. ◆

Final regulations clarify HRAs integrated with individual coverage

The IRS has released final regulations that clarify the application of the employer shared responsibility provisions and certain nondiscrimination rules to health reimbursement arrangements (HRAs) integrated with individual health insurance coverage or Medicare (T.D. 9949). The final regulations also provide certain safe harbors for the application of those provisions to individual coverage HRAs, to facilitate the adoption of such HRAs by employers.

Shared responsibility affordability

An employer-sponsored plan is affordable for an employee if the amount the employee must pay for self-only coverage for a plan does not exceed a percentage of the employee's household income. An eligible employer-sponsored plan also provides minimum value if the plan's share of the total allowed costs of benefits provided under the plan is at least 60%, and the plan provides substantial coverage of inpatient hospitalization and physician services.

> "Further, the location safe harbor may be used in combination with the other safe harbors provided in the regulations."

As with other types of employer-sponsored coverage, employers that offer individual coverage HRAs will not know employees' household incomes. Therefore, the final regulations provide that an employer offering an individual coverage HRA to a class of employees may use safe harbors to determine whether the cost of the HRA is affordable.

Location safe harbor

Under existing premium tax credit (PTC) regulations, an individual coverage HRA is considered affordable for a month if the employee's required HRA contribution for the month does not exceed $1/12$ of the product of the employee's household income for the tax year and the required contribution percentage. The Treasury Department and the IRS have concluded that the cost of the affordability plan at an employee's primary site of employment is

a reasonable proxy for the cost of the affordability plan at the employee's residence, while avoiding the burdens that may arise for some employers in keeping records of their employees' current residences.

Thus, for determining whether an offer of an individual coverage HRA to a full-time employee is affordable, the final regulations provide that an employer may use the lowest cost Silver plan for the employee for self-only coverage offered through the Exchange where the employee's primary site of employment is located. Further, the location safe harbor may be used in combination with the other safe harbors provided in the regulations.

Age safe harbor

Under existing PTC regulations, affordability for an employee is based on the employee's relevant circumstances, including age. The final regulations do not provide a safe harbor for the age used to determine the premium of an employee's affordability plan. Rather, affordability of the offer of an individual coverage HRA is determined, in part, based on each employee's age.

Look-back month safe harbor

Affordability of an individual coverage HRA for a month under existing regulations is determined, in part, based on the cost of the PTC affordability plan for that month. For example, an employee's required contribution for January 2020 for an individual coverage HRA would be based on the cost of the PTC affordability plan for January 2020.

Under the final regulations, an employer offering an individual coverage HRA with a calendar-year plan year may use the look-back month safe harbor. However, the regulations provide additional specificity reflecting that even within a calendar year, from calendar month to calendar month, the lowest cost Silver plan in an employee's applicable location may change due to plan termination or because the lowest cost Silver plan closes to enrollment (sometimes referred to as plan suppression). Therefore, the final regulations provide that, in determining an employee's required contribution for any calendar month, an employer offering an individual coverage HRA with a calendar-year plan year may use the monthly premium for the lowest cost Silver plan for January of the prior calendar year. ◆

IRS highlights temporary tax changes for individuals and businesses giving to charity

The IRS has highlighted four temporary tax changes which are a part of the Coronavirus Aid, Relief, and Economic Security Act (CARES) Act (P.L. 116-136). These tax changes were designed to help individuals and businesses giving to charity before the end of 2020 (IR-2020-278).

Individuals who don't itemize

Individuals who elect to take the standard deduction generally cannot claim a deduction for their charitable contributions. However, the CARES Act permits these individuals to claim a limited deduction on their 2020 federal income tax returns for cash contributions made to certain qualifying charitable organizations and still claim the standard deduction. Under this change, these individuals can claim an above-the-line deduction of up to $300 for cash contributions made to qualifying charities during 2020. The maximum above-the-line deduction is $150 for married individuals filing separate returns.

Individuals who itemize

Subject to certain limits, individuals who itemize may claim a deduction for charitable contributions they make to qualifying charitable organizations. These limits generally range from 20% to 60% of an individual's adjusted gross income (AGI) and vary by the type of contribution and type of charitable organization. The CARES Act permits individuals to apply an increased limit, up to 100% of their AGI, for qualified contributions. The election is made on a contribution-by-contribution basis. Qualified contributions are limited to those made in cash during 2020 to qualifying charitable organizations. Individuals who would like to take advantage of the increased limit must make their elections with their Form 1040, *U.S. Individual Income Tax Return*, or Form 1040-SR, *U.S. Tax Return for Seniors*.

> "Qualified contributions are limited to those made in cash during 2020 to qualifying charitable organizations."

Increased corporate limit for charitable contributions

The CARES Act has permitted C corporations to apply an increased limit of 25% of taxable income for charitable contributions of cash to eligible charities during 2020. The maximum allowable deduction is usually limited to 10% of a corporation's taxable income. C corporations must elect application of the increased limit on a contribution-by-contribution basis.

