

Current Federal Tax Developments

Week of March 29, 2021

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ACCOUNTING
CONTINUING EDUCATION

CURRENT FEDERAL TAX DEVELOPMENTS
WEEK OF MARCH 29, 2021
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SECTION: 85

IRS MAKES A SIGNIFICANT MODIFICATION TO COMPUTATION OF ARPA EXCLUDABLE UNEMPLOYMENT COMPENSATION

Citation: “New Exclusion of up to \$10,200 of Unemployment Compensation,” IRS website, 3/23/21

As a tax adviser, you may have recently installed a tax software update to take into account the unemployment compensation exclusion for 2020 passed as part of the American Rescue Plan Act of 2021 and found at IRC §85(c). Now it turns out that, due to an IRS change of heart on how to read IRC §85(c)(2)(B), your software may now be subjecting unemployment to tax the IRS has now decided is not to be subject to such tax.

On March 12, 2021, the IRS provided updated instructions on their website for preparing returns that have excludable unemployment compensation.¹ However, on March 23, 2021 the IRS made a significant change in those instructions.²

Originally the IRS instructions had taxpayers *include* the unemployment compensation in determining the modified AGI (reading “without regard to this section” in IRC §85(c)(2)(B) to mean without regard to the exclusion at IRC §85(c)) but now they have decided that means *without regard to any unemployment compensation covered by §85*.

In the interim, many (but not all) tax software providers updated their product to calculate the exclusion, presumably using the original March 12 instructions. Advisers will need to carefully review returns run under that software that determined the unemployment was taxable to determine if that remains correct under the March 23 worksheet.

The revised IRS notice and March 23 version of the Form 1040 instructions read as follows:

If your modified adjusted gross income (AGI) is less than \$150,000, the American Rescue Plan enacted on March 11, 2021, excludes from income up to \$10,200 of unemployment compensation paid in 2020, which means you don’t have to pay tax on unemployment compensation of up to \$10,200. If you are married, each spouse receiving unemployment compensation doesn’t have to pay tax on unemployment compensation of up to \$10,200. Amounts over \$10,200 for each individual are still taxable. If your modified AGI is

¹ “New Exclusion of up to \$10,200 of Unemployment Compensation,” IRS website, March 12, 2021, <https://www.irs.gov/faqs/irs-procedures/forms-publications/new-exclusion-of-up-to-10200-of-unemployment-compensation> (retrieved March 13, 2021)

² “New Exclusion of up to \$10,200 of Unemployment Compensation,” IRS website, March 23, 2021 version, <https://www.irs.gov/faqs/irs-procedures/forms-publications/new-exclusion-of-up-to-10200-of-unemployment-compensation> (retrieved March 23, 2021)

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\$150,000 or more, you can't exclude any unemployment compensation. If you file Form 1040-NR, you can't claim the unemployment compensation exclusion for your spouse.

The exclusion should be reported separately from your unemployment compensation. See the updated instructions and the Unemployment Compensation Exclusion Worksheet to figure your exclusion and the amount to enter on Schedule 1, line 8.

Include the full amount of your unemployment compensation from Schedule 1, line 7 when figuring the following deductions or exclusions from income. See the specific form or instructions for more information. If you file Form 1040-NR, you aren't eligible for all of these deductions. See the Instructions for Form 1040-NR for details.

- Taxable social security benefits (Instructions for Form 1040 or 1040-SR, Social Security Benefits Worksheet)
- IRA deduction (Instructions for Form 1040 or 1040-SR, IRA Deduction Worksheet)
- Student loan interest deduction (Instructions for Form 1040 or 1040-SR, Student Loan Interest Deduction Worksheet)
- Nontaxable amount of Olympic or Paralympic medals and USOC prize money (Instructions for Form 1040 or 1040-SR, Schedule 1, line 8)
- The exclusion of interest from Series EE and I U.S. Savings Bonds issued after 1989 (Form 8815)
- The exclusion of employer-provided adoption benefits (Form 8839)
- Tuition and fees deduction (Form 8917)
- The deduction of up to \$25,000 for active participation in a passive rental real estate activity (Form 8582)

If you have already filed your 2020 Form 1040 or 1040-SR, there is no need to file an amended return (Form 1040-X) to figure the amount of unemployment compensation to exclude. The IRS will refigure your taxes using the excluded unemployment compensation amount and adjust your account accordingly. The IRS will send any refund amount directly to you.

The instructions for Schedule 1 (Form 1040), line 7, Unemployment Compensation, are updated to read as follows.

Line 7 Unemployment Compensation

<http://www.currentfederaltaxdevelopments.com>

You should receive a Form 1099-G showing in box 1 the total unemployment compensation paid to you in 2020. Report this amount on line 7.

