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Tax Policy Update: Examining Recent COVID-19 Tax Developments and Surveying Potential Changes on the Horizon

As we head into the 2021 tax season, it is important to take note of some of the tax policy changes passed in connection with the COVID-19 pandemic that may impact 2020 returns and other compliance obligations in the new year. In addition to the Coronavirus Aid, Relief, and Economic Security Act (CARES) Act passed in March 2020, an additional coronavirus relief package was approved in December 2020 as part of the Consolidated Appropriations Act, 2021.

More changes may also be ahead as President Joseph Biden and a Democratic-controlled House and Senate have signaled that further pandemic-related relief is a top priority for the new administration. From a state and local tax perspective, states and cities continue to work through tax issues related to work-from-home arrangements and significant budget gaps.

Below are highlights of recent COVID-19 tax developments, including the latest coronavirus relief package, potential tax changes under the Biden Administration, and how telecommuting employees may make compliance with certain state and local taxes especially complicated this year.

COVID-19 Relief Bill Allows Deductions of Expenses Paid with Forgiven PPP Loans, Makes Business Meals Fully Deductible, Extends Credits

The COVID-19 relief and spending bill (H.R. 133, the Consolidated Appropriations Act, 2021) passed by Congress and signed by President Donald Trump on December 27, 2020, clarifies that business expenses paid for with Paycheck Protection Program (PPP) loans are tax deductible. While the legislation characterizes the treatment of business expenses paid with forgiven PPP loan amounts as a *clarification*, it represents a clear departure from guidance issued by IRS on the issue and comes as welcome news to PPP borrowers. H.R. 133 also temporarily makes business meals fully deductible in 2021 and 2022 and extends and expands the Employee Retention Credit (ERC), which was established under the CARES Act.

The year-end coronavirus relief legislation also extends scores of tax credits and other favorable tax provisions such as the look-through rule for related controlled foreign corporations and the temporary adjusted gross income (AGI) limit increase on charitable deductions for cash gifts for individuals through 2021 to 100% of AGI. The expansion and extension of tax credits and other taxpayer-friendly provisions will hopefully help businesses survive through the end of the pandemic.

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Gauging the Momentum of President-Elect Biden's Proposed Tax Policy Changes With the Democratic Party Control of the Senate

Following the 2020 elections, the Democratic Party has secured control of the presidency and both Houses of Congress, albeit with slim majorities. While the Democrats have advocated for tax increases for corporations and high-income individuals on the campaign trail, competing priorities and slim majorities will make it a challenging environment for the stated tax proposals to advance.

For now, the COVID-19 pandemic and resulting economic turmoil are taking center stage in the legislative arena. If or when tax policy does come into focus, the Democratic Party's narrow hold on both the House and Senate would require that the measure be supported by its most moderate members. Tax increases retroactive to the beginning of the year of enactment rarely occur. Thus, it is possible, but highly unlikely, that tax increases could be enacted during 2021 that would be retroactive to January 1, 2021. Taxpayers must carefully evaluate 2020 tax positions and 2021 transactions in light of potential changes that could be coming and opportunities to carryback 2020 losses to earlier years.

For more information, see our 2021 Policy Outlook and Read More here.

Telecommuting Employees Will Likely Complicate Employers' Compliance With Seattle's New Payroll Expense Tax

Seattle's payroll expense tax took effect on January 1, 2021. However, much has changed since the so-called *head tax* levy, was originally conceived. The tax aims to tax employers' payroll expense on compensation to employees or

independent contractors primarily assigned to a business location in Seattle. However, in response to the COVID-19 pandemic, telecommuting or remote work arrangements have become the norm for many companies. One result is that for purposes of determining their liability for the payroll expense tax, employers will need to focus on whether the payroll expenses for these workers meets the definition of *paid in Seattle*. If not, such payroll expenses will not be subject to the tax.

To accurately report payroll incurred within a city or other local tax jurisdiction, it is important to note the specific rules related to a jurisdiction in which an office was previously operating. It is equally important to track such rules for the locations in which employees now work.

Follow the link below for an explanation of how Seattle's new payroll expense tax works and the applicable criteria for determining if compensation is subject to the tax.

