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Coronavirus Aid, Relief and Economic Security (CARES) Act

Business Tax Provisions

BEST of Accounting™ CLIENT SATISFACTION 2020

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TODAY'S PRESENTERS

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Legal Disclaimer

The webinar will remain live for approximately ten minutes after the conclusion of the presentation to provide the opportunity to submit follow up questions via the Q&A function. A summary of top questions may be provided to all attendees.

Additionally, all attendees will be emailed a link to a recording of the webinar, a pdf of the presentation, and speaker bios and contact information.

Today's presentation is not:

- Legal advice
- The final word on today's topics – updates will be continuously provided via herbein.com
- Qualified for continuing education credits (i.e. CPE.)

Before taking any action, companies should check with their internal and/or external advisors

POLL QUESTION

What was the number one issue you faced during the pandemic?

- ❑ Cashflow issues
- ❑ Supply chain issues
- ❑ Workforce issues
- ❑ Navigating the CARES act
- ❑ Other

The following payroll credit is *<u>not</u>* available to taxpayers utilizing the Paycheck Protection loans:

- Refundable Employment Tax Credit
  - Credit against employer's portion of FICA payroll taxes for 50% of wages for each quarter;
  - Limited to first $10,000 of wages (including health insurance) per employee;
  - Paid or incurred from March 13, 2020 through December 31, 2020.

For employers either:

- Partially or totally shut down by a government authority due to a virus;
- Quarterly gross receipts declined by more than 50% compared to the comparable quarter in 2019;
- Ceases when comparable quarterly sales recover to 80%;
- For employers with more than 100 employees, credit only applies when employees unable to work due to the virus.

- Deferral of remitting employer's portion of social security taxes
  - May defer payment of the employer's portion of the social security taxes from the date of the bill through December 31, 2020;
  - 50% would be required to be paid December 31, 2021;
  - Remaining 50% required to be paid December 31, 2022;
  - Self-employed taxpayers can utilize this deferral by excluding 50% of their FICA taxes due from their quarterly estimates.
  - Employers may defer remitting employer's share of social security taxes and apply for a Payroll Protection Loan.
    - May only defer employer's share of social security taxes until the employer receives a loan forgiveness decisions from the lender.

Interest Limitation Rules – Section 163(j)

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Old Rules:

- Corporations – beginning January 1, 2018: The deduction for business interest expense was limited to 30% of adjusted taxable income (net income before depreciation and amortization):
    - For partnerships, any business interest expense in excess of the 30% of adjusted taxable income was suspended until the partnership passed down either excess taxable income or excess business interest income.

New Rules:

- Corporations – the limitation on deductibility of interest expense increased from 30% to 50% of net income before depreciation and amortization:
    - For tax years 2019 and 2020.
- Partnerships – no change for 2019;
    - In 2020, any excess business expense allocated to the partner:
        - 50% of the excess business expense is fully deductible;
        - Remaining 50% is subject to the 30% of adjusted taxable income limitations.
- May use 2019 adjusted taxable income for 2020 calculation if elected (Notice 2020-22).

Example – Old Law:

- Corporation A has adjusted taxable income of $30,000, business interest income of $1,000 and interest expense of $12,000 with no floor plan financing interest for tax year 2018.
- The 2018 limitation amount is $10,000 (($30,000 x 30%) + 1,000). Assuming it's not eligible for any of the exceptions, Corporation A deducts $10,000 of interest expense in 2018 and carries forward the $2,000 of disallowed interest to 2019.

Example – New Law:

- Corporation A has adjusted taxable income of $30,000, business interest income of $1,000 and interest expense of $12,000 with no floor plan financing interest for tax year 2019.
- The 2019 limitation amount is $16,000 (($30,000 x 50%) + 1,000). Based on the new law, Corporation A can deduct the full $12,000 of interest expense in 2019.

Net Operating Losses

Old Law:

- After the Tax Cuts and Jobs Act (TCJA), net operating losses for 2018 and beyond could no longer be carried back and could only offset 80% of taxable income going forward;
- Net operating losses from 2018 and on could be carried forward indefinitely.

New Law:

- Net operating losses from 2018, 2019, and 2020 can be carried back up to 5 years;
- Can be carried forward to offset 100% of taxable income through 2021;
- After 2021, only losses from pre-2018 can offset up to 100% of post-2020 taxable income;
    - o Losses from 2018 forward can only offset 80% of taxable income after 2020.

