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Legislative update: Year-end funding and COVID relief legislation; includes important tax measures

After months of negotiation and wrangling over additional coronavirus (COVID-19) pandemic relief legislation, House and Senate leaders struck a bipartisan funding deal over the weekend.

The massive **year-end deal** [PDF 8.43 MB] (5,593 pages) includes over $900 billion for various COVID relief programs, government funding of $1.4 trillion, as well as a bevy of tax provisions.

Included in the tax provisions are a number of items directly related to COVID relief such as a provision allowing recipients of Paycheck Protection Program (PPP) loans to deduct associated costs. Similarly, the bill includes an extension and significant expansion of the employee retention credit originally enacted in the “Coronavirus Aid, Relief, and Economic Security Act” (CARES Act).

But the tax provisions in the legislation go far beyond simply COVID-19-related items. They address, among other things, extending (or in some cases making permanent) dozens of temporary tax measures. For example, the legislation would make the railroad maintenance tax credit permanent, would extend for five years the CFC look-though rule for controlled foreign corporations, and would extend and expand tax credits for renewable energy. The bill also includes significant other tax provisions (including changes relating to the low-income housing tax credit rate and to the depreciation of residential rental property), as well as provisions for disasters other than COVID-19.

Read a **summary** [PDF 246 KB], of the legislation provided by the House Ways and Means Committee. The bill is expected to pass both the House and the Senate and signed into law by the president this week.

Read a revenue estimate prepared by the Joint Committee on Taxation: **JCX-24-20**

Highlights of tax measures

Tax provisions in the bill are included in Division N of the bill (the “COVID-Related Tax Relief Act”) as well as in Division EE, which addresses expiring provisions, miscellaneous tax provisions, and tax provisions for disasters unrelated to COVID-19.

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COVID-related Tax Relief Act

Subtitle B of Title II of Division N of the bill includes the "COVID-related Tax Relief Act of 2020." Some of the tax provisions in this part of the bill are:

- Clarification that no deduction is denied, no tax attribute is reduced, and no basis increase is denied by reason of the exclusion from gross income from forgiveness of PPP loans
- Additional 2020 Recovery Rebates of up to $600 per qualifying taxpayer and child
- Extension of time for repayment of certain deferred payroll taxes through December 31, 2021
- Expansion of above-the-line $250 teacher tax deduction to include costs for personal protective equipment (PPE) and other COVID-related expenses
- Clarification of the tax treatment of forgiveness of certain covered loans and emergency financial aid grants
- Allowance of an election regarding the tax treatment of certain farming losses for 2018, 2019, and 2020
- Extension of the credit for paid sick and family leave (including for certain self-employed individuals) through March 31, 2021
- Election to terminate transfer period for qualified transfers from pension plan for covering future retiree costs
- Application of special rules to money purchase pension plans

Additional COVID-19 related measures (including extension of, and modifications to, the employee retention credit) are included in Division EE of the bill—the Taxpayer Certainty and Disaster Tax Relief Act. Division EE of the bill also addresses expiring provisions unrelated to COVID, miscellaneous tax matters, and tax relief for disasters other than COVID-19.

Expiring provisions

Title I of Division EE of the bill would make permanent certain expiring tax incentives and would provide temporary extensions (for varying periods of time) for other expiring provisions. Almost all of the Tax Code sections being extended currently are scheduled to expire at the end of 2020.

Permanent extensions of temporary provisions

Provisions that would be made permanent include:

- Energy efficient commercial buildings deduction (with modifications relating to inflation adjustments as well as to energy efficiency standards)

- Reduced excise tax rates on beer, wine, and distilled spirits, as well as other modifications

- Railroad track maintenance credit (with modification to credit rate)

- Reduction in medical expense deduction floor to 7.5%

- Exclusion from income for certain benefits provided to volunteer firefighters and emergency responders

- Increased phase-out threshold of Lifetime Learning Credit (with transition from deduction for qualified tuition and related expenses)

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Long-term extensions of temporary provisions

Provisions that would be extended for five years (i.e., through 2025) include:

- Look-thru rule for related controlled foreign corporations
- New Markets Tax Credit
- Work opportunity tax credit
- Employer credit for paid family and medical leave (section 45S)
- Empowerment zone incentives (with modifications)
- Carbon oxide sequestration credit
- Oil spill liability trust fund rate
- Expensing rules for certain productions
- Seven-year recovery for motorsports entertainment complexes
- Exclusion from gross income of discharge of qualified principal residence indebtedness (with reduction in maximum acquisition indebtedness taken into account)
- Exclusion for certain employer payments of student loans