Read More

The Takeaway

From a tax policy perspective, 2020 brought many unexpected developments. Looking ahead, 2021 could also be a year of significant legislative tax changes. While the COVID-19 pandemic and associated economic distress is the current focus for the new administration, tax policy may soon also be on the legislative agenda. With retroactive tax measures unlikely, tax and financial planning opportunities should focus on potential upcoming law changes.

Please see the Andersen COVID-19 Tax Relief Developments page for the latest tax guidance related to the COVID-19 pandemic. If you have questions, please contact your Andersen advisor.

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The Many Sides of a Gift

In anticipation of a President Joseph Biden administration and the expected revenue raising tax measures to come, many clients rushed to use their remaining lifetime gift exclusion before the year 2020 concluded. The tax planning environment was (and still is) incredibly favorable, with interest rates at historic lows and rapidly changing valuations on which to capitalize, creating the perfect storm of wealth transfer activity. But while tax motivations often start the

conversation and are certainly one driver of wealth transfer, equal if not more important considerations are understanding and embracing donative intent and the need for succession planning, which can create a more robust, holistic, and ultimately successful wealth transfer process.

Turning Fear into Opportunity

What we hear most often from clients is a desire to retain some control over transferred wealth, because they fear that they may transfer too much and not retain enough, or they feel that they are still best positioned to preserve and protect those assets. Frequently, a beneficiary may not be told a gift was made or is told rather antiseptically by an advisor through the signing of legal documents. It is also unlike that beneficiary was included in discussions with respect to why the gift was made and the donor's intent. This robs the donor of the honor they may feel in making the gift and the reasons behind it, and it handicaps the recipient by not equipping them with the full and rich story of the gift as well as the tools to properly manage the assets.

Instead, the wealth transfer process can be thought of as a way to transfer both financial and non-financial assets, using the transfer of wealth to engage the rising generation in an understanding of how to manage wealth. This process can be done with beneficiaries of almost any age and incorporate age-appropriate life lessons. Facilitating these discussions can enrich the process by going beyond mere giving of the financial capital of a family to the giving of all the forms of family capital that can be transferred across generations. This family capital may include storied lessons and wisdom, the history behind various decisions and documents, the meaning behind treasured heirlooms that can bridge the gap between the lived experience and the told one. Strong family governance is best achieved when there are shared values and purpose, and no better way to communicate those values than in the wealth transfer process. As a donor, consider writing a letter to the beneficiary of your gift commemorating what you hope the gift will achieve, why you felt the gift appropriate, and how you feel about the beneficiary. There is art in both giving wisely and receiving wisely, and more value can be extracted when we dedicate some process to the people involved in the transaction than just to the asset being transferred.

Telling Your Story

A well-crafted gift and estate plan includes several key legal documents such as a will and various trusts meant to carry out the wishes of the donor/decedent in the most tax-efficient way possible. With respect to the wealth transfer process, such documents often include precatory language which, although non-binding, seeks to convey the donor's intent with respect to the document terms. But as we all know, these documents rarely imbue a sense of connection with the donor/decedent and are not meant to convey warmth and belonging. Unfortunately, these are often the only deliberate documents drafted during life and/or left behind after death that give any instruction at all. At best, they are a simple manual for the executor or trustee, who are left to use it as a guide in telling and re-telling the donor/decedent's life story, possibly for generations.

The good news is that there is a growing movement towards the drafting of supplementary documentation to address matters outside of the typical legal framework. Such documents are meant to enhance and enrich the wealth transfer process by adding context and texture to what is given and how it is given. For example, an Ethical Will can supplement an actual will by addressing the life lessons and family values that must go hand in hand with any financial assets that are passed on. Likewise, effective family governance may call for a family mission statement to define family purpose, and a family constitution to give direction to the family with respect to how to govern itself for years to come. Without such a blueprint, families often fall short of both their wealth and non-wealth goals within just three generations despite well-drafted legal documents stipulating where the money goes and how it is shared. Another document, the Letter of Intent or Letter of Wishes, is sometimes included within a trust document and allows a donor to explain what he/she intended and how to interpret certain dispositive provisions. It is often a plain English explanation to help protect against misinterpretation and mismanagement.

