AMERICAN HORSE COUNCIL'S
TAX BULLETIN
1616 H Street, NW, 7th Floor, Washington, DC 20006 (202) 296-4031 / www.horsecouncil.org

Tax Bulletin #396 – July 2020

Congress, SBA Implement Ongoing Paycheck Protection Flexibility Measures

By Marsha Heinke, DVM, EA, CPA, CVPM, Grafton, OH

Enacted on June 5, the "Paycheck Protection Program (PPP) Flexibility Act" (PPPFA) expands options for small businesses that have taken PPP Loans. More good news came through on June 17, 2020 with the SBA announcement of a revised, more simplified loan forgiveness application for borrowers who obtained funds prior to the original June 30 deadline. Congress and the president subsequently extended this deadline to August 8, per legislation enacted on July 4 (for details, see article below).

The $349 billion of PPP loans made available through the March 27 CARES Act passage were supplemented by an additional $310 billion of SBA funding on April 21. While June 30 was the deadline for PPP loan application, more than $130 billion had not been lent as of June 27.

The original CARES Act and SBA guidance required borrowers to use the funds for specified purposes during the 56-day period (eight weeks) immediately following funding. Depending on use of the funds, borrowers can apply to have most or all of the loans forgiven.

Small business owners who applied and received funds in early April are now well past the eight-week period and are considering how to proceed. The PPP Flexibility Act significantly relaxed the loan forgiveness requirements. Borrowers will want to check out the adjusted requirements and should be glad for the reprieve it gives.

The changes made by the PPPFA include the following:

1. The loan forgiveness measurement "covered period" is tripled on all loans, from eight weeks to 24 weeks, starting with the date of loan disbursement to the borrower. Many businesses were struggling to spend all the proceeds in the two-month window, especially if partially shut down due to COVID-19 related governmental restrictions on business operations. The extended period allows businesses to spend the loan on payroll, the primary purpose of the Paycheck Protection Program. Businesses that wish to use the originally prescribed eight-week period must elect to do so.

2. For businesses that do not elect out of the retroactively applied 24-week "covered period," the safe harbor re-hire and wage-restoration date of June 30 is extended to December 31, 2020.

3. Originally, the SBA said 75 percent of the loan proceeds had to be spent on defined payroll costs; the requirement is reduced to 60 percent. Partial loan forgiveness can still be attained, even if payroll costs fall below 60 percent.

4. The payroll spend on business owners with annualized salaries of $100,000 or greater is capped at $20,833 (the 2.5 month equivalent of $100,000) for the longer 24-week "covered period," as compared to the eight-week "covered period" maximum of $15,385. Keep in mind, though, that this is the top amount. If an owner's 2019 salary or proprietor/partner draw was less than $100,000, then the limit is the 2019 amount divided by 12 months, multiplied by 2.5 months, when using the 24-week "covered period." If electing the eight-week "covered period," divide the 2019 salary by 52 weeks and multiply by eight.

5. Non-owner employees with annualized salaries of more than $100,000 are capped at $15,835 for the eight-week "covered period. For a 24-week "covered period," the cap is $46,154.

6. The PPPFA outlines additional protections from reduced loan forgiveness due to decreases in full-time employee (FTE) equivalency measurements.

7. Additional safe harbor protections are afforded through proof of inability to hire qualified employees for unfilled positions by December 31, 2020.

8. Any businesses gaining a PPP loan beginning June 5 will have five years to repay any loan proceeds that are not forgiven. Businesses with PPP loans prior to June 5 will continue to have two-year repayment periods unless they are able to renegotiate maturity terms with their lending banks.

9. The act extends and defers the borrower's payment of principle and interest on any unforgiven portions of the loan to the date the SBA remits the forgiven portion of the loan to the bank lender. Previously, payments were to start six months from the date the borrower was funded.

10. Borrowers have until 10 months past the end of their preferred "covered period" (24 weeks or eight weeks) to make the forgiveness application to their lender.

Many find the SBA's original PPP Loan forgiveness application and instructions to be complicated and time consuming to complete. Businesses that meet one of the following requirements should consider the new “EZ” form and instructions that the SBA introduced on June 17.

1. Borrowers who are self-employed and have no employees (and did not include any employee wages in the PPP loan application computation), or
2. Borrowers who did not reduce the salaries or wages of their employees by more than 25 percent, and did not reduce the number or hours of their employees, or
3. Borrowers who experienced reductions in business activity as a result of the health directives related to COVID-19 and did not reduce salaries or wages of their employees by more than 25 percent.

