2021 Post-Filing Season Update

May 20, 2021

Highlights

- ✔ Trillions of Dollars in Passed and Proposed Legislation
- ✔ Guidance on Recently Enhanced Credits
- ✔ Last of TCJA Implementation?
- ✔ IRS Funding to Improve Enforcement

Inside

SPECIAL REPORT

Implementing Guidance and Tax Legislation, With More on the Horizon

Filing season for the 2020 tax year got off to a bit of a late start in 2021. After the passage of the Consolidated Appropriations Act, 2021 in late December 2020, the IRS had its hands full updating systems to reflect the changes in the new law, as well as administering the second round of stimulus payments provided by the legislation. Finally, the IRS announced that filing season would begin February 12, 2021, more than two weeks later than the filing season began in 2020.

Almost immediately after filing season began, there were reports that the IRS was far behind in processing returns. Lawmakers and tax professionals began to suggest that the IRS should once again postpone the filing deadline, as was done in 2020 in response to the COVID-19 crisis.

The IRS initially declined to provide such a delay, announcing that it was catching up on filing. However, once the American Rescue Plan Act of 2021 was signed into law, bringing with it additional law changes for the IRS to manage, as well as a third round of stimulus payments and other recovery programs to administer, the IRS finally relented. On March 17, the IRS delayed the filing deadline for individuals' 2020 tax returns from April 15 to May 17, 2021.

During this slightly extended filing season, the IRS has continued to issue guidance implementing the sizable volume of legislation over the last few years and ongoing relief and recovery assistance. Also, President Biden has proposed two massive pieces of legislation to aid in the recovery from the ongoing COVID-19 crisis. While you've been working on your clients' returns we've been keeping track of everything else. As we do every year, Wolters Kluwer publishes this Special Report on the things you may have missed during this slightly longer filing season.

LEGISLATION

American Rescue Plan Act

On March 11, 2021, President Biden signed the American Rescue Plan Act of 2021 into law. The Act included several tax provisions, including a third round of direct stimulus payments, enhancements of many personal credits meant to benefit parents and people with lower incomes, extensions of highly popular payroll tax credits for employers first instituted at the beginning of the pandemic, and changes related to retirement plan funding.

The most significant, and immediate, impact to taxpayers was a third round of direct stimulus payments, this time $1,400 per individual (including dependents). The payments are essentially credits against 2021 taxes, but fully refundable and payable in advance (similar to the prior payments). Also, like previous stimulus payments, this third round is subject to income limitations. The payments have been dispersed throughout March, April, and May in batches, and taxpayers generally do not have to do anything to receive them. However, the IRS has urged individuals who don't normally file returns to file 2020 returns to ensure they receive payments, and to use the *Get My Payment* tool on irs.gov to check the status of their payments.

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The Act also included a massive, and for now temporary, expansion of the child tax credit. For 2021 only, the credit is increased to $3,000 per child (or $3,600 for a child under the age of six) and made fully refundable, while also increasing the maximum age of qualifying children to include 17-year old children. This temporary increase over the pre-Act amount of $2,000 is subject to income limitations. The Act also directs the IRS to periodically distribute half of the credit amount in advance, beginning in July 2021. The details of this advance payment are discussed more fully below.

The Act also provided expansions of the earned income tax credit and the dependent care assistance credit, again only applicable to 2021. In addition, the legislation expanded the eligibility of taxpayers to claim the premium tax credit.

For businesses, the popular COVID-19-related paid sick and family leave credit as well as the employee retention credit were both extended through September 2021 and December 2021, respectively. However, in both cases, the "new" versions of the credit under the Act are applicable to the hospital insurance (HI) tax, not old-age, survivors, and disability insurance (OASDI) taxes.

COMMENT. *You can find in-depth coverage of the details of the American Rescue Plan Act of 2021 on CCH® AnswerConnect.*

PROPOSED LEGISLATION

In his campaign, President Biden promised massive tax reform, middle-class tax relief, and infrastructure funding, none of which was included in the American Rescue Plan Act. However, on the heels of the American Rescue Plan, the White House released a framework for the $2.1 trillion American Jobs Plan, which provides infrastructure funding for highways, schools, and utilities. The centerpiece of the massive bill is the Made in America Tax Plan, which will fund the cost of the infrastructure proposals.

While the details of the tax provisions are not very specific, the central thrust of the proposal is an increase in the corporate tax rate and changes to international taxation that will ensure that domestic corporations pay a proper amount of tax on foreign income and not shift domestic income to foreign tax havens. The proposal seeks to increase the tax rate on corporations to 28 percent.

COMMENT. *The push to increase the rate to 28 percent, and even the overall infrastructure proposal does not currently have support among enough Democrats to get approval by the 50-50 Senate, let alone bipartisan support. However, President Biden has signaled an openness to negotiation on the provisions, including a lower corporate tax rate.*

The White House then followed this up with another proposal, the $1.8 trillion American Families Plan, which includes the remainder of the tax proposals from President Biden's campaign, as well as an extension of the enhanced credits from the American Rescue Plan Act of 2021.

To pay for it all, the proposal includes an increase in the tax rate on ordinary income for individuals in the top bracket to 39.6 percent, where it was before passage of the Tax Cuts and Jobs Act of 2017. The proposal also includes an increase in the capital gains rate for higher income individuals, the elimination of the step-up in basis for inherited property, as well as some other targeted increases.

COMMENT. *Notably absent from the proposal is an increase, or elimination, of the cap on the state and local tax deduction. Many Democratic lawmakers from high tax states such as California and New York feel at least a partial rollback of the limitation is essential, while other lawmakers, including some Democrats, feel that it is too costly to increase the cap and largely benefits higher-income taxpayers.*

The American Families Plan also proposes a significant increase in funding for the IRS. The proposal intends to cover a significant amount of its cost by closing the tax gap, the difference between what is actually collected by the IRS and what *should* be collected, which the White House estimates could be as much as $700 billion over a ten year period. The increased funding would help the IRS close the gap by improving enforcement.

At this point, these proposals are just that, proposals. No proposed legislative text has yet been released, and tax-writing committees have not signaled that they have begun their processes yet.

COMMENT. *Many of these proposals are a long way off from becoming reality, and the details around them may change as negotiations begin around the contents. You can find the latest coverage on CCH® AnswerConnect.*

DEVELOPMENTS FOR INDIVIDUALS

Advanced 2021 Child Tax Credit

As discussed above, the American Rescue Plan Act of 2021 included an increase in the amount of the child tax credit and allows for half to the credit to be received in advance on a periodic basis beginning in July. At the time the Act was being negotiated, there was much discussion as to whether it would be possible for the IRS to administer it (the text of the provision was even changed from “monthly” payments to “periodic” payments.) However, the Treasury has announced that monthly payments up to $300 per child (depending on the age of the child and income limitations) will begin being deposited on July 15th, and will continue on the 15th (or later if the 15th is a weekend of holiday) of every month through the end of 2021.

The Act requires the IRS to create a website for taxpayers to provide updated information in the case of a birth of a child, or to opt out of receiving the advance payments. The IRS has not yet set up the required online portal.

The IRS has also provided guidance (Rev. Proc. 2021-24) as to how taxpayers who are not required to file a return for 2020 can file a simplified return to ensure they receive both the advance child tax credit and the third economic stimulus payment.

Guidance on Expanded Credits

In addition to the specific guidance related to the advance payment of the child tax credit, the IRS has also issued guidance related to the other credits increased or expanded by the American Rescue Plan Act of 2021. Specifically, updated tables and inflation-adjusted amounts were issued for the child tax credit, the dependent care assistance credit, the earned income tax credit, and the premium tax credit for the 2021 tax year (Rev. Proc. 2021-23).

DEVELOPMENTS FOR BUSINESSES

Final Guidance on TCJA

In January, in the waning days of the outgoing Trump administration, the IRS issued some final guidance on the provisions of the Tax Cuts and Jobs Act of 2017.

The IRS issued final regulations (T.D. 9943) providing additional guidance on the limitation on the deduction for business interest under Code Sec. 163(j). The regulations finalize various portions of the proposed regulations issued in 2020 with few modifications. They address the application of the limit in the context of calculating adjusted taxable income (ATI) with respect to depreciation, amortization, and depletion. The regulations also finalize rules on the definitions of real property development and redevelopment, as well as application to passthrough entities, regulated investment companies (RICs), and controlled foreign corporations.

The IRS issued final regulations (T.D. 9945) under Code Sec. 1061 that provide guidance related to carried interests in a partnership. The final regulations also amend existing regulations on holding periods, to clarify the holding period of a partner’s interest in a partnership that includes in whole or in part an applicable partnership interest and/or a profits interest. These regulations affect taxpayers who directly or indirectly hold applicable partnership interests in partnerships and the passthrough entities through which the applicable partnership interest is held.

For determining W-2 wages under the Code Sec. 199A qualified business income (QBI) deduction, the IRS has provided guidance that modifies the rule for all taxpayers with short tax years, as well as three methods for most agricultural cooperatives to use (Rev. Proc. 2021-11). The rules under this guidance apply to tax years ending after 2017. Final regulations governing the qualified business income (QBI) deduction under Code Sec. 199A for Specified Agricultural Cooperatives and their patrons were also issued (T.D. 9947). These final regulations largely adopt proposed regulations issued in 2019.

Finally, the IRS released final regulations (T.D. 9946) that address the changes made to Code Sec. 162(f), concerning the deduction of certain fines, penalties, and other amounts. The final regulations also provide guidance relating to the information reporting requirements for fines and penalties under Code Sec. 6050X. The final regulations adopt proposed regulations released in May of 2020.

Paycheck Protection Program

The highly popular Paycheck Protection Program (PPP) was part of the original package of legislation Congress passed in the early days of the pandemic. The program is credited with helping save many small businesses and jobs, but has been refined and reauthorized in many subsequent pieces of legislation. As the program is relatively unprecedented in both scope and size, the IRS has had to continually tweak its guidance, both due to the original nature of the program, also because of the many legislative refinements to the program.

For example, the IRS had originally determined that taxpayers who received PPP loans that were subsequently forgiven, and thus excludable, could not also deduct business expenses paid with the proceeds of an excludable forgiven loan. However, Congress provided for the deduction of such expenses in the Consolidated Appropriations Act, 2021. As a result, the IRS provided a safe harbor (Rev. Proc. 2021-20) for certain PPP loan recipients who relied on prior IRS guidance and did not deduct eligible business expenses. These taxpayers may elect to deduct the expenses for their first tax year following their 2020 tax year, rather than filing an amended return or administrative adjustment request for 2020.

Employment Taxes

Another popular temporary program provided during the COVID-19 crisis has been employment credits. As discussed above, new versions of the credits applicable to most of 2021 were made a part of the American Rescue Plan Act of 2021. However, the IRS issued guidance related to the original versions, applicable to 2020 and 2021.

The IRS issued guidance (Notice 2021-23) for employers claiming the employee retention credit under Act Sec. 2301 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), as modified by Act Secs. 206 and 207 of the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (part of the Consolidated Appropriations Act, 2021), for the first and second calendar quarters in 2021. The guidance explains changes made to the employee retention credit for the first two calendar quarters of 2021, including:

- the increase in the maximum credit amount,
- the expansion of the types of employers that may be eligible to claim the credit,
- modifications to the gross receipts test,
- revisions to the definition of qualified wages, and
- new restrictions on the ability of eligible employers to request an advance payment of the credit.

The IRS also extended penalty relief (Notice 2021-24) for failure to deposit employment taxes, to eligible employers that reduce their required deposits in anticipation of the following credits:

- the paid sick and family leave credits under the Families First Coronavirus Response Act, as amended by the COVID-related Tax Relief Act of 2020, for qualified leave wages paid with respect to the period beginning January 1, 2021, and ending March 31, 2021;
- the paid sick and family leave credits under Code Secs. 3131, 3132, and 3133, added by the American Rescue Plan Act of 2021, for qualified leave wages paid with respect to the period beginning April 1, 2021, and ending September 30, 2021;
- the employee retention credit under section 2301 of the CARES Act, as amended by the Taxpayer Certainty and Disaster Tax Relief Act of 2020, for qualified wages paid with respect to the period beginning January 1, 2021, and ending June 30, 2021;
- the employee retention credit under Code Sec. 3134, added by American Rescue Plan Act of 2021, for qualified wages paid with respect to the period beginning July 1, 2021, and ending December 31, 2021; and
- the COBRA Continuation Coverage Premium Assistance credit under Code Sec. 6432, added by American Rescue Plan Act of 2021, for continuation coverage premiums not paid by assistance eligible individuals under section 9501(a)(1) of the ARP, during the period beginning April 1, 2021, and ending September 30, 2021.

Business Meals

The IRS provided guidance (Notice 2021-25) related to the temporary 100-percent deduction for business meals provided by a restaurant. The Taxpayer Certainty and Disaster Tax Relief Act of 2020 temporarily increased the deduction from 50 percent to 100 percent for a business's restaurant food and beverage expenses for 2021 and 2022. All other food and beverage expenses are still subject to the 50 percent deduction limitation unless some other exception applies.

According to the IRS's guidance, a restaurant is a business that prepares and sells food or beverages to retail customers for immediate consumption. Note that the food and beverages do not need to be consumed on the premises for the 100-percent deduction to apply.

Restaurants are not businesses that predominantly sell pre-packaged food or beverages that are intended for later consumption. Food or beverages purchased from such businesses are still subject to the 50-percent deduction limitation. Examples of businesses that are not restaurants include grocery stores, specialty food stores, liquor stores, drug stores, convenience stores, newsstands, vending machines, or kiosks.

Restaurants are also not eating facilities located at an employer's business that provide meals that are excluded from the employees' gross income under Code Sec. 119, or that are considered a de minimis fringe under Code Sec. 132(e)(2). This also applies to eating facilities on the employer's premises that are operated by a third party with regards to Reg. §1.132-7(a)(3).

DEVELOPMENTS FOR TAX PRACTITIONERS

Treasury Funding for Enforcement

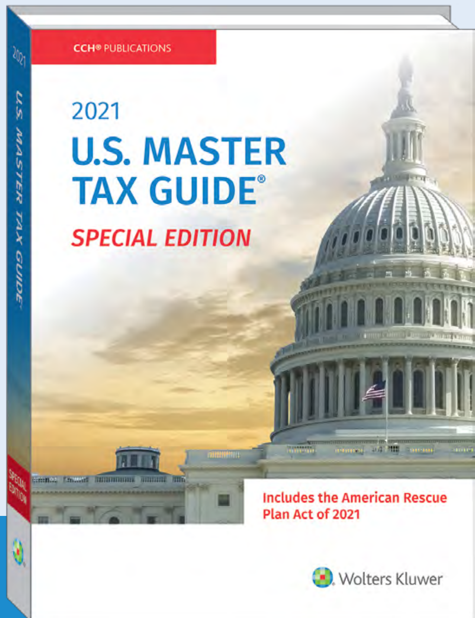
On April 28, 2021, the Treasury Department issued a release calling for increased funding for the IRS. As discussed above, President Biden's proposal for the American Families Plan includes increased funding for IRS enforcement, estimating the tax gap to be as high as $70 billion a year over the next ten years. The Treasury release doubled down (and then some) on that estimate, citing a study that underreporting by the top one percent of earners may result in underpayment of as much as $175 billion in taxes annually.

The Treasury release used this statistic to make the case that the IRS needs to crack down on sophisticated tax evasion by increasing enforcement operations as well as updating outdated IRS systems. The proposal from the Treasury also states the need to increase the amount of information third parties, particularly financial institutions, are required to report to the IRS.

Meanwhile, the IRS recognizes the importance of service to many taxpayers, especially when it has been called on so much over the last two years to distribute stimulus payments and, soon, advance child tax credits. The proposal includes increasing taxpayer service within the IRS.

Finally, the proposal includes a request for authority to regulate tax return preparers. After the courts struck down the last attempt by the Treasury to regulate preparers through regulatory means, it became necessary for Congress to grant Treasury the authority to regulate the industry to ensure taxpayers are fully reporting all income and are not the victims of fraud by unscrupulous tax return preparers.

RESOURCES *from Wolters Kluwer*



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