More Purpose into Trust

Another way for a gift to be more than just the financial assets themselves is to set funds aside in trust for family process, education, and growth. Such assets are not intended to be distributed directly to a beneficiary but to continue in trust to support and empower a broad set of goals for and on behalf of the family. Often called a Purpose Trust, such a trust is endowed by gift to keep the family values alive and well long after the donor is gone. This trust would use its pool of funds

to further the family's mission by paying for related experiences, which might include family meetings, family retreats, family education, family training and mentoring, and/or a family bank which could make loans to family members to start a new business venture, for example. The trust can become the centerpiece of the family's shared ideals, making sure that all family members have the tools to manage the wealth with a sense of fairness and transparency, and a way to come together to share in the family's successes and struggles.

A Purpose Trust can also hold legacy real estate. Shared ownership of real estate is often fraught with conflict, so setting up a Purpose Trust to fully endow the property, as well as govern its use, can be a powerful way to gift such assets without undue burden on the recipients. When considering gifting real estate or other tangible assets so that such assets stay in the family, it is critical to have those conversations with beneficiaries well before the gift is made. Too often, planning around hard assets is rooted in how the donor feels about these passion assets, but beneficiaries may not share in those passions. Facing these uncomfortable truths is better navigated beforehand, so that both the donor and his/her beneficiaries can come together with plenty of time and careful thought around creating an inheritance plan that will be cherished and respected by all.

The Many Sides of a Gift

The wealth transfer process can be myopic when only focused on the financial assets and the tax efficiency of a transaction. However, comprehensive family wealth planning also considers the non-financial assets and the most important messages that should be communicated with a transfer to connect donor and beneficiary in something more transformative.

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Corporate Transparency Act of 2020 Creates New Beneficial Ownership Reporting Requirements for U.S. and Foreign Businesses

On January 1, 2021, the Senate passed H.R. 6395, the National Defense Authorization Act, 2021 (NDAA). The NDAA includes the Anti-Money Laundering Act of 2020, which in turn contains the Corporate Transparency Act (CTA). The legislation is intended to curb the use of shell companies to facilitate illegal money laundering. The CTA requires that a report be filed with the U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN) to identify each beneficial owner of and applicant forming a reporting company. The new CTA reporting regime is similar to beneficial ownership registers mandated by the European Union (EU), but with some key differences.

Required Disclosures

The CTA, as enacted, imposes an obligation on many entities operating in the U.S. to file a report with FinCEN identifying each beneficial owner. The CTA will apply to existing reporting companies and require an initial report within two years after the new law becomes effective. Newly formed entities will need to file with FinCEN at the time of formation. These compliance obligations will not become effective until Treasury issues regulations to implement the CTA, the timing of which is uncertain.

The CTA provides that the information collected will not be made available to the public. The CTA empowers FinCEN, however, to disclose beneficial ownership information to federal agencies engaged in national security, intelligence, or law enforcement; state, local, or tribal law enforcement agencies seeking information in criminal or civil investigations; federal agencies seeking information on behalf of the law enforcement agency of another country; banks for customer due diligence confirmation requests; and other federal regulatory agencies.

Key Definitions

A *reporting company* is defined as a corporation, limited liability company or other similar entity that is created by filing a document with the secretary of state (or an equivalent office) of any state, or formed under foreign law and registered to do business in the U.S. in a like manner. Certain companies are exempted from the reporting requirement including:

- companies that are already subject to supervision or otherwise closely regulated by the federal government (*e.g.*, banks and credit unions);
- dormant companies;
- companies that employ more than 20 people, filed a tax return reporting gross receipts in excess of $5 million, and that have a physical presence in the U.S.; and
- any entity owned by an entity otherwise exempt.

A *beneficial owner* is defined as an individual who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise:

- exercises substantial control over an entity, or
- owns or controls at least 25% of the ownership interests in an entity.

Exceptions apply for minors; intermediaries, custodians, or the like, who are acting on behalf of another individual; and those whose control over a company is solely due to employment in a management capacity, or due to inheritance.

An *applicant* is defined broadly as an individual who files an application to form an entity.

Potential Penalties

Willful failures to provide the information required by the CTA or willfully providing false or fraudulent information may result in penalties of up to $500 per day while the violation continues, as well as criminal fines of up to $10,000 and/or imprisonment of up to two years.

