GROWERTALKS

Features

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A Surprise COVID-19 Tax Bill

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As tax season rolls around, it will likely be a particularly difficult time for growers as, bad year or not, they could face a number of tax surprises. While the government has employed a number of programs designed to help struggling businesses cope with the economic fallout from the coronavirus pandemic, a potentially expensive surprise may be awaiting many of those who reaped and, perhaps continue to reap, the benefits of these programs—an unexpected tax bill.

The new payroll tax deferral scheme

One such potential problem area involves the President's August Executive Order that allowed employees to skip paying their share of the 6.2% Social Security tax normally applying to the first $137,700 (for 2020) of their annual wages. The grace period was scheduled to last from September 1 through the end of 2020 with deferral generally available to an employee earning $4,000 every two weeks or about $104,000 for the year.

The economic stimulus program passed in March as part of the Coronavirus Aid, Relief and Economic Security (CARES) Act had already authorized a Social Security tax deferral for employers for the balance of 2020. Under the CARES Act, an employer can pay back 50% of the amount of payroll taxes due by the end of 2021 and the remaining 50% by the end of 2022.

It should be kept in mind, however, that both of these programs are only "deferrals," not a complete waiver. Although the Treasury Department and lawmakers are reportedly exploring forgiveness of these amounts (as of press time), both voluntary plans illustrate the current payback requirement and the unexpected tax bill that awaits.

Trust fund penalties

Despite recent legislation allowing employers to temporarily defer payment of payroll taxes, you or a "responsible party" is still ultimately responsible for meeting these obligations. If payroll taxes aren't remitted to the IRS in time, the "responsible party" may be held personally responsible for the full amount of the "trust fund penalty."

That's right—in other words, an owner, manager or the person handling your finances could be required to pay the IRS an amount equal to 100% of the shortfall out of your own pocket.

The PPP tax glitch

As mentioned before, in August, the President's Executive Order allowed employers to defer employees' payroll taxes from September 1 through December 31, 2020. However, the loan forgiveness rules of the Payroll Protection Program (PPP) require at least 60% of those funds must be used for payroll costs.

The program's design was simple: use local banks to provide loans to smaller employers during the shutdown. If the employers used the money to keep workers employed and for other necessary expenses, their loans could be forgiven and tax-free. Unfortunately, recent IRS and Treasury policies deny borrowers a tax deduction for many of the same expenses that qualified them for the loan forgiveness.

Failure to confirm the deductibility of PPP loans also means that some states already considering taxing those amounts will be adding insult to injury. Fortunately, lawmakers can fix this problem quite simply as a "technical correction."

EIDL loans and grants

A number of growers and retailers took out Economic Injury Disaster Loans (EIDLs) from the Small Business Administration (SBA) to help pay expenses during the recent disruptions. A business applying for an EIDL was eligible to receive a grant of up to $10,000 from the SBA after applying for an EIDL loan.

These grants don't need to be repaid under any circumstances—even if your business was subsequently denied an EIDL. Although the cash advances are most likely not taxable because they seemingly fall under the tax law's "general welfare exception," the expenses offset or covered by those cash advances cannot be claimed as a tax deduction.

A potential bugaboo

While grants to small businesses appear to fit under the general welfare doctrine, the IRS has, in the past, ruled business grants generally don't qualify for the general welfare exclusion because they aren't based upon individual or family needs. Congress, for its part, recently changed the tax law to make it clear that any contribution by a government entity to a corporation is taxable. Although this new rule only applies to corporations, the IRS will quite likely treat other business entities similarly.

Don't forget the state and local governments

Under normal circumstances, having a physical presence in a state establishes "nexus"—a connection creating a tax obligation within that state. When stay-at-home orders first led businesses to allow or require work-from-home policies, several states made it clear that protection from nexus would apply only so long as official work-from-home orders (issued by an applicable government agency) or states of emergency were in effect. Once these expire, normal nexus enforcement will likely resume—with a vengeance.

With unemployment levels remaining high and state coffers strained to the maximum, employers are looking down the barrel of a precipitous increase in unemployment insurance taxes. As states attempt to replenish their depleted unemployment trust funds and begin repaying the Treasury loans, some businesses could see tax increases in 2021.

Employers will also see automatic increases in federal unemployment taxes if states haven't repaid their 2020 Treasury loans by a November 2022 deadline. And these likely tax increases represent only one of many tax surprises facing their businesses.

Recapturing excess employment tax credits

The IRS has issued regulations to reconcile advance payments of refundable employment tax credits and to recapture these credits when necessary. The regulations authorize the assessment of erroneous refunds of the credits paid under both the Families First Coronavirus Response Act and the CARES Act.

Many employers received advance payment of these credits up to the total allowable amounts using the IRS' Form 7200, Advance Payment of Employer Credits Due to COVID-19. Employers were required to reconcile any advance payments claimed with the total credits claimed and total taxes due on their employment tax returns.

However, any refund of these credits paid to a taxpayer that exceeded the amount the taxpayer should have been allowed is labeled as an "erroneous refund" for which the IRS is required to seek repayment.

On the plus side

Those IRAs used by so many independent contractors, small business owners and others recently learned they could borrow $100,000 from their IRA and pay it back three years later with no tax consequences. That's right—IRA owners who are adversely affected by the coronavirus pandemic will be eligible to take tax-favored distributions from their IRAs.

In effect, the new policy allows an IRA owner to borrow up to $100,000 from their IRA and recontribute (repay) the amount any time up to three years later with no federal income tax consequences. There are no restrictions on what the withdrawals can be used for during that three-year period. And, best of all, they don't have to pay the 10% additional early distribution tax.

A different tax treatment

The income and losses of many businesses operating "pass-through" entities—such as S corporations, partnerships and sole proprietorships—flow through to the owner's personal income tax return. The losses may or may not be deductible, but the income is reportable.

Fortunately, the owners of pass-through entities can deduct 20% of qualified business income when calculating their taxes, but it's not automatic. After all, the law limits the deduction for certain "service" businesses—such as legal, medical or accounting practices—where taxable income exceeds $321,000 for joint filers ($160,700 for single filers). Owners of service businesses with taxable income in excess of $421,000 for joint filers ($210,700 for single filers) get no deduction.

Although the pass-through deduction and limits are only temporary, consideration might be given to changing your operation's tax status from a pass-through business to a regular corporation. While pass-through entities may offer advantages, don't forget the 2017 TCJA reduced income tax rates from 35% to a flat 21% for all regular corporations.

Utilizing those inevitable losses

Don't forget that there's now a five-year carryback for net operating losses (NOLs) arising not only in 2020, but also in 2018 and 2019. While the five-year carryback is providing a welcome injection of liquidity for many businesses suffering the impact of the pandemic, the relief, unfortunately, is only temporary. NOLs arising after 2020 don't have a carryback period and can only be carried forward to offset future taxable income. Of course, an unlimited carryforward period continues to apply to all post-2017 NOLs.

This is just a small taste of the tax complexities and considerations every business could potentially face as governments at almost every level continue taking steps to lessen the impact of the coronavirus pandemic. While tax concerns may not be a priority now, considering the possible tax ramifications of these and other programs can ensure the financial survival of your business later. Of course, qualified professional assistance is also strongly recommended. **GT**

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