

ADVISOR'S BULLETIN

WHAT'S IN THIS MONTH'S NEWSLETTER

The CARES Act:

Details, Ambiguities, and Opportunities

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A MESSAGE FROM MICHAEL W. LAGOS, CFP®

Dear Strategic Advisor:

On March 27, 2020, President Trump signed into law the CARES Act (Coronavirus Aid, Relief, and Economic Security Act). The nearly \$2 trillion relief package was enacted quickly in response to the COVID-19 pandemic.

The CARES Act includes a wide variety of provisions aimed to jump-start the U.S. economy during and after the business-slowness side effects of the coronavirus. The legislation includes direct financial assistance to individuals, indirect aid to individuals affected by COVID-19, various salves to employers designed in part to help keep people employed, and miscellaneous provisions expected to help stimulate economic activity.

As with several recent federal law changes, the speed at which the CARES Act was crafted and approved has led to

- a lag in understanding some of its key provisions,
- ambiguity over some of the details, and
- opportunities for clients and advisors who are prepared to act now.

The information in this issue of *the Advisor's Bulletin* is a snapshot of the CARES landscape as of the date of publication. Much is likely to change over time as technical adjustments are made by legislative, executive, or regulatory action.

However, financial professionals and their clients need to understand the provisions of the CARES Act right now so they can assess how CARES affects them and then seize the opportunities available.

Regards,
Michael W. Lagos, CFP®

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Recent developments in estate, business, and insurance planning are outlined for your reference. Should you wish to receive additional information related to financial planning, estate planning, insurance planning, or investment management, please do

The CARES Act: Details, Ambiguities, and Opportunities

THE CARES ACT

Financial Assistance to All Individuals

All individuals, whether they had a direct economic loss due to COVID-19 or not, are potentially eligible for the following benefits created by the CARES Act.

SPECIAL 2020 FEDERAL INCOME TAX CREDIT

The CARES Act created a special federal income tax credit for 2020, which is refundable immediately. The IRS said it will have already started to mail checks to eligible taxpayers—or transferred funds by direct deposit—by the time this article is published. See <https://www.irs.gov/newsroom/economic-impact-payments-what-you-need-to-know>.

For information about eligibility and to get an update on the status of the check, the IRS has provided an online tool: <https://www.irs.gov/coronavirus/economic-impact-payments>.

Eligibility

Tax filers with adjusted gross income up to \$75,000 for individuals and up to \$150,000 for married couples filing joint returns will receive the full payment of \$1,200 for individuals or \$2,400 for married couples and up to \$500 for each qualifying child. For filers with income above those amounts, the payment amount is reduced by \$5 for each \$100 above the \$75,000/\$150,000 thresholds. Single filers with income exceeding \$99,000 and \$198,000 for joint filers with no children are not eligible.

Depending on the nature of the taxpayer eligible for a benefit, the IRS will use one or more of the following sources to determine eligibility for the checks:

- 2019 federal income tax return
- 2018 federal income tax return
- Form SSA-1099
- Form RRB-1099

Ambiguities

The checks are essentially an advance on new federal income tax credits for 2020. If a person gets a check, the taxpayer is receiving the credit. If it turns out later that the individual was not entitled to the tax credit—perhaps because the AGI levels exceeded the threshold—it seems likely that the money will have to be paid back. Exactly how the IRS may enforce the payback has not yet been clarified. It seems likely that for those who file 2020 income tax returns, the reconciliation will be made there.

Readers may have seen stories about checks having been sent people who passed away in 2019 or earlier. Based on the speed at which the funds were sent by Treasury after CARES's passage, it feels likely that some others who are not eligible for the credit have or will receive money. It's hard to guess how the IRS may try to recoup any tax credit monies sent by mistake in those cases.

MISCELLANEOUS INDIVIDUAL INCENTIVES

Unemployment Benefits

The CARES Act increased the amount of unemployment insurance to individuals who are eligible for unemployment benefits. Those individuals will receive an extra \$600 of weekly benefit for all weeks of unemployment between April 5, 2020, and July 31, 2020, in addition to the amount the individual otherwise would be entitled to receive under state law.

The CARES Act also adds a potential 13 weeks of unemployment benefits for individuals who have exhausted benefits they are otherwise entitled to under state law. Therefore, eligible individuals now may receive unemployment benefits up to a maximum of 39 weeks, whereas previously many states capped regular benefits at 26 weeks. The extended benefits are available through December 31, 2020.