The unauthorized disclosure of information collected under the CTA carries the same civil penalty but a higher criminal penalty of up to $250,000 and a higher maximum term of imprisonment of five years. Unauthorized disclosure includes both a disclosure by a government employee and disclosure by a third-party recipient of information under the CTA.

EU Anti-Money Laundering Directives

The CTA reflects a growing trend towards enhanced transparency in beneficial ownership around the globe. The EU has adopted the most developed and targeted standards to date. The CTA notes that “[i]n contrast to practices in the U.S., all 28 countries in the European Union are required to have corporate registries that include beneficial ownership information.” Div. A, Sec. 2(8) of the CTA.

The EU’s 4th Anti-Money Laundering Directive (MLD 4) was adopted in May 2015 with implementation required of EU Member States by June 2017. MLD 4 requires Member States to maintain centralized registers listing beneficial ownership information of legal entities formed in their jurisdiction. Information from the registers can only be disclosed to

enforcement authorities, obliged entities in connection with due diligence, or persons able to show “legitimate interest.” The definition of a beneficial owner is “any natural person(s) who ultimately owns or controls the customer and/or natural person(s) on whose behalf a transaction or activity is being conducted.” Ch. 1, Sec. 1, Art. 3 (6) of MLD 4.

A subsequent directive, the EU 5th Anti-Money Laundering Directive (MLD 5), was adopted in July 2018 with implementation required of EU Member States by January 2020. MLD 5 updates the legal framework of MLD 4 and extends the reach of the EU’s beneficial ownership reporting regime with respect to trusts. It also requires Member States to connect their beneficial ownership registers to a central EU platform and provides public access to the registers (although a “legitimate interest” is required in connection with trust data). MLD 5 also provides rules for cryptocurrency transactions.

The CTA currently parallels the parameters set forth in MLD 4. However, MLD 5 may be representative of what is to come in future U.S. legislative or administrative developments.

The Takeaway

Financial institutions in the U.S. have generally held the burden of identifying beneficial ownership as they are required to identify and verify beneficial owners through the Bank Secrecy Act’s customer due diligence and know-your-customer requirements. The CTA will instead shift the burden to reporting companies similar to the beneficial ownership registers that are mandated for Member States of the EU.

Any compliance requirements under the CTA will not become effective until Treasury issues regulations, the timing of which is currently unknown. The CTA leaves open the definition of certain key terms, including what constitutes the “substantial control” over an entity for purposes of beneficial ownership. Additional guidance from FinCEN and/or Treasury will be essential for companies to determine the scope of their compliance responsibilities. In the interim, businesses should begin to consider how best to comply with this new filing requirement.

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Reducing Concerns Over Gifting Too Much

Now that the Senate run-off elections in Georgia have passed and legislative control is narrowly vested in the hands of the Democrats, there is renewed focus on potential tax legislation. As has been consistent throughout his campaign, the President Joseph Biden tax plan includes various measures focused on estate planning. One of the most discussed provisions calls for a reduction in the gift, estate and generation-skipping transfer tax exemption amounts to "historical norms", which appears to mean $3,500,000 per person. While most believe it is still

unlikely any change would be applied retroactively, there remains what may be a small window of time to effectively use exemptions at their current $11,700,000 amount. This reality has and will force taxpayers and their tax advisors to wrestle with the question, how much should be gifted. Of course, there is no "correct" answer to this question and even if there was, it would vary depending on the individual taxpayer. However, at least from a non-tax perspective, this analysis typically centers around concerns about whether a child donee is being given too much, and whether a parent donor will have enough after making a large gift. This article will focus on the latter.

Whenever assessing whether an individual will have enough after making a gift, it is critical the right fundamental question be asked. Is the concern not having enough assets, or not having enough cash-flow? There may be instances where a much larger estate consisting of illiquid, non-income producing assets could be more problematic from a cash-flow perspective than a smaller estate, consisting of liquid, cash-producing assets.

If the issue is in fact not having enough assets, there are certain, very specific transfer techniques designed for such circumstance. Although beyond the scope of this article, these techniques include gifting a promise to pay a donee assets at some point in the future or using partnership interests to create "artificial" gifts under a specific and somewhat esoteric code section. These transactions, and others like them, all involve essentially making a gift for tax purposes, but not actually giving away any assets. Besides the various technical risks associated with this planning, these techniques are designed to use gift tax exemption, but not necessarily to get the future appreciation associated with that amount of assets out of an individual's estate and are therefore limited economically.