Caution. *If the amount reported in box 1 of your Form(s) 1099-G is incorrect, report on line 7 only the actual amount of unemployment compensation paid to you in 2020.*

Caution. *When figuring any of the following deductions or exclusions, include the full amount of your unemployment benefits reported on Schedule 1, line 7: taxable social security benefits, IRA deduction, student loan interest deduction, nontaxable amount of Olympic or Paralympic medals and USOC prize money, the exclusion of interest from Series EE and I U.S. Savings Bonds issued after 1989, the exclusion of employer-provided adoption benefits, the tuition and fees deduction, and the deduction of up to \$25,000 for active participation in a passive rental real estate activity. See the specific form or instructions for more information. If you file Form 1040-NR, you aren't eligible for all of these deductions. See the Instructions for Form 1040-NR for details.*

Note. If your modified adjusted income (AGI) is less than \$150,000, the American Rescue Plan enacted on March 11, 2021 excludes from income up to \$10,200 of unemployment compensation paid to you in 2020. For married taxpayers, you and your spouse can each exclude up to \$10,200 of unemployment compensation. For example, if you were paid \$20,000 of unemployment compensation and your spouse was paid \$5,000, report \$25,000 on line 7 and report \$15,200 on line 8 as a negative amount (in parentheses). The \$15,200 excluded from income is \$10,200 for you and all of the \$5,000 paid to your spouse. If your modified AGI is \$150,000 or more, you can't exclude any unemployment compensation. Use the Unemployment Compensation Exclusion Worksheet to figure your modified AGI and the amount to exclude. However, if you file Form 1040-NR, you can't claim the unemployment compensation exclusion for your spouse.

If you made contributions to a governmental unemployment compensation program or to a governmental paid family leave program and you aren't itemizing deductions, reduce the amount you report on line 7 by those contributions. If you are itemizing deductions, see the instructions on Form 1099-G.

Caution. *Your state may issue separate Forms 1099-G for unemployment compensation received from the state and the additional \$600 a week federal unemployment compensation related to coronavirus relief. Include all unemployment compensation received on line 7.*

If you received an overpayment of unemployment compensation in 2020 and you repaid any of it in 2020, subtract the amount you repaid from the total amount you received. Enter the result on line 7. Also enter "Repaid" and the amount you repaid on the dotted line next to line 7. If, in 2020, you repaid more than \$3,000 of unemployment compensation that you included in gross income in an earlier year, see Repayments in Pub. 525 for details on how to report the payment.

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Tip. If you received unemployment compensation in 2020, your state may issue an electronic Form 1099-G instead of it being mailed to you. Check your state's unemployment compensation website for more information.

Unemployment Compensation Exclusion Worksheet – Schedule 1, Line 8

1. If you are filing Form 1040 or 1040-SR, enter the total of lines 1 through 7 of Form 1040 or 1040-SR. If you are filing Form 1040-NR, enter the total of lines 1a, 1b, and lines 2 through 7.

2. Enter the amount from Schedule 1, lines 1 through 6. Don't include any amount of unemployment compensation from Schedule 1, line 7 on this line.

3. Use the line 8 instructions to determine the amount to include on Schedule 1, line 8, and enter here. Do not reduce this amount by the amount of unemployment compensation you may be able to exclude.

4. Add lines 1, 2, and 3.

5. If you are filing Form 1040 or 1040-SR, enter the amount from line 10c. If you are filing Form 1040-NR, enter the amount from line 10d.

6. Subtract line 5 from line 4. This is your modified adjusted gross income.

7. Is the amount on line 6 \$150,000 or more?

Yes. Stop You can't exclude any of your employment compensation

No. Go to line 8

8. Enter the amount of unemployment compensation paid to you in 2020. Don't enter more than \$10,200.

9. If married filing jointly, enter the amount of unemployment compensation paid to your spouse in 2020. Don't enter more than \$10,200. If you are filing Form 1040-NR, enter -0- .

10. Add lines 8 and 9 and enter the amount here. This is the amount of unemployment compensation excluded from your income.

11. Subtract line 10 from line 3 and enter the amount on Schedule 1, line 8. If the result is less than zero, enter it in parentheses. On the dotted line next to Schedule 1, line 8, enter "UCE" and show the amount of unemployment compensation exclusion in parentheses on

the dotted line. Complete the rest of Schedule 1 and Form 1040, 1040-SR, or 1040-NR.³

SECTION: 213

PURCHASE OF COVID-19 PERSONAL PROTECTIVE EQUIPMENT TREATED AS DEDUCTIBLE MEDICAL CARE BY THE IRS

Citation: Announcement 2021-7, 3/26/21

In Announcement 2021-7,⁴ the IRS has broadened the definition of amounts paid for medical care to include amounts paid for personal protective equipment (PPE).

Examples of PPE given in the Announcement are:

- Masks;
- Hand sanitizers and
- Sanitizing wipes.⁵

If the items were acquired for the primary purpose of preventing the spread of COVID-19, they are referred to in the Announcement as *COVID-19 PPE* and treated as an amount paid for medical care under IRC §213(d).