Claiming A Net Operating Loss (NOL) Carryback

How to claim a Net Operating Loss Carryback for 2018 or 2019:

- Revenue Procedure 2020-24
  - Addresses how to waive NOL carrybacks for 2018 and 2019 NOLs
    - Must attach an election to return for the first tax year ending after March 27, 2020
- Notice 2020-26
  - This notice provides a 6-month extension to the deadline to file a NOL carryback form (Form 1045 or Form 1139).
- Issues
  - Bank covenants
  - Excess Business Losses in 2018
  - AMT NOLs

Qualified Improvement Property Fixed

Qualified Improvement Property:

- Corrects omission error in the Tax Cuts and Jobs Act (TCJA) by restoring 15-year depreciable tax life to qualified leasehold improvements;
- Qualified leaseholds will again qualify for bonus depreciation;
- The Alternative Depreciation System life has been reduced to 20 years;
- Correction retroactively applies to tax years starting after December 31, 2017.

The problem: How can taxpayers take advantage of this rule change for 2018?

- Will the IRS allow us to file Form 3115 – Application for a Change in Accounting Method?
- Will we need to file amended 2018 tax returns?
- Another problem exists for taxpayers that elected out of the business interest expense limitation by electing as a real property trade or business in 2018:
    - Notice 2020-22 allows taxpayers to file an amended return to withdraw the election by including a statement;
    - Withdrawal will treat the election as having never been made in the first place;
    - Amended returns must be filed by October 15, 2021.

Other Business Tax Changes

- C Corporations can elect to utilize any unused AMT credits on a 2018 return;
    - Otherwise, remaining must be utilized on a 2019 tax return.
- C Corporations charitable contribution limitation increased from 10% to 25% of taxable income;
- Taxable income limitation on food contributions increased from 15% to 25%.

Notice 2020-17, -18, -20, -23

Effect on Businesses

NOTICE 2020-18

- President Donald Trump signs a national emergency declaration on March 13, 2020;
    - Instructed IRS to provide relief from tax deadlines to Americans affected by COVID-19;
    - The IRS treated the declaration as equivalent to a federally declared disaster, similar to other natural disasters in smaller geographic areas.

DELAYED FILING DEADLINES

Who qualifies:

- Any taxpayer with any of the following due between April 1, 2020 and July 15, 2020:
  - A tax return;
  - A payment for a 2019 tax liability;
  - A quarterly 2020 estimate income tax payment.
- For any of those items originally due between April 1, 2020 and July 15, 2020 – the deadline is now July 15, 2020;
- No extension is required to take advantage of the July 15 deadline;
- Notice 2020-18 supersedes notice 2020-17, no longer a tax liability threshold to take advantage of delayed filing deadline;
- Notice 2020-23 amplified the original notices and added a host of returns and payments that were originally due between April 1, 2020 and before July 15, 2020.

APPLICABLE FILINGS DELAYED

IRS offers additional clarity regarding which filings are delayed to July 15:

- Form 1040, 1040-SR, 1040-NR, 1040-NR-EZ, 1040-PR, 1040-SS;
- Form 1041, 1041-N, 1041-QFT;
- Form 1120, 1120-C, 1120-F, 1120-FSC, 1120-H, 1120-L, 1120-ND, 1120-PC, 2210-POL, 1120-REIT, 1120-RIC, 1120-SF;
- Form 8960;
- Form 8991;
- Form 990-T and 990-PF (if the due date falls between April 1, 2020 and July 15, 2020);
- Form 706 (Updated by Notice 2020-23);
- Form 709 (Updated by Notice 2020-20);
- 1st Quarter Estimated Income Tax Payments for Individuals and Corporations originally due April 15, 2020;
- 2nd Quarter Estimated Income Tax Payments for Individuals and Corporations originally due June 15, 2020 (Updated by Notice 2020-23).

APPLICABLE FILINGS DELAYED

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Some state and local tax returns have also been delayed until July 15, 2020:

- For a listing of states that have followed the IRS's lead and have delayed their filing deadlines, see our blog post at: https://www.herbein.com/blog/2020-tax-deadlines-the-latest-news
- There are a number of filings for different states that may or not be extended, so be sure to double check that state's Department of Revenue for confirmation as to whether or not a particular filing deadline was extended.

FILINGS NOT DELAYED

IRS offers additional clarity regarding which filings are delayed to July 15:

- Any partnership or S-Corporation returns originally due or have an extended due date that doesn’t fall between on April 1, 2020 and before July 15, 2020;
    - Form 990 - Return of Organization Exempt From Income Tax.
- Payroll and excise tax returns;
- Form 4446, Corporate Application for a Quick Refund of Estimated Income Tax.

