The Tax Implications of Three Programs Created by the CARES Act

TAX SECTION

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The landscape of the United States has changed in the past weeks as COVID-19 continues to sweep across our nation. The Federal government attempted to mitigate the economic damage of the virus on March 27 with the Coronavirus Aid, Relief, and Economic Security ("CARES") Act. Although the programs created by the CARES Act are being explained by media outlets, there is some confusion in the general public about the tax implications of these programs.

Most have heard about the $1,200 per person payments being sent by the IRS to qualifying individuals. These payments are increased by $500 for each dependent under the age of 17 and subject to a phase out for taxpayers above a certain income level. However, some taxpayers are confused about how these payments will be treated for tax purposes. The Act explains the payments are advance refundable tax credits for taxpayers' 2020 taxes. For tax purposes, a tax credit is a dollar for dollar reduction in tax due. Credits are more powerful than deductions, which are a reduction in taxable income, not in tax. Some credits, such as this one, are refundable, meaning that if the credit exceeds the tax due, the excess is paid to the taxpayer. However, in this case, the government treated the credit as fully refundable in advance so taxpayers are able to receive these needed funds quickly. That does not mean that the payments are loans that must be repaid. It also does not mean the payments will be taxable income in 2020 or any other year. Rather, the payments are truly free money the government has sent to Americans to help them get through the COVID-19 pandemic.

The CARES Act also created a $349 billion loan program called the Paycheck Protection Program ("PPP") for certain small business. The intent of the program, as the name suggests, is to provide cash to struggling businesses to assist in retaining the businesses' employees. The loan proceeds can also be used for certain necessary expenses such as rent, utilities, and interest on preexisting business loans. What is less commonly understood, however, is although the program is described as a loan, the principal of the loans can be forgiven provided the business keeps the same average number of employees during the applicable months and only uses the loan proceeds for qualifying expenses. Normally, cancellation of debt results in taxable income. However, the debt cancelled by this program is not taxable. Therefore, provided the business follows the guidelines of the PPP, the principal portion of the loans are actually free money. The business will, however, be required to pay the interest accrued on the loan.

Finally, the CARES Act incentivizes public support for local charities during the COVID-19 Pandemic. Normally, charitable deductions are available only to taxpayers who itemize deductions. However, the CARES Act allows an above-the-line deduction for cash contributions up to $300 to a qualifying charity in 2020. An above-the line-deduction is a deduction that is allowed for all taxpayers, including those who elect the standard deduction. Therefore, charitably inclined taxpayers are encouraged to take advantage of this new provision and give at least $300 to a qualifying charity in 2020.

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