Provisions that would be extended for three years (through the end of 2023) include:

- Energy credit, with adjustments to phase-out schedules
- Residential energy-efficient property credit, with addition of rules for inclusion of biomass fuel property expenditures

Short-term extensions of temporary provisions

Provisions that would be extended for one year include:

- Credit for electricity produced from certain renewable resources
- Second generation biofuel producer credit
- Nonbusiness energy property credit
- Qualified fuel cell motor vehicle rules for alternative motor vehicles credit
- Alternative fuel refueling property credit
- Two-wheeled plug-in electric vehicle credit
- Production credit for Indian coal facilities
- Energy efficient homes credit
- Excise tax credits relating to alternative fuels
- Black lung disability trust fund excise tax
- Indian employment credit
- American Samoa economic development credit
- Mine rescue team training credit
- Classification of certain race horses as three-year property
- Accelerated depreciation for business property on Indian reservations
- Treatment of mortgage insurance premiums as qualified residence interest
- Credit for health insurance costs of eligible individuals

KPMG observation

Assuming the bill is enacted, there would be a smaller number of provisions scheduled to expire at the end of 2021 than otherwise would be the case. Further, many of the provisions that the bill would make permanent or would extend for multiple years have broad and deep support.

Nonetheless, under the 2017 tax law (Pub. L. No. 115-97)—the law that is also referred to as the

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"Tax Cuts and Jobs Act" (TCJA)—amortization of research and experimentation expenses is scheduled to begin in 2022. The amount of business interest expense that can be deducted also is scheduled to be reduced, in effect, for many businesses at that same time. Potential efforts in 2021 or shortly thereafter to postpone or eliminate both of these scheduled changes could drive future legislation and possibly provide a vehicle for other extenders to be addressed as well.

Miscellaneous tax provisions

Title II of Division EE of the bill contains a number of miscellaneous tax provisions, as well as some temporary provisions relating to COVID-19 relief. Provisions in this part of the bill include:

- **Modifications to the low-income housing tax credit rate**, including a new minimum rate of 4% for certain buildings

- **Depreciation of certain residential rental property over 30-year period**, allowing for the use of 30-year ADS depreciation for residential real property placed in service prior to January 1, 2018, held by an electing real property trade or business in certain circumstances

- **Expansion of current section 48 energy credit to include waste "energy recovery property"**

- **Extension of current section 48 energy credit for offshore wind facilities to January 1, 2026**

- **Minimum rate of interest for certain determinations related to life insurance contracts**

- **Retirement provisions**
    - Modification to minimum age for distributions during working retirement
    - Temporary rule preventing partial plan termination

- **Employee retention credit (ERC) and rehiring tax credit**
    - Clarifications and technical improvements to the CARES Act employee retention credit, including a clarification regarding the definition of "gross receipts," a modification to the treatment of health plan expenses, and improved coordination with the PPP
    - Extension of the ERC to July 1, 2021, and expansions including increase in the credit percentage from 50% to 70%, increased per employee limitation, and modifications to the definition of eligible employer

- **Business meals deduction**—a temporary allowance of a full deduction for business meals paid or incurred between December 31, 2020, and January 1, 2023

- **Earned income tax credit and child tax credit**—a temporary special rule for determination of earned income.

- **Charitable contributions**
    - Extension of the CARES Act non-itemizer charitable contribution deduction for certain contributions through 2021
    - Extension of the CARES Act modification of donor percentage-of-income limitations for certain charitable contributions through 2021
    - For corporations, a temporary suspension of limitations on the deduction for charitable contributions associated with qualified disaster relief made from January 2020 through late February 2021

- **Health and dependent care flexible spending arrangements**, temporary special rules for health and dependent care flexible spending accounts with unused balances

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- **Life insurance**—reduce the required interest rates used to determine if a policy meets the definition of life insurance for federal tax purposes

Tax relief measures for disasters unrelated to COVID-19

Title III of Division EE includes a number of tax provisions directed at disaster relief. These provisions, however, do not apply to areas subject only to the ongoing COVID-19 emergency proclamation. This part of the bill would:

- Provide an exception to the 10% early retirement plan withdrawal penalty for qualified disaster relief distributions (not to exceed $100,000)

- Provide an employee retention credit for 40% of wages (up to $6,000 per employee)

- Eliminate requirement that personal casualty losses must exceed 10% of adjusted gross income (AGI)

- Increase the 2021 and 2022 state ceilings for 9% low-income housing tax credit allocations for allocations to qualified disaster zones

- Provide the Secretary of the Treasury authority to make payment to territories equal to losses incurred on account of disaster relief provisions

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