Borrowers should work with their accountants to determine whether to use the eight-week or 24-week “covered period” when making the forgiveness application. Business circumstances could change dramatically depending on what COVID and the economy do in the ensuing months. If a business uses its funds in 16 or 18 weeks, for example, and suffers a downturn in business requiring workforce reduction, the business may be disqualified from forgiveness of a portion of the loan based on the drop in employee FTE numbers.

Also, many professionals are concerned that the SBA and Treasury will continue to adjust the rules. Some businesses that qualify for full forgiveness with the eight week “covered period” measurement may wish to simply file the application as soon as possible and put the whole documentation burden behind them. Stay tuned to SBA posted guidance, including frequently asked questions.

Borrowers should communicate with their PPP bank lenders for their guidance which may augment that of the SBA. Assure management calendar alerts are in place to warn of pending deadlines for each of the critical due dates regarding “covered period” conclusion and for filing the forgiveness application.

Recent Income Tax Changes May Benefit Individuals, Businesses in the Equine Sector

By Maddie Schueler and Jen Shah, Dean Dorton, Lexington, KY

This article originally was published in the May 2nd, 2020 edition of The BloodHorse

As the COVID-19 pandemic continues to impact families and businesses across the country, government leaders have focused on helping Americans cope with the economic fallout of the virus. Over the past several weeks, the industry’s focus has been on the various stimulus packages for which horse and farm owners may apply in order to help current cash flow. In addition to these loan programs, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law at the end of March, contains numerous income tax provisions benefiting taxpayers. Some of these provisions impact 2019 tax filings but may also provide amendment opportunities for 2018 tax filings. Other changes are effective for tax years beginning in 2020. The goal of all of these income tax provisions is to either accelerate cash refunds or keep cash with individuals and businesses.

Below, we break down some of the recent tax changes that may benefit individuals and businesses in the equine industry.

A Note on Income Tax Deadlines

Before diving into the CARES Act, it is important to note some changes to income tax deadlines. In response to COVID-19, the Department of Treasury has postponed to July 15 the deadline for most federal income tax returns and payments due on or after April 1 and before July 15, 2020. This extension applies to federal income tax returns and payments for the 2019 tax year that are normally due by April 15. It also applies to first and second quarter estimated income tax payments for tax year 2020, which would otherwise be due on April 15 and June 15. For taxpayers struggling with cash flow in the wake of the pandemic, postponement of these tax payment deadlines allows them to retain cash a little longer.

Elimination of the Excess Business Loss Limitation for Tax Years 2018, 2019, and 2020

In a big win for the equine industry, the CARES Act retroactively postpones implementation of the excess business loss (EBL) limitation until tax years beginning after December 31, 2020. The Tax Cuts and Jobs Act (TJCA), passed at the end of 2017, introduced a limitation on business losses deductible by individuals and other non-corporate taxpayers (trusts and estates) against non-business income. This is calculated at the individual level and not at the pass-through entity level, as individuals combine all business activities when determining overall net business income or loss. Specifically, the TCJA disallowed net 2018 tax losses from active businesses in excess of $250,000 (for individual taxpayers) and $500,000 (for joint filers), adjusted annually for inflation. Disallowed losses are treated as net operating loss carryforwards to the following tax year. Under the TCJA, the EBL limitation was effective for tax years 2018 through 2025.

Many horse and farm owners who used income tax incentives, like the 100 percent bonus depreciation, were subject to this EBL limitation beginning in 2018, which often resulted in a one-year deferral of this EBL.

The CARES Act retroactively postpones the effective date of the EBL limitation until tax years beginning in 2021. Taxpayers that filed a 2018 tax return reflecting a disallowed EBL or a 2019 tax return reflecting a disallowed EBL (or a carryover of a disallowed EBL from 2018) should consider amending those returns.

On a less favorable note, once the EBL limitation returns in 2021, W-2 wages will no longer be included in the net business calculation.

Favorable Changes to Net Operating Losses

The CARES Act also makes taxpayer-friendly changes to the rules governing net operating losses (NOLs). The TCJA generally eliminated the ability of taxpayers to carry NOLs back to prior tax years, with the exception of farm losses which could be carried back two years. This change was effective for tax years beginning after December 31, 2017. Prior to the TCJA, taxpayers were permitted to carry NOLs back two years (or five years for farm losses) or forward twenty years.

The CARES Act reinstates carrybacks of NOLs arising in tax years beginning after December 31, 2017 and before January 1, 2021, allowing these losses to be carried back five years. This applies to both corporations and individuals, trusts and estates with net business losses. NOLs eligible for the five-year carryback period include farm losses, which would otherwise be subject to a carryback period of two years under the TCJA. Corporations that were subject to a 35 percent tax rate before the TCJA reduced the corporate rate to 21 percent as of January 1, 2018, may particularly benefit from carrying back NOLs.