Businesses donating food inventory

Businesses donating food inventory eligible for the enhanced deduction (contributions for the care of the ill, needy, and infants) are eligible for increased deduction limits. For contributions made in 2020, the limit for these contribution deductions is increased from 15% to 25%. For C corporations, the 25% limit is based on taxable income. For other businesses, including sole proprietorships, partnerships and S corporations, the limit is based on aggregate net income for the year from all trades or businesses from which the contributions were made. A special method for computing the enhanced deduction continues to apply, as do food quality standards and other requirements.

In addition, the IRS has reminded both individuals and businesses that special recordkeeping rules apply to any taxpayer claiming a charitable contribution deduction. For donations of property, additional recordkeeping rules may apply, including filing a Form 8283, *Noncash Charitable Contributions*, and obtaining a qualified appraisal. The IRS has requested taxpayers see Publication 526, *Charitable Contributions*, for additional details on how to apply the percentage limits described above and a description of the recordkeeping rules for substantiating gifts to charity. ◆

Time extended for withholding and paying deferred employee Social Security tax

The IRS has extended the period during which employers must withhold and pay the employee portion of Social Security tax that employers elected to defer on wages paid from Sept. 1, 2020, through Dec. 31, 2020 (Notice 2021-11; IR-2021-17). Specifically, the end date for withholding and paying the deferred tax is postponed from April 30, 2021, to Dec. 31, 2021, and any interest, penalties, and additions to tax for late payment of any unpaid deferred tax will begin to accrue on Jan. 1, 2022, rather than May 1, 2021.

Employee payroll tax deferral

In response to the COVID-19 pandemic, the President issued a memorandum on Aug. 8, 2020, directing the Treasury Secretary to use his Code Sec. 7508A authority to defer withholding, deposit and payment of the employee portion of the 6.2% old-age, survivors and disability insurance tax (Social Security tax) under Code Sec. 3101(a), and the Railroad Retirement Tax Act (RRTA) Tier 1 tax that is attributable to the 6.2% Social Security tax under Code Sec. 3201, on wages paid from Sept. 1, 2020, through Dec. 31, 2020. The deferral was available only for employees whose biweekly pre-tax pay was less than $4,000, or a similar amount where a different pay period applied.

"The deferral was available only for employees whose biweekly pre-tax pay was less than $4,000, or a similar amount where a different pay period applied."

The Treasury Secretary and the IRS issued guidance directing employers that elected to apply the deferral to withhold and pay the deferred taxes ratably from wages and compensation paid between Jan. 1, 2021, and April 30, 2021. Interest, penalties and additions to tax would begin to accrue on May 1, 2021, on any unpaid applicable taxes (Notice 2020-65, I.R.B. 2020-38, 567).

Payment period extended

The recent COVID-related Tax Relief Act of 2020 (Division N of the Consolidated Appropriations Act, 2021) (P.L. 116-260)

extended the payment period and required the Treasury Secretary to apply Notice 2020-65 by changing the withholding and payment end date to Dec. 31, 2021, and changing the date interest, penalties and additions to tax would begin accruing to Jan. 1, 2022.

Employers that elected to defer employees' payroll taxes can now withhold and pay the deferred tax throughout 2021, instead of just during the first four months of the year. Notice 2020-65, I.R.B. 2020-38, 567, is modified. ◆

IRS releases final regulations on exempt organization excess remuneration

The IRS has released final regulations relating to excise taxes imposed on remuneration over $1 million and any excess parachute payment paid by an applicable tax-exempt organization (ATEO) to any covered employee (T.D. 9938). The regulations apply to certain tax-exempt organizations and other entities treated as related organizations. The final regulations adopt proposed regulations issued in June 2020, with modifications.

Code Sec. 4960 generally imposes an excise tax on an ATEO that pays a covered employee either remuneration exceeding $1 million for a tax year or any excess parachute payment, at the Code Sec. 11 tax rate imposed on corporations (currently 21%). A covered employee is any employee or former employee of an ATEO that was one of the five highest-compensated employees of the organization during the current or immediately preceding tax year. A parachute payment is any payment to a covered employee that is in the nature of compensation, is contingent on the employee's separation from employment with the ATEO and has an aggregate present value that exceeds triple a specified base amount.

Proposed regulations

The proposed regulations clarify that, when a person performs services as an employee of an ATEO and also for one or more of its related organizations, liability for the year's excise taxes is allocated between the employers according to their proportional share. If an organization is liable for excise tax on an employee both directly (as the organization's employee) and through a related organization, the proposed regulations provided that the organization is liable only for whichever amount is greater.

