KPMG

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KPMG report: Review of compensation and benefits-related tax provisions in Consolidated Appropriations Act, 2021

The stimulus legislation—the "Taxpayer Certainty and Disaster Tax Relief Act of 2020" that is part of the Consolidated Appropriations Act, 2021 (Pub. L. No. 116-260) and enacted December 27, 2020—includes a variety of compensation and benefits-related tax provisions such as an expansion of the employee retention credit (ERC) through June 30, 2021 (from January 1, 2021) as well as full deductibility of business meals provided by a restaurant for two calendar years.

The following discussion examines certain compensation and benefits-related tax provisions in the stimulus legislation.

Employee retention credit (ERC) extension and modifications

This provision in the legislation extends and expands the employee retention tax credit (ERC), originally enacted as part of the "Coronavirus Aid, Relief, and Economic Security Act" (CARES Act) for a six-month period from January 1, 2021, through June 30, 2021. The legislation also contains modifications and clarifications to the CARES Act aligned with existing guidance (that is "frequently asked questions" (FAQs), etc.).

The legislation includes several provisions that are retroactive to the original effective date of the ERC provisions under the CARES Act (that is, CARES Act section 2301) to:

- Provide that employers who receive Paycheck Protection Program (PPP) loans may still qualify for the ERC with respect to wages that are not paid for with forgiven PPP proceeds
- Codify that gross receipts for certain tax-exempt organizations are determined under section 6033
- Codify that group health plan expenses can be considered qualified wages even when no other wages are paid to the employee (consistent with IRS guidance)

For calendar quarters beginning on January 1, 2021, and through June 30, 2021, the legislation makes a variety of changes that:

- Increase the limit on per-employee qualified wages from $10,000 for the year to $10,000 for each quarter
- Increase the credit rate from 50% to 70% of qualified wages
- Expand eligibility for the credit by reducing the required year-over-year gross receipts decline from 50% to 20% and provide a safe harbor allowing employers to use prior quarter gross receipts to determine eligibility
- Increase the threshold for purposes of determining the relevant qualified wages from employers with more than 100 employees to employers with more than 500 employees
- Expand ERC eligibility to public colleges and universities, as well as government entities with a principal purpose or function of providing medical or hospital care
- Provide rules to allow new employers that were not in existence for all or part of 2019 to be able to claim the credit
- Provide for an outreach campaign for small employers—special notice and educational materials to be provided to employers with 500 or fewer employees
- Remove the 30-day wage limitation to allow credits for bonus pay

KPMG observation

One retroactive change provides taxpayers that received a 2020 PPP loan are still eligible for the ERC. Smaller employers that received a PPP loan may now be evaluating whether they met the 2020 requirements for the ERC.

The requirements for 2021 ERC provide that a large employer for purposes of determining eligible wages is one with more than 500 employees. It is possible that certain employers with between 100 to 500 employees previously determined in 2020 that there was too much effort in exchange for little ERC benefit. However, changes to increase in credit as well as to allow all wages to be eligible wages may cause smaller employers to reconsider taking the ERC credit in 2021.

A significant change for 2021 ERC includes the new eligibility for public colleges and universities. These entities had been excluded from ERC participation in 2020, but may now be eligible in 2021 for the credit.

Full deduction for certain business meals

Code section 274 is amended to provide a 100% deduction for business meal food and beverage expenses provided by a restaurant and that are paid or incurred in calendar year 2021 and 2022.

KPMG observation

Questions have been raised regarding how broadly this provision can be interpreted. Based on the statutory language in the legislation, the provision is only extended to food and beverages from a restaurant and not to any entertainment expenses. However, it is possible that there will be further guidance on the application of this provision, given there is very little detail in the legislation.

Minimum age for distributions during working retirement.

The legislation allows certain construction and building-trades workers age 55 years or older who are receiving retirement benefits to continue to work and receive such benefits. Generally, distributions cannot be taken out until age 59½ years.

This provision is effective for distributions before, on or after December 27, 2020.

Partial plan termination changes for 2020

A partial termination generally occurs when a plan has turnover in excess of 20%. A partial termination can cause significant cost and administrative expense to the plan sponsor.

In recognition of the high turnover since March 2020, the legislation provides a temporary rule for any plan year that includes March 13, 2020, because of the high workforce turnover since March 2020. The legislation provides that a determination of the partial termination can be delayed until March 31, 2021, to give companies time to restore their workforce above 80% and avoid the partial termination.