Another transaction commonly associated with asset and cash-flow concerns are Spousal Limited Access Trusts, or SLATs. A SLAT is basically a trust that includes a spouse as a beneficiary. While it is not intended the spouse receive distributions, it does allow for the grantor to have some access to the amounts gifted via the spouse as long as that spouse is alive and still married to the grantor. Often, the other spouse will set-up a similar trust, including the first spouse as a beneficiary. In that instance, each spouse would fund his or her created trust with $11,700,000 (or some lessor amount). This way, the mortality risk is cut in half because if one spouse dies, the other will have access to the amount the deceased spouse gifted to that trust. The mortality risk could possibly be eliminated entirely if each spouse also has the ability to appoint trust property to the survivor at his or her death.

While this construct does sound beneficial, it is not without its detriments. From a tax risk perspective, SLATs are potentially susceptible to the reciprocal trust doctrine. This legal doctrine allows IRS to essentially uncross the gifts so that it is deemed one spouse has made a gift to a trust that he or she is also a beneficiary of, and the other spouse has done the same thing. The deemed uncrossing could either render the gift to be incomplete or create estate tax inclusion. Either way, the result is the gift is taxed in the grantor's estate. Additionally, the more spousal access the trusts allow for, the more likely IRS could prevail with a reciprocal trust doctrine argument, particularly if there are actual distributions to the spouses. To limit this risk, drafters try to make the trusts as dissimilar to each other as possible. However, as implied above, the more dissimilar to each other, the less access each spouse will have.

Besides tax risk, SLATs also have economic downside. Put simply, if distributions are made to spouses, that effectively wastes gift tax exemption by putting assets back into their estates. For these reasons, it is generally not a good practice to enter into a SLAT transaction with the intent of making spousal distributions. Thus, we come full circle on the question of whether having enough assets or having enough cash-flow is the issue. After analyzing an individual taxpayer's situation, it will often be discovered the real issue is cash-flow. In many cases, it is possible to mitigate if not eliminate cash-flow concerns with gifts to trusts without having to navigate the tax and non-tax problems outlined above.

Most of the time, trust planning involves grantor trusts. In the vernacular, grantor trusts are trusts that do not exist for income tax purposes, even though they are separate legal entities that keep assets out of a grantor's estate. Because a grantor trust does not exist for income-tax purposes, not only is the grantor responsible for paying the tax on income generated in the trust, but the grantor can also engage in transactions with the trust completely income-tax free. Therefore, if there is cash generated inside the trust, as long as there are assets outside the trust, the grantor can substitute in those assets and take back an equal amount of cash. In thinking back to the individual with the large balance

sheet of illiquid assets, each time one of those assets in the trust produces some cash, the grantor can substitute in more illiquid assets for that cash, again completely income-tax free. Additionally, if those assets are also discounted, this can augment the planning already done without generating gift tax. Further, as long as the cash is swapped for assets of equal worth, there is little risk IRS can challenge the transaction. Finally, from an economic standpoint, unlike the distribution from a SLAT, this exchange does not dilute the value of the trust, it simply changes the type of asset held in the trust.

If a taxpayer does not have sufficient outside assets or for some other reason does not want to part with them, the grantor can also borrow cash from the trust. With historically low interest rates, this borrowing is basically free. Based on the January 2021 rates, a 9-year term loan carries an Applicable Federal Rate (AFR) of .52%. The AFR is the lowest permissible interest rate that can be changed without adverse tax consequences. That said, the AFR is an interest rate floor, not ceiling. If there is still an appetite for additional gift and estate tax planning, the interest rate can be higher and therefore transfer more wealth to the trust but in a much slower and controlled manner. Similar to the asset swap, if the note is paid off with a discounted asset, that can push additional wealth into the trust as well. If the grantor dies with the note, that liability would reduce any estate tax.

The Takeaway

As concerns grow over a reduction in gift, estate, and GST exemptions, so too will the importance of gifting. However, this tax planning need not come at the cost of fear of not having enough. With some foresight and asset management, these concerns can be mitigated with relatively easy, and with little to no tax-risk or economic downside.

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