Federal COVID Stimulus Bills
Tax and Other Provisions

CARES Act

Items with Vermont flow-through:

- **Early withdrawals from retirement accounts without penalty**
  - Up to $100,000 may be disbursed from a retirement account without paying the usual 10% tax penalty.
    - To be eligible, you or your spouse must have been diagnosed with COVID-19 or faced some sort of financial hardship because of the virus such as being furloughed, laid off, or quarantined.
    - Any withdrawal is counted as taxable income but the amount withdrawn can be prorated over three years.
    - Individuals can then repay the amount back without penalty or tax consequences.
    - All minimum distribution retirement rules are waived for 2020.
  - Impact on Vermont:
    - IRA withdrawals are considered part of gross income and Adjusted Gross Income (AGI). Vermont picks this up because AGI is the starting place for Vermont taxable income

- **Above the line charitable deduction**
  - Individuals now take a pre-AGI deduction not totally more than $300 for any charitable contributions made
  - This deduction cannot be taken if the taxpayer itemizes their charitable contributions.
  - Some limits on charitable giving have been suspended (such as the limit that the contributions not exceed 50% of taxable income).
  - Only effective for tax year 2020.
  - Impact on Vermont:
    - This is a pre-AGI level deduction. Vermont picks this up because AGI is the starting place for Vermont taxable income
    - Taxpayers who do not itemize charitable deductions would in effect receive a double benefit on Vermont taxes: 1) through the deduction flowing through to Vermont and 2) through Vermont's Charitable Giving Tax Credit.

- **Changes to the limitation of business income deductibility**
  - Prior to the Tax Cuts and Jobs Act, businesses were able to deduct most of the interest expense of borrowing. That was limited by TCJA to no more than 30% of taxable income.
  - This stimulus bill relaxes that threshold by making the limitation 50% of taxable income.

- Impact on Vermont
  - Federal Corporate Taxable Income is the starting place for Vermont Corporate Taxable Income.
  - This change would lower overall Federal Corporate Taxable income, and therefore, would lower Vermont Corporate Taxable Income.

- **Other smaller items:**
  - The bill allows for the payments of employer-paid student loans to be deducted as income for the individual. For payments before January 2021. The limit is $5,250 per employee.
    - Vermont flow-through likely through AGI, but unclear where on the form this deduction would happen.

<u>Items with possible Vermont flow-through:</u>

- **Changes to the limitations on business net operating losses**
  - Net operating losses (NOLs) are business losses that can be spread across tax years by a business to smooth fluctuations in the business cycle.
  - Tax Cuts and Jobs Act scaled back the ability of businesses to use NOLs. Specifically, they were not allowed to carry back losses to previous tax years.
  - The stimulus bill allows businesses to carry back losses 5 years, back to 2015. It also does not put any limits on the amount of NOLs as a percentage of taxable income.
  - Impact on Vermont is not through Corporate Income Tax because Vermont decoupled from NOLs for CIT, but possibly through Personal Income tax pass-throughs.

<u>Other Relevant Items</u>

- **Recovery Rebates for Individuals**
  - o Individuals and families will be receiving rebates from the Federal government
  - $1,200 for an individual, $2400 for a married couple plus $500 for each child.
  - Phases out after income is greater than $75,000 for an individual and $150,000 for a married couple. Phase-out $5 for every $100 after those thresholds.
  - Individuals with AGI greater than $75,000 and couples with greater than $150,000 will receive no rebate.

  o Payment is considered an “advanced refund” tax credit. To be paid out as soon as possible by the Treasury. Therefore, not taxable income.

- **Employee retention tax credits**
    - Creates a new credit against Social Security payroll taxes equal to 50% of wages paid, not to exceed $10,000 for businesses to keep workers on their payroll. Only for businesses with less than 100 employees.
    - Refundable tax credit
    - For employers that see a significant drop in activity due to COVID-19 as defined by an at least 50% drop in revenues from last year's first or second quarter.
    - Also applies to tax exempt organizations.
    - Eligibility of the credit against wages is limited based upon employer size:
        - For those with more than 100 full-time employees, the credit is only available for the wages when they are not providing services because of COVID-19 or if they see a significant drop in business

- **Delay of payment of employer payroll taxes**
    - Employers and self-employed may defer Social Security taxes for two years, to be paid back on December 31, 2021 and 2022.
    - Employers who have taken out loans under the same bill are not eligible for this.