Notice 2020-23:

- IRS Notice 2020-23 provides that a fiscal year corporation with an extended due date falling between April 1, 2020 and July 15, 2020 would be able to take advantage of the delayed due date of July 15, 2020;
    - The original tax due would have still been required to pay the liability due with the original due date of October 15, 2020.

Notice 2020-18:

- Returns that benefit from Notice 2020-18 do not need to file an extension by April 15, 2020 to take advantage of the July 15, 2020 delayed deadline;
- If you do need more time to file beyond July 15, 2020, you will need to file an applicable extension and pay any related extension payment required;
  - The extension will only extend the due date of the tax return to October 15, 2020 as opposed to the automatic 6 months.

Other Benefits

- Contributions to an IRA, employer contributions to a qualified retirement plan, and HSA contribution deadlines are also delayed until July 15, 2020;
- Interest and penalties will begin accruing on any unpaid or underpaid balances on July 16, 2020.

COVID-19 Stimulus Packages for Manufacturers

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STIMULUS LOANS FOR MANUFACTURERS

- Paycheck Protection Program (PPP) Loans
- Economic Injury Disaster Loan (EIDL)
- Main Street Lending Program

Paycheck Protection Program

PAYCHECK PROTECTION PROGRAM

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- This loan program can be fully or partially forgiven if the proceeds are used for qualified expenses
- You must be an eligible small business
- Loan is based on 250% of your average monthly payroll costs
- No Collateral is required
- No personally guarantees required

PPP Loan Eligible expenses

Authorized uses for the PPP loan proceeds include:

- Payroll costs;
- Continuation costs of group health care benefits (during periods of PTO for sick, medical and FMLA) and insurance premiums;
- Interest on mortgage obligations incurred before February 15, 2020;
- Rent, under lease agreements in force before February 15, 2020; and/or
- Utilities, for which service began before February 15, 2020.
- Interest payments on any other debt obligations incurred before February 15, 2020

SBA guidance currently indicates that up to 100% of the PPP loan principal and interest may be forgiven

The "Covered Period"

Your "**loan forgiveness covered period**" is the 24-week period beginning on the date your PPP loan is disbursed; however, if your PPP loan was made before June 5, 2020, you may elect to have your loan forgiveness covered period be the eight-week period beginning on the date your PPP loan was disbursed.

PPP Loan – Are there forgiveness limitations?

1. The loan proceeds must be spent on at least 60% for payroll costs

2. You must not reduce your full time equivalents (FTE) compared to one of the two pre-pandemic periods

3. You must not have a salary or wage reduction of more than 25% per employee

PPP Loan – Downside

- Company information can be published

- No tax deduction for eligible expenses

- Need to complete a forgiveness application

Economic Injury Disaster Loan

Economic Injury Disaster Loan (EIDL)

The SBA Economic Injury Disaster Loan (EIDL) loan program specifically serves people affected by natural disasters in the U.S. For COVID-19 relief, all small businesses, including sole proprietors and independent contractors

Terms:

- Borrow up to $2 Million
- Interest rate of 3.75%; not-for-profit 2.75%
- Up to 30 Year maturity
- Provides for up to $10,000 grant as an advance

Economic Injury Disaster Loan (EIDL)

- As of June 15, 2020, the SBA is once again accepting EIDL Advance and loan applications from all eligible borrowers.
- Covid-19 related EIDL loans include an up-to-$10,000 forgivable advance.
- You must qualify as a small business by number of employees.
- Maximum loan is $2 million, with the exact amount based on economic injury suffered.
- The normal EIDL application has been streamlined and should take about 2 hours.
- The SBA says your loan advance should come in a few days.

Main Street Loan Programs

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Main Street Lending Program

The Federal Reserve established the Main Street Lending Program (Program) to support lending to small and medium-sized businesses that were in sound financial condition before the onset of the COVID-19 pandemic. The Program will operate through three facilities: the Main Street New Loan Facility (MSNLF), the Main Street Priority Loan Facility (MSPLF), and the Main Street Expanded Loan Facility (MSELF).

In addition, the Federal Reserve and U.S. Department of the Treasury are seeking comment through June 22, 2020, on two facilities designed to support lending to nonprofit organizations: the Nonprofit Organization New Loan Facility (NONLF) and the Nonprofit Organization Expanded Loan Facility (NOELF).

The MSLP offers loans as low as $250,000 and up to $300 million to businesses with up to 15,000 employees or up to $5 billion in annual revenue are now eligible. The program has been expanded multiple times since its inception to allow more small and medium-sized businesses to receive support and to provide borrowers with greater flexibility in repaying the loans. Reports indicate that the program will be operational in the coming days to weeks.