Charitable Giving Incentives

The CARES Act also incentivizes charitable giving by

- increasing from 60 percent of AGI limit to 100 percent for itemized charitable contributions made in cash to qualifying organizations during 2020 and
- creating a temporary above-the-line charitable deduction (capped at \$300) available for donors who do not itemize deductions on their federal taxes.

Indirect Financial Support of Individuals Affected by COVID-19

The following provisions are available to a taxpayer

- who was diagnosed with COVID-19,
- whose spouse or dependent was diagnosed with COVID-19, or
- who experienced adverse financial consequences as a result of
 - *being quarantined,
 - *being furloughed,
 - *being laid off,
 - *having work hours reduced,
 - *being unable to work due to lack of childcare due to COVID-19,
 - *closing or reducing hours of a business owned or operated by the individual due to COVID-19, or
 - *other factors as determined by the Treasury Secretary.

WAIVER OF PENALTY TAX, DELAYED TAXATION, AND ENHANCED ROLLOVER

The CARES Act provides an exception to the 10 percent early distribution penalty for IRA or qualified plan distributions of up to \$100,000 taken in 2020 for individuals affected by COVID-19. If the qualifying distribution comes from an employer-sponsored plan, the mandatory 20 percent federal income tax withholding normally applicable to eligible rollover distributions is waived, although a 10 percent federal tax withholding will still be made unless affirmatively waived by the participant.

If an individual affected by COVID-19 takes such a distribution, that taxpayer has the ability to include income attributable to the distribution over a three-year period.

A person taking a qualifying distribution will also have the ability to recontribute the distribution to a qualified plan or IRA within three years. This new rule essentially creates a three-year indirect rollover period for qualifying COVID-19 distributions.

POTENTIAL QUALIFIED PLAN FUNDS ACCESS

The new law also permits employer plan administrators to allow for enhanced in-service distributions of a COVID-19-qualifying participant's funds up to \$100,000.

Employers are not required to provide their employees access under this provision. For employers who do provide access, there is no requirement to immediately amend the plan document. For employers who do provide COVID-19 qualified fund access, the law allows them to rely on the participant's self-certification for eligibility.

POTENTIAL ENHANCED QUALIFIED PLAN LOAN PROVISIONS

For those employer-sponsored plans that offer plan loans, the old rules limited loan amounts to \$50,000 or 50 percent of the vested account balance, whichever was less.

The CARES Act permitted the plan administrator to double the loan amount available to COVID-19-qualifying individuals to the lesser of \$100,000 or 100 percent of the vested account balance.

For COVID-19-qualifying individuals who had existing plan loan balances as of March 27, 2020, the CARES Act allows employers to offer a suspension of the loan repayment obligations—at the participant's option—for up to one year. The loan interest would continue to accrue during the loan suspension period. The change would effectively extend the loan repayment period from five to six years for qualifying debt.

As with the new in-service COVID-19 qualified fund withdrawal access, plan sponsors are not required to offer the new loan provisions. However, the new loan feature may be offered now, and the plan document can be updated later.

AMBIGUITIES

Within these new qualified plan provisions, the following questions have not yet been fully addressed:

How will the three-year rollover extension be coordinated with the tax liability associated with the distribution? A person taking a COVID-19 distribution from a qualified plan will be able to pay the income tax associated with the withdrawal in equal installments over a three-year period. If the person does a subsequent indirect rollover of the lump sum, say in the third year, it's not clear how any tax previously paid will be recouped.

Can a COVID-19-eligible taxpayer perform a Roth conversion while spreading the income tax result over three years? We do not see anything in the Act that deals with this possibility one way or the other. The strategy seems to be inconsistent with the primary intent of the change, which was to give those affected by the virus better access to cash for their needs. Having said that, based on what we know today, it seems like the Roth conversion technique could work. It's possible that the IRS will eventually publish anti-abuse regulations to deal with this and other prospective perceived loopholes.

What paperwork will employers rely on to satisfy eligibility for a COVID-19 distribution? While the law allows employers to accept a self-certification of eligibility by a plan participant for a COVID-19 distribution, it is unclear exactly how the process will work and what paperwork any particular plan sponsor will require.

What will happen if a participant takes a maximum loan against a qualified account, defers interest payments, and then defaults when the loan balance is larger than the vested account balance? Based on the more generous plan loan rules, it is possible for a plan participant to run up a loan balance that will be larger than the qualified account balance. In the event of a loan default under those circumstances, who will be responsible for the shortfall?