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<u>Items with Vermont flow-through:</u>

Earned Income Tax Credits (EITC and Child Tax Credit)

- The bill allows those applying for the federal EITC and Child Tax Credit to "look back" to their 2019 incomes for the basis of these credits.
    - For many taxpayers, their 2020 wages could be too low to make them eligible for these credits when they file their taxes in April 2021. The lookback prevents this issue.
- Applicable only for the 2020 tax year.
- *Impact on Vermont taxes:*
    - Modest direct impact. Vermont's EITC piggybacks on the Federal EITC (36% of the Federal EITC). The rules around Vermont's EITC are the same as the Federal (for example, income thresholds).
    - Absent any Vermont legislation, Vermont's EITC would follow the same federal lookback for tax year 2020.
    - Vermont does not provide a child tax credit, and the federal child and dependent care credit is not impacted by this change.

Above the Line Charitable Deduction

- Allows a $600 (married) or $300 (single) charitable deduction for non-itemizing individuals to be taken before the calculation of adjusted gross income.
- This provision was in the CARES Act but was set to expire at the end of 2020. It has now been extended through tax year 2021.
- *Impact on Vermont taxes:*
    - Modest direct impact. Since the deduction is taken before Federal adjusted gross income, Vermont would be picking it up because AGI is the starting point for Vermont income taxes.
    - Absent any Vermont legislation, taxpayers would be "double dipping" on their charitable contributions: Vermont would be providing a tax benefit indirectly through the new deduction and also giving them a 5% credit through Vermont's charitable tax credit.

Payroll Protection Program (PPP)

- The bill makes two important changes to PPP
    - A) It creates a second round of PPP. Loans will be limited to smaller businesses (less than 300 employees) who have experienced at least a 25% revenue drop in a 2020 quarter as compared to 2019.
        - Maximum loan size is $2 million.
    - B) It allows the deductibility of PPP expenses. Typically, a business cannot deduct expenses from their taxable income if the expense was paid for with tax-free income, like PPP. The bill now states that if a business used PPP money for expenses, the money can be deducted against their taxable income.
- *Impact on Vermont taxes:*
    - Direct, unknown, but potentially significant impact. In theory, the deductibility of PPP expenses could significantly drive down net income of Vermont businesses, and therefore, have a major impact on taxes paid by businesses (corporate and personal income).
        - Size of impact is not fully known.
        - Impact is likely to affect numerous fiscal years via refunding and loss carryforwards.
    - $1.2 billion in loans were issued to Vermont companies, but many of them are not the largest taxpayers in the state.
    - Uncertainty remains about unitary, out-of-state taxpayers who took PPP loans.

7.5% AGI Medical Deduction Threshold

- For the Federal medical deduction, taxpayers are able to deduct medical expenses in excess of 7.5% of their AGI. This limitation was increased to 10% in tax year 2020. The 7.5% threshold makes the deduction more generous and has been made permanent starting in tax year 2021.
- *Impact on Vermont taxes:*
    - Vermont's Medical Deduction is based upon the Federal Medical Deduction. The 7.5% AGI threshold means Vermont Deduction will become more generous, and therefore, result in increased foregone revenue.

    - Note that the previous current law 10% of AGI threshold never went into effect Federally.

Other smaller tax provisions:

- 100% deduction for business meals for tax year 2021 and 2022
    - Will impact Vermont taxes through business net income, although the impact is expected to be modest.
- The CARES Act allowed for the payments of employer-paid student loans to be deducted as income for the individual. The limit is $5,250 per employee. The original expiration date was January 2021 but has been extended until 2026.
    - Minimal direct revenue impact on Vermont through the net income of businesses. It is estimated that very few businesses currently or will do this in Vermont.
- Unspent money from 2020 flexible spending accounts (FSA) can now be carried into 2021 and again in 2022.

<u>Other relevant provisions, likely not affecting Vermont revenues directly</u>

Recovery Rebates for Individuals and Families

- Similar to CARES stimulus checks but smaller.
- $600 per individual in the household (adult dependents not eligible)
- Phases out depending upon income of the household: $75,000 for a single household, $150,000 for a married couple, and $112,500 for a head of household.

Employee Retention Credits

- The CARES Act created the Employee Retention Credits, which were credits against Social Security Taxes paid equal to 50% of wages paid, not to exceed $10,000 in wages paid per year.
- The new bill expands the credits by making the credits up to 70% of wages paid up to $10,000 per quarter.
- The bill also allows businesses who used PPP to take Employee Retention Credits, which was not permitted in the CARES Act.

Others

- Delay of payment of Social Security and railroad retirement taxes has been extended from December 2020 through December 2021.
- Extension or alterations of several Federal tax credits likely used by Vermonters, including the low-income housing credit (used by developers to fund the construction of low-income housing), the New Market Tax Credit program, the energy investment tax credit, and other renewable energy incentives.
- Permanent extension of lower federal excise taxes for alcohol passed in the CARES Act.