The proposed regulations also clarify that an ATEO is only liable for the excise tax on excess parachute payments that were actually paid by that organization. This is true even though the covered employee's base remuneration calculation includes the income from the applicable tax-exempt organization and all the related organizations.

Each employer liable for excise tax under Code Sec. 4960 is separately responsible for reporting and paying the tax using Form 4720, *Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code*. An employer may prepay the excise tax for excess parachute payments in the year of separation or in any tax year prior to the year in which the parachute payment is made.

"The final regulations adopt proposed regulations issued in June 2020, with modifications."

Final regulations

The final regulations clarify that, for purposes of identifying an ATEO's five highest-compensated employees for a tax year, remuneration during the applicable year for medical services is not considered. They also define various terms set forth in Code Sec. 4960.

Further, the final regulations provide rules for determining the following:

- The amount of remuneration paid for a tax year for purposes of identifying covered employees and calculating the excise tax
- Whether excess remuneration has been paid and in what amount
- Whether a parachute payment has been paid and in what amount
- Allocation of liability for the excise tax among related organizations
- The applicability date of the final regulations ◆

IRS Chief Counsel finds insurance premiums not deductible

The IRS Chief Counsel has issued guidance on the deductibility of certain policy premiums under Code Secs. 162(a) and 212 (CCA 202053010, Jan. 4, 2021). The Chief Counsel concluded that the premium paid toward the policy was not directly or proximately connected to any trade, business or income-producing activity of the taxpayer. As a result, the premium was not deductible under Code Secs. 162(a) and 212. Further, the premium, as part of a contractual arrangement to pay non-deductible tax, was not deductible under Code Sec. 212(3).

The reimbursable claims under the policy were unrelated to any purported trade or business activities of the taxpayer. Under the terms, provided the taxpayer fulfilled its obligations under the policy, it was entitled to payment for amounts calculated with reference to the disallowed conservation easement deduction. Moreover, because any reimbursement under the policy would pass through to the taxpayer's members, the policy's terms were necessarily unrelated to any trade or business activities at the partnership level. Neither the deduction itself, nor any insurance payout for its disallowance, arose due to any purported investment activity, or correlated to the success or failure of such activity. As a result, the premium paid toward the policy was not deductible under Code Sec. 212. Lastly, since the insurer was under no obligation to perform any services related to a tax proceeding, no portion of the premium could be regarded as consideration for such services. Thus, the contract explicitly contemplated the reimbursement of non-deductible tax and penalty amounts. Consequently, the premium paid toward the policy was not deductible under Code Sec. 212(3). ◆

"The reimbursable claims under the policy were unrelated to any purported trade or business activities of the taxpayer."

IRS issues 2020 Required Amendments List for qualified plans

The IRS has issued its 2020 Required Amendments (RA) List for individually designed employee retirement plans (Notice 2020-83). RA Lists apply to both Code Sec. 401(a) and Code Sec. 403(b) individually designed plans.

There are two required amendments for 2020:

- Plans maintained by employers that have provided difficulty of care payments during plan years beginning after Dec. 31, 2015, and before Jan. 1, 2021, must be amended by Dec. 31, 2022, or, if later, the SECURE Act Sec. 601 (P.L. 116-94) date applicable to the plan, as set forth in section G of Notice 2020-68, I.R.B. 2020-38, 567. If an employer changes its practice and begins difficulty of care payments to its employees in future years, the plan must be amended to include difficulty of care payments in the definition of Code Sec. 415(c)(1) compensation by the end of the second calendar year following the year in which the employer begins to make difficulty of care payments.
- Under Code Sec. 414(y)(1)(D), as added by Act Sec. 3609 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136), the definition of a cooperative and small employer charity (CSEC) pension plan includes a defined benefit plan that, as of Jan. 1, 2000, was maintained by a tax-exempt employer that met specific characteristics. A CSEC plan cannot include the benefit restrictions of Code Sec. 436. ◆

IRS releases guidance on business deductions of PPP loan recipients

The IRS has issued guidance clarifying that taxpayers receiving loans under the Paycheck Protection Program (PPP) may deduct their business expenses, even if their PPP loans are forgiven (Rev. Rul. 2021-2; IR-2021-4). The IRS previously issued Notice 2020-32 and Rev. Rul. 2020-27, which stated that taxpayers who received PPP loans and had those loans forgiven would not be able to claim business deductions for their otherwise deductible business expenses.

The COVID-related Tax Relief Act of 2020 (P.L. 116-260) amended the CARES Act (P.L. 116-136) to clarify that business expenses paid with amounts received from loans under the PPP are deductible as trade or business expenses, even if the PPP loan is forgiven. Further, any amounts forgiven do not result in the reduction of any tax attributes or the denial of basis increase in assets. This change applies to years ending after March 27, 2020. Notice 2020-32, I.R.B. 2020-21, 83 and Rev. Rul. 2020-27, I.R.B. 2020-50, 1552, are obsolete. ◆

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