A taxpayer who seeks to take advantage of enhanced distribution, loan, or penalty tax-avoidance rules should be advised to keep evidence of having been adversely affected by COVID-19.

Provisions Supporting the Economic Health of Businesses

Perhaps the most generous provisions of the CARES Act are connected to supporting businesses, especially small companies.

PAYCHECK PROTECTION PROGRAM (PPP)

The Paycheck Protection Program (PPP) originally authorized up to \$349 billion in forgivable loans to small businesses to pay their employees during the COVID-19 crisis. All small businesses with fewer than 500 employees were originally eligible to borrow money under the program.

Program Details

The Treasury Department narrowed the “eligible company” standard in late April, saying that that borrowers:

. . . must assess their economic need for a PPP loan under the standard established by the CARES Act and the PPP regulations at the time of the loan application (and) still must certify in good faith that their PPP loan request is necessary. . . . For example, it is unlikely that a public company with substantial market value and access to capital markets will be able to make the required certification in good faith, and such a company should be prepared to demonstrate to SBA, upon request, the basis for its certification.

https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf?mod=article_inline

In addition, the Treasury Secretary and members of Congress have made comments that indicate the federal government will seek civil and criminal remedies against companies that secure loans which turn out not to have been needed.

All funding authorized by the original program was used up in just weeks. As a result, Congress and the President authorized an additional \$310 billion for the program in late April. There was also a great deal of political pressure on public companies that secured PPP loans to return those funds, which many have already done.

The maximum loan amount to eligible borrowers is the lesser of

- \$10 million or
- two and a half times average monthly qualifying payroll.

Payroll costs are capped at \$100,000 on an annualized basis for each employee.

Loan payments will be deferred for six months. The interest rate on loan amounts not forgiven is 1 percent.

The loan amounts will be forgiven as long as:

the loan proceeds are used to cover payroll costs, and most mortgage interest, rent, and utility costs over the eight-week period after the loan is made and

employee and compensation levels are maintained.

The program is administered by the Small Business Association (SBA) in connection with local bank or credit union lenders. Bankers have been deluged by loan requests, guidelines, and form changes from the SBA, which have complicated the process with both the first and second round of funding. Most banks are pulling people from other areas to help ensure all documentation is correct so that applications are as streamlined as possible.

The volume of applications from banks across the nation initially put strain on the SBA funding system during the first round of funding. Since that time, adjustments have been made, and banks are working around the clock to process as many applications as possible.

Bankers expect the supplemental funding supply to be exhausted quickly.

Ambiguities

The April federal supplemental funding approval created a new certification requirement for borrowers to obtain a loan. Banks and borrowers are struggling to figure out what it means. Here is an edited excerpt from a letter one prospective business applicant received from a bank:

Unfortunately, there is no additional guidance (about whether a PPP loan is necessary). We also do not know how aggressive the SBA will be in reviewing these standards. For example, the SBA could interpret this to require borrowers to draw on existing lines of credit before applying for PPP loans.

While it is possible that (the necessity requirement) is intended politically to send a message to public companies, it is not limited to public companies and raises the possibility that forgiveness of PPP loans may be analyzed more strictly than originally thought. . . . While there is no specific guidance on what businesses need to show to assess whether the PPP loan is necessary to support the ongoing operations of the applicant, borrowers should consider documenting in writing internally current and projected decreases in revenue and/or profitability; recent and projected cuts to compensation levels or employee counts; and inability to obtain capital elsewhere.

Presumably . . . if a borrower is found to have violated the above good faith certification, the SBA can reject any forgiveness of the PPP loan and require repayment of the loan. Additional fraud charges are also possible for “knowing” violations.

What is a knowing violation of the eligibility rule? We are not sure today. Perhaps the SBA and Treasury Department will provide regulations eventually, although if those rules are published, it will almost certainly be after the funding has been used up.

For those businesses that are legitimately eligible for a PPP loan, what happens if the money still runs out—even with some funds having been returned and the supplemental federal loan authorization? Who gets priority? Is first come, first served still going to be the rule?

FICA TAX RELIEF

Fifty Percent Credit

The CARES Act created a fully refundable tax credit for employers equal to 50 percent of qualified wages that certain employers pay their employees.

Eligible employers are those that carry on a trade or business during calendar year 2020 that either:

- fully or partially suspend operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19 or
- experience a significant decline in gross receipts during the calendar quarter.