For NOLs arising in tax years beginning after December 31, 2017, the TCJA also limited the NOL deduction to 80 percent of a taxpayer's taxable income. The CARES Act suspends application of the 80 percent taxable income limitation for tax years beginning after December 31, 2017, and before January 1, 2021, allowing losses to offset 100 percent of taxable income.

These modifications to the NOL rules permit taxpayers to use NOLs to a greater extent to offset taxable income in prior or current tax years, providing taxpayers with liquidity in the form of tax refunds and reduced current tax liability. The IRS is temporarily accepting faxed refund claims for NOL carrybacks and the corporate AMT credit discussed below in order to expedite these refunds.

<u>Acceleration of Ability to Claim Corporate Minimum Tax Credits</u>

Before the TCJA, corporations were subject to an alternative minimum tax (AMT), which was imposed if the AMT calculation resulted in a greater tax liability than the liability computed under the regular income tax. If a corporation was subject to AMT, the amount of the AMT was allowed as a minimum tax credit in any later tax year to the extent the corporation's regular tax liability exceeded its tentative minimum tax in the later year.

The TCJA repealed the corporate AMT for tax years beginning after December 31, 2017. It also established a method for taxpayers to fully use their AMT credit carryforwards by the end of tax year 2021.

The CARES Act accelerates the ability of corporations to claim AMT credits. Under the CARES Act, corporations can claim 100 percent of the credit by the end of either tax year 2018 or 2019. Corporations seeking to accelerate an AMT credit refund for tax year 2018 can utilize a "quick" refund procedure by filing Form 1139 with the Internal Revenue Service.

<u>Increased Tax Benefits for Charitable Contributions During 2020</u>

The CARES Act modifies certain rules governing charitable contributions, providing taxpayers with greater tax incentives to donate to charitable organizations. For individual taxpayers who do not itemize deductions, the CARES Act creates a $300 above-the-line deduction for cash contributions to qualifying charitable organizations made during a tax year beginning in 2020. This change benefits taxpayers taking the standard deduction, who otherwise would not be able to deduct charitable contributions.

In addition, the CARES Act changes the limitations on individual and corporate cash contributions to charitable organizations during 2020. Generally, individuals are allowed a deduction for cash contributions to qualifying charitable organizations of up to 60 percent of their adjusted gross income (AGI). The CARES Act removes this limitation for cash contributions made during 2020 only, allowing individuals to offset 100 percent of their AGI by making cash contributions to qualifying charitable organizations during the current year.

For corporations, charitable contribution deductions generally cannot exceed 10 percent of taxable income. This limitation is increased to 25 percent of taxable income for cash contributions made to qualifying charitable organizations during 2020.

The new rules do not apply to cash contributions made to donor advised funds or to certain supporting organizations.

Like nearly every industry in the country, the equine business has been tremendously impacted by the COVID-19 pandemic. With postponed or cancelled racing and sales and the uncertainty for what will happen during the rest of the year, the need to maximize cash flow remains top priority. The recent income tax changes in the CARES Act can provide some liquidity to industry participants and assist in weathering this storm.

Reasons to Select an S Corporation for Your Equine Business

By T. Randolph Catanese, Esq., Los Angeles, CA

There are many forms an equine business can adopt. The business can be a sole proprietorship, a corporation or a partnership. Also, there are hybrid organizations that can be used like a limited liability company which has features found in a corporation and a partnership.

The Internal Revenue Code has Chapter C and Chapter S regarding taxation of corporations. Chapter C generally taxes income at the corporate level and then again when profits are distributed to the shareholders at the shareholder level. This is known as “double” taxation. Chapter S allows for the earnings which occur at the corporate level to go untaxed, but taxation will occur at the shareholder level which avoids double taxation. This type of entity is often times referred to as a “pass through” entity.

Whether the entity is a C Corporation or an S Corporation under state law (which allows for the creation of this legally recognized entity), the corporation will be recognized as an independent legal entity. If created and operated properly, the corporation will allow for asset protection to the individual shareholders by limiting liability to third parties.

A corporation will be taxed as a C Corporation under the Internal Revenue Code unless an election is made by the taxpayer to have the corporation taxed as an S Corporation. In order to qualify for S Corporation status, the corporation must have 100 or fewer shareholders (generally only individuals may be shareholders). And, there can only be one class of stock. Generally, the fiscal year must end concurrent with the calendar year or on December 31st. In addition, the stockholders must receive wages paid by the corporation (income may be divided between wages and dividends to limit self-employment taxes).