Health and dependent care flexible spending arrangements

The legislation provides flexibility for taxpayers to rollover unused amounts in their health and dependent care flexible spending arrangements from 2020 to 2021 and from 2021 to 2022. The legislation thus allows an extended 12-month grace period. In addition, employers are permitted to allow employees to make a 2021 mid-year prospective change in contribution amounts.

KPMG observation

Retroactive plan amendments are allowed for this provision, as long as the plan is operated consistently with the amendment. Plan amendments must be adopted not later than the last day of the first calendar year beginning after the end of the plan year in which the amendment is effective. For a calendar year plan with an amendment effective for 2021, the amendment must be adopted by the end of 2022.

Employers need to work carefully with administrators to provide accurate communications to participants.

Expiring tax provisions extended through 2025

- The "family leave credit" under section 45S allows a tax credit for providing paid "Family and Medical Leave Act" (FMLA) leave. This provision was originally enacted under the 2017 tax law known as the "Tax Cuts and Jobs Act" (TCJA) for a two-year period, but was extended through 2020. This legislation continues to extend the effective date of the credit through 2025.

- The CARES Act provided an exclusion from income for certain employer-paid student loan payments made through a section 127 educational assistance program. This provision was set to expire after December 31, 2020. However, the legislation extends the use of a section 127 program for student loan payment through December 31, 2025.

KPMG observation

The extension through 2025 of student loan payments from a 127 plan may make this benefit more interesting to employers. The payment of student loan amounts requires an employer to either modify an existing 127 plan or adopt a new 127 plan if there had been one in place. There must be a written plan document and benefit limits (currently $5,250 per employee). Notice must be given to all eligible employees regarding the terms of the plan and eligibility.

As employers consider future forward compensation arrangements, student loan repayment opportunities may be a valuable opportunity to include as part of that discussion.

Medical expense deduction provision made permanent

This legislation makes permanent the reduced requirement of 7.5% of adjusted gross income for a medical deduction.

Section 213 allows a deduction for medical expenses that exceed a certain percent of adjusted gross income. The requirement had been 10% of adjusted gross income, but the TCJA reduced the percentage to 7.5%. The reduced percentage was set to expire at the end of 2020.

Disaster tax relief (not COVID-19 disaster, e.g., certain declared disasters relating to fires, hurricanes, etc.)

The legislation includes a provision for disaster tax relief for individuals and businesses in presidentially declared disaster areas for major disasters declared (other than COVID-19) after December 31, 2019, through 60 days after the date of enactment (December 27, 2020)—or February 25, 2021.

- **Use of retirement funds for disaster mitigation**: This allows residents of disaster areas to borrow or take out a loan of up to $100,000 from a retirement plan or IRA account without penalty. Amounts withdrawn are included in income, but the income is spread over three years. Also, the amount may be recontributed to the plan to avoid tax. For new and outstanding plan loans, the repayment period is extended for one year.

- **Employee retention credit for disaster zones**: The legislation provides a tax credit of 40% of wages (up to $6,000 per employee) to employers in disaster zones. The credit applies to wages paid without regard to whether services associated with those wages were performed.

KPMG observation
Employers with any footprint in a disaster area (refer to the FEMA list for potential locations) need to carefully review the availability of disaster tax relief.

Employee payroll tax deferral repayment extended

In August 2020, a presidential memorandum was issued directing the Secretary of the Treasury to utilize his authority to defer the withholding, deposit, and payment of certain payroll tax obligations. Employee payroll tax could be deferred from September 1, 2020, through December 31, 2020. Under IRS Notice 2020-65, the deferred amount would be repaid from January 1, 2021, through April 30, 2021, with penalties accruing as of May 1, 2021.

The legislation extends the payroll period for employees, and provides that repayment is extended from January 1, 2021, through December 31, 2021. Penalties do not accrue until January 1, 2022.

KPMG observation
In the meantime, Notice 2021-11 was issued to align with the changes made by the legislation. The IRS notice extends through December 31, 2021, the time period an employer must withhold and pay applicable taxes. The notice further provides that interest, penalties, and additional tax do not accrue until January 1, 2022.

Read a summary of the legislation: ***TaxNewsFlash***

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