MAINTAIN YOUR EMPLOYEE HEADCOUNT

Three separate facilities make up the program: (1) the Main Street New Loan Facility (MSNLF); (2) the Main Street Priority Loan Facility (MSPLF); and (3) the Main Street Expanded Loan Facility (MSELF). Each use the same borrower eligibility criteria and the facilities have similar commercial components – including the same term (five years), interest rate (LIBOR plus 3%), deferral of principal for two years and interest for one year, and permit prepayment without penalty. Lenders are required to retain 5% of each loan.

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Program Details

	Main Street New Lending Facility (MSNLF)	Main Street Priority Lending Facility (MSPLF)	Main Street Expanded Lending Facility (MSELF)
Borrower Eligibility	• The business[1] must meet at least one of the following two conditions: (i) the business has 15,000 employees or fewer, or (ii) the business had 2019 annual revenues of $5 billion or less. • The business must have been established prior to March 13, 2020. • The business must be a US business. • The business must not be an ineligible business. • The Business may only participate in one of the MSLP facilities and cannot also participate in the Primary Market Corporate Credit Facility (PMCCF). • The business cannot have received specific support under Title IV of the Coronavirus Economic Stabilization Act of 2020 (CARES Act). A business that has received loans under the Small Business Administration's Paycheck Protection Program (PPP), or that has affiliates that have received PPP loans, is permitted to borrow under the MSLP.		

PROBLEMS WE FACE WITH REDUCTION ISSUES

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	Main Street New Lending Facility (MSNLF)	Main Street Priority Lending Facility (MSPLF)	Main Street Expanded Lending Facility (MSELF)
Eligible Loans	A secured or unsecured term loan made by lender that was originated after April 24.	A secured or unsecured term loan made by lender that was originated after April 24.	A secured or unsecured term loan or revolving credit facility made by lender that was originated on or before April 24, and that has a remaining maturity of at least 18 months (accounting for any adjustments made to the maturity of the loan after April 24, including at the time of upsizing).
Term	5 years	5 years	5 years
Minimum Loan Size	$250,000	$250,000	$10 million
Maximum Loan Size	Lesser of $35 million or 4x 2019 adjusted EBITDA.	Lesser of $35 million or 6x 2019 adjusted EBITDA.	Lesser of $300 million or 6x 2019 adjusted EBITDA.
Lender Loan Risk Retention	5%	5%	5%
Payment Schedule (Year One Deferred for All; Prepayment Permitted Without Penalty)	Years 3: 15% Year 4: 15% Year 5: 70%	Years 3: 15% Year 4: 15% Year 5: 70%	Years 3: 15% Year 4: 15% Year 5: 70%
Interest Rate	Adjustable rate of LIBOR (1 or 3 month) + 3%	Adjustable rate of LIBOR (1 or 3 month) + 3%	Adjustable rate of LIBOR (1 or 3 month) + 3%
Subordination	Loan is not, at the time of origination or at any time during the term of the loan, contractually	At the time of origination and at all times the loan is outstanding, the loan is senior to or pari passu with,	At the time of upsizing and at all times the upsized tranche is outstanding, the upsized tranche is

Manufacturing and PPP Loan Forgiveness

Financial Impact

Financial Impact Agenda

- Managing Cash Flow
- GAAP Accounting for PPP Loans
- Other PPP Loan consideration impact in GAAP financial statements
- New accounting standard changes resulting from COVID-19 impact

Managing Cash Flow

- Monitor your accounts receivable closely
- Encourage your customers to pay you faster when possible, by offering prompt payment discounts or potentially other incentives
- Manage your payables, defer when possible to keep more cash in the bank
    - Consider asking your major vendors for discounts

Managing Cash Flow

- Managing your inventory
  - Don’t make the mistake of buying too much inventory, which can tie up a lot of cash.
  - Liquidate unnecessary or obsolete inventory to recoup some cash

- Restructure your debt
  - Communicate with your lender, find out what programs they are offering, as you may be able to defer payments on current obligations

Managing Cash Flow

- Review any discretionary spending
- Review current sales and marketing programs
- Review payroll
  - Payroll is typically a Company's biggest cost. Based on your forecasting, you may need to make some changes
- Apply for a PPP loan or another financial assistance program

Debt Model

Balance sheet presentation

- Loan is recognized as a liability, with current and long-term portions based on the terms of the agreement
- Interest accrued will be recorded as an additional liability and expensed over the term of the loan

Cash Flow statement

- Receipt of the PPP funds will be presented as a cash inflow from financing activities
- Any interest paid will be presented as a cash outflow for operating activities
- Any principal repaid will be presented as a cash outflow for financing activities
- Any loan amount forgiven would be disclosed as a non-cash financing activity

Debt Model

Accounting for PPP Forgiveness

Based on the guidance in FASB ASC 405-20-40-1, the proceeds from the loan would remain recorded as a liability until either:

- The loan is, in part or wholly, forgiven and the debtor has been "legally released" or
- The debtor pays off the loan to the creditor

Once the loan is, in part or wholly, forgiven and legal release is received, a nongovernmental entity would reduce the liability by the amount forgiven and record a gain on extinguishment.