Schedule A Itemized Deduction

The Announcement begins by providing that such items are now considered medical expenses for purposes of the Schedule A medical expense deduction:

Therefore, amounts paid by an individual taxpayer for COVID-19 PPE for use by the taxpayer, the taxpayer's spouse, or the taxpayer's dependent(s) that are not compensated for by insurance or otherwise are deductible under § 213(a) provided that the taxpayer's total medical expenses exceed 7.5 percent of adjusted gross income.⁶

FSAs, MSAs, HSAs and HRAs

IRC §213(d)'s definition of medical care is also used to define items that are eligible for reimbursement under a series of tax advantaged medical programs.

³ "New Exclusion of up to \$10,200 of Unemployment Compensation," IRS website, March 23, 2021 version

⁴ Announcement 2021-7, March 26, 2021

⁵ Announcement 2021-7, March 26, 2021

⁶ Announcement 2021-7, March 26, 2021

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COVID-19 PPE is eligible to be reimbursed by:

- Health flexible spending arrangements (health FSAs);
- Archer medical savings accounts (Archer MSAs);
- Health reimbursement arrangements (HRAs); or
- Health savings accounts (HSAs).⁷

The Announcement cautions:

However, if an amount is paid or reimbursed under a health FSA, Archer MSA, HRA, HSA or any other health plan, it is not deductible under § 213.⁸

Amendment of Employee Benefit Plans

The Announcement provides guidance to employers looking to amend their employee benefit program for the treatment of COVID-19 PPE:

Group health plans, including health FSAs and HRAs, under the terms of which expenses for COVID-19 PPE may not be reimbursed, may be amended pursuant to this announcement to provide for reimbursements of expenses for COVID-19 PPE incurred for any period beginning on or after January 1, 2020, and such an amendment will not be treated as causing a failure of any reimbursement to be excludable from income under § 105(b) or as causing a § 125 cafeteria plan to fail to meet the requirements of § 125. Group health plans may be amended pursuant to this announcement if the amendment is 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, no amendment with retroactive effect is adopted after December 31, 2022, and the plan is operated consistent with the terms of the amendment, including during the period beginning on the effective date of the amendment through the date the amendment is adopted.⁹

⁷ Announcement 2021-7, March 26, 2021

⁸ Announcement 2021-7, March 26, 2021

⁹ Announcement 2021-7, March 26, 2021

SECTION: PPP LOAN

SENATE APPROVES PPP PROGRAM EXTENSION, SENDS BILL ON TO THE PRESIDENT FOR SIGNATURE

Citation: PPP Extension Act of 2021, 3/25/21

The U.S. Senate, by a vote of 92-7, passed the PPP Extension Act of 2021¹⁰ in identical form to the bill passed earlier by the House, sending the bill on to the President for his signature.

The very short bill has the following provisions:

- Applications for both first draw and second draw PPP loans will be accepted through May 31, 2021, resulting in a two-month extension beyond the original deadline enacted in December 2020 of March 31, 2021;¹¹
- The SBA will be allowed to approve and fund loans for applications submitted by the May 31 deadline through the end of June.¹²

Previously the last day for applying for a loan was also the last day to receive a loan under prior versions of the program, meaning that loan applications submitted in the final few days of the program had little/no chance of being approved before the funding was shut down.

However, the program may end much earlier without additional Congressional action. The *Journal of Accountancy* reported online that Patrick Kelley, associate administrator for the SBA's Office of Capital Access, had testified before the Senate Small Business Committee on March 24 that the program would likely run out of funds about a month and a half before the new application deadline:

The PPP Extension Act does not provide any additional funding for the current round of the PPP, which Congress provided with more than \$290 billion to make forgivable loans to small businesses and not-for-profits. From the program's opening on Jan. 11 through March 21, the SBA has approved more than 3.1 million loans totaling nearly \$196 billion. In his testimony Wednesday, Kelley said that at the current lending rate, the PPP should have enough funding to last through mid-April.¹³

¹⁰ PPP Extension Act of 2021, Senate passage March 25, 2021, <https://www.congress.gov/bill/117th-congress/house-bill/1799/text?q=%7B%22search%22%3A%5B%22PPP+extension+act+of+2021%22%5D%7D&r=1&s=2> (retrieved March 25, 2021)

¹¹ PPP Extension Act of 2021, Act Section 2(a), (c)

¹² PPP Extension Act of 2021, Act Section 2(c)

¹³ Jeff Drew, "Senate passes PPP deadline extension," *Journal of Accountancy* online site, March 25, 2021, <https://www.journalofaccountancy.com/news/2021/mar/senate-passes-ppp-application-deadline-extension.html> (retrieved March 25, 2021)

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