This credit applies to qualified wages paid after March 12, 2020, and before January 1, 2021. The maximum amount of qualified wages considered with respect to each employee for all calendar quarters is \$10,000, so that the maximum credit available for qualified wages paid to any one employee is \$5,000.

Delayed Deposit of FICA Tax Liability

The Act allows employers to delay the payment of the employer's share of old-age, survivors, and disability insurance tax (OASDI Social Security). The deficit is to be made up half by the end of 2021, and half by the end of 2022.

This FICA tax relief program is not available to those employers who acquire a loan through PPP.

INCENTIVES TO HELP EMPLOYEES PAY STUDENT LOANS

The CARES Act waived accruing interest on federal student loan balances between March 13 and September 30 of this year. It also modified existing rules with regard to employer subsidies of employees' education expenses.

The law allows up to \$5,250 in employer-provided tuition assistance to be excluded from an employee's income each year. Eligible expenses include current tuition, fees, and course materials like textbooks, supplies, and equipment.

The CARES Act modification allows employers who pay student loans as an employee benefit to contribute up to \$5,250 tax-free toward the payment of that existing loan debt in 2020.

ENHANCED BUSINESS LOSS DEDUCTIONS

Business owners have had the ability to use a current year's net operating loss (NOL) and apply the NOL past tax years by filing an application for refund or amended return. Prior to the Tax Cut and Jobs Act (TCJA), NOLs could generally be carried back two years.

The TCJA eliminated most carrybacks for NOLs.

As a result of the CARES changes, firms may use NOLs from 2018, 2019, or 2020 and carry back those losses five years.

NET INTEREST DEDUCTION INCREASE

The net interest deduction limitation, which has limited a business's ability to deduct interest paid on tax returns to 30 percent of earnings before interest, tax, depreciation, and amortization (EBITDA), has been expanded to 50 percent of EBITDA for 2019 and 2020.

Waiver of RMDs

The CARES Act has waived the RMD obligations that were to come due in 2020. The waiver applies to:

- RMDs for 2019 for those who turned 70 ½ in 2019, but had planned to defer to the first RMD until April 1 of 2020.
- Calendar year 2020 RMDs for those who reach the required beginning date (age 72 for most) in 2020.
- Calendar year 2020 RMDs for who had already begun their RMDs prior to 2020.
- Beneficiary RMDs for 2020 from inherited IRAs and qualified accounts.

Some of our clients may have taken their expected 2020 minimum distributions prior to the passage of the CARES Act. While there is no automatic relief available to them, some may be able to take advantage of 60-day rollover rules to get monies previously believed to be RMDs back into qualified accounts without incurring an income tax result.

The indirect rollover idea is available for qualified account owners who are within 60 days of taking the distribution. It cannot be used by nonspouse beneficiaries of inherited accounts.

In Notice 2020-23, the IRS extended the 60-day rollover deadline to July 15, 2020, for eligible rollover distributions taken after January 31, 2020.

Even though RMDs for 2020 from IRAs have been suspended, eligible taxpayers may still use the qualified charitable distribution (QCD) technique to make donations to churches or certain other Section 501c3 organizations.

OPPORTUNITIES AND CONCLUSION

Life insurance and financial professionals can serve their clients by helping them make sure to take full advantages of the changes made by the CARES Act:

- 1. Make sure eligible individuals get their special 2020 federal income tax credit checks.**
- 2. Help make sure eligible businesses, if adversely affected financially by COVID-19, apply for PPP loans before the money runs out.**
- 3. For those business owners who have applied for or received PPP loan funds, discuss the new eligibility requirement, and evaluate whether to withdraw the application or return the funds.**
- 4. For those businesses with qualified plans, especially those with Section 401K plans, decide about whether to offer special COVID-19 enhanced withdrawal and loan features.**
- 5. Inform business owners about other tax opportunities created by CARES.**
- 6. Visit with beneficiaries of inherited accounts and older than 70 account owners about the choice to avoid this year's RMD.**
- 7. Discuss possible rollover remedies where amounts previously thought to be RMDs taken in 2020 are not needed by the taxpayer.**

Many in our business are still trying to understand the details of the CARES Act and resolve ambiguities as best we can. We can bet our best clients and prospects are trying to do the same. Even though we may not have all the answers, it's a good time to engage with our customers to help them figure out the questions they should be considering.

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Building Protecting and Perpetuating Family Wealth

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