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Government Assistance Model

- Allows business entities to account for forgivable loan as a government grant (International Accounting Standard (IAS) 20)
- Borrowers will need to assess their situation and conclude that they are "reasonably assured" that they will comply with loan forgiveness conditions
- Once there is reasonable assurance that the conditions will be met, the earnings impact of the government grants would be recorded on a systematic basis over the periods in which the entity recognizes as expenses the related costs for which the grants are intended to compensate.

Other PPP Loan Financial Statement Impacts

Loan origination/financing costs

- Costs paid in conjunction with securing the debt should be considered debt issuance costs and reflected as a reduction from the carrying amount of the debt. These costs are amortized into interest expense over the term of the debt.

Interest expense

- Even though the PPP loans provide for a six-month deferral of interest and principal payments, interest should be accrued for on a monthly basis.

Other PPP Loan Financial Statement Impacts

Expenses paid with PPP Funds: The related qualified expenses should continue to be accounted for as expenses on the income statement. Costs such as payroll, rent, utilities and mortgage interest should be shown in the income statement as usual, and not as reductions of PPP, during the measurement period.

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Lease Concessions

FASB offers two methods to account for a coronavirus-related concession granted in the form of payment deferral (i.e. only timing, not total amount, of consideration in the contract changes) when the option not to apply lease modification accounting guidance has been elected.

- Account for a payment deferral as if there has been no change to the lease contract. Lessees and lessors would continue their current lease accounting. A payment deferral would be accounted for (a) by a lessor as an increase to its lease-related receivable on its balance sheet with continued lease-related income recognition in its income statement; and (b) by a lessee as an increase to its accounts payable with continued lease-related expense during the deferral period.

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Lease Concessions Continued

Account for payment deferrals as variable lease payments. Lessees and lessors would continue their current lease accounting, but would recognize a concession as it occurs. During the period for which the concession was granted:

- (a) a lessor would not recognize lease-related income on the lease because it would be offset by the concession; and
- (b) a lessee would not recognize lease-related expense because it would be offset by the concession.

However, lessor and lessee balance sheets, to the extent applicable, would be adjusted accordingly. When the deferred payments are subsequently paid, lessors and lessees would recognize payments of the previously deferred amounts as incremental lease-related income and lease-related expense, respectively.

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Asset impairments

- Intangible assets such as goodwill and intangibles, as well as long-lived assets such as property, plant and equipment will likely need consideration as to whether a triggering event has occurred that would result in the need for an impairment test to be performed.

Going concern

- Entities may face continued hardships such as extended operating shutdowns of operations, supply chain disruptions, difficulty collecting outstanding receivable balances from customers, limited access to alternative financing and loan covenant violations.

- Careful consideration may be required to assess whether such external or internal factors raise substantial doubt about whether the entity may be able to continue as a going concern.

OTHER COVID RELATED GAAP CONSIDERATIONS

Changes in production capacity

- Consider the impact of work stoppages and shortages of labor or materials on inventory costing.
- Accounting guidance states that fixed overhead is to be allocated based on normal capacity of the production facilities. If an entity stops its production or significantly reduces production for a period of time, significant portions of fixed production overhead including rent, utilities and depreciation, would need to be expensed rather than capitalized. This would result in a decrease in the amount of fixed overhead costs normally allocated to each inventory item.
- Judgment is required to determine whether production is actually lower than normal capacity.

Accounting Standard Deferrals Related to COVID-19

The standards impacted by the deferred effective dates for non-public entities include:

- Revenue from Contracts with Customers (ASC 606) - deferred one year in June 2020
    - Now effective for years beginning January 1, 2020

- Leases (ASC 842) – deferred one year in November 2019, additional deferral of one year granted in June 2020
    - Now effective for years beginning January 1, 2022

Poll Question

How high is your confidence level for the future of your business?

- ❑ Very high
- ❑ Somewhat high
- ❑ Neutral
- ❑ Somewhat low
- ❑ Low

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