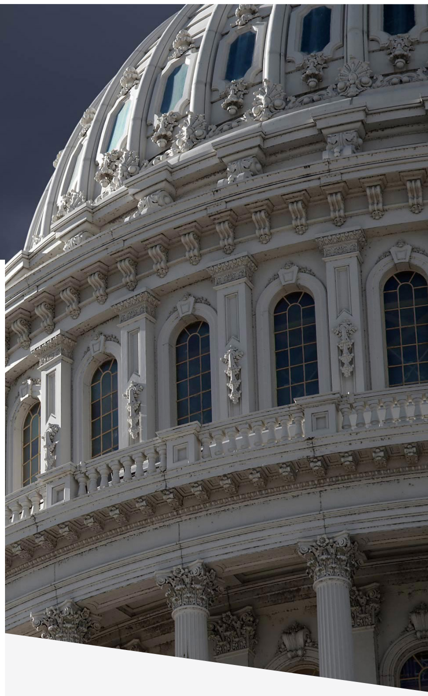
Essential components of the CARES Act

April 24, 2020

The CARES Act is complex. But there are two essential provisions that businesses with 500 or fewer employees and individuals with retirement assets should understand and consider.



On March 27, the over $2 trillion Coronavirus Aid, Relief and Economic Security (CARES) Act was signed into law. It builds on prior legislation intended to address the COVID-19 pandemic by providing support to businesses and individuals. Two essential components of the act are the Paycheck Protection Plan (PPP) and the Coronavirus Related Distribution (CRD) from retirement accounts.

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Paycheck Protection Plan for smaller businesses

The Paycheck Protection Plan is a two