An S Corporation allows its shareholders the opportunity for income distribution to limit self-employment tax. A sole proprietorship will have self-employment tax on all income. A limited liability company may have a limited life under state law, and it may be deemed terminated when a member leaves the company for whatever reason. The S Corporation will continue even after a shareholder leaves the corporation. A general partnership exposes the partners to unlimited personal liability. An S Corporation allows for shareholder asset protection. Distributions to shareholders of an S Corporation are taxed at the individual level, whereas a C Corporation may have a lower tax rate.

Given the above, the facts and circumstances of your individual situation will dictate whether an S Corporation makes sense for your equine business. In a large number of cases, the S Corporation allows for asset protection, tax planning and reduction of taxes paid on any level. For those reasons, the S Corporation may serve as the entity of choice.

Congress Extends Paycheck Protection, Industry Continues Push for Tax, Other Flexibility

By Bryan Brendle, the American Horse Council, Washington, DC

On Saturday, July 4, President Trumped signed S. 4116, a one-page bill "to extend the authority of the paycheck protection program" beyond June 30 - the deadline memorialized in the original CARES Act - to August 8. The new law effectively extends the popular loan program for five additional weeks, giving small businesses more time to apply for funds to address economic disruptions caused by coronavirus closures. On June 30, the Senate passed the legislation by unanimous consent, with the House of Representatives following suit on July 1. When the program shut down temporarily on June 30, SBA had not yet allocated approximately $130 billion, after having awarded $520 billion to nearly 4.9 million businesses across the country, according to a recent SBA report: https://home.treasury.gov/system/files/136/PPP-Results-Sunday.pdf.

In another effort to provide even more flexibility to the program, on July 1, the American Horse Council, American Farm Bureau Federation, U.S. Chamber of Commerce and other groups sent a letter urging congressional leaders to support the Small Business Expense Protection Act (S. 3612/H.R. 6821). Introduced in May, this important bill would allow small businesses to deduct eligible expenses paid with forgiven Paycheck Protection Program (PPP) loans from their tax returns. Unfortunately, the IRS currently excludes these deductions, thereby contradicting the original intent underlying the CARES Act.

While a path forward for the bill remains uncertain, fortunately lawmakers have established a rare, bipartisan track record to pass legislation focusing on narrow "fixes" to the popular loan program. These include the aforementioned S. 4116, enacted on July 4, to extend PPP authority, the "PPP Flexibility Act" (Public Law No: 116-142), passed on June 3, and the "PPP and Health Care Enhancement Act" (Public Law No: 116-139), signed into law on April 24.

In a related effort, on May 26, AHC, the American Farm Bureau Federation, the National Grange and other agriculture groups submitted joint-letters to Sens. McConnell (R-KY), Rubio (R-FL) and Cardin (D-MD), urging extension of the PPP to organizations filing as 501(c)(4), (c)(5) and (c)(6) entities. The CARES Act restricts non-profit eligibility for PPP to 501(c)(3) and a handful of other groups, thereby excluding a broad spectrum of professional and trade associations and labor unions.

While the House-passed "HEROES Act" extended PPP eligibility to all not-for-profit organizations, much work needs to be done, especially in the Senate. The coalition points out that there are thousands of not for profits groups formed as a 501(c)(4), (5) or (6) that support or promote essential professions, industries, small businesses and workers. Many of these are important ag-focused, non-profit groups that serve as key resources for farming best practices, market data, educational outreach, agricultural education, and most urgently, pandemic-related assistance. Without the benefit of 501(c) (4), (5) or (6) operations, a diverse group of employers including family farms, horse breeding operations, and state and county fairs, just to name a few examples, could lose an important resource for tools necessary to move beyond the pandemic and resume their roles as top job creators. As Congress and the Administration discuss outlines for another round of coronavirus relief legislation in July, the horse industry and its allies will continue to fight for flexibility measures that will mitigate disruptions caused by the pandemic.

AHC's Tax Advisory Board

T. Randolph Catanese, Esq.
Catanese & Wells, A Law Corporation
Los Angeles, CA
www.cataneselaw.com

Marsha Heinke, DVM, EA, CPA, CVPM
Grafton, OH
www.vpmp.net

Doug Dean
Dean Dorton Allen Ford, PLLC
Lexington, KY
www.ddafcpa.com

Paul Husband, Esq
Husband Law Group
Universal City, CA
www.husbandlaw.com

Jen Shah, CPA
Dean Dorton Allen Ford, PLLC
Lexington, KY
www.ddafcpa.com

Barbara Pate, Esq.
Davis & Harman LLP
Washington, DC
www.davis-harman.com

Bruce Oberfest, Esq, CPA
Bruce D. Oberfest & Associates
Chappaqua, NY

John Kropp, Esq
Graydon, Head & Ritchey
Cincinnati, OH
www.graydonhead.com

Alison Peak, Esq.
Davis & Harman LLP
Washington, DC
www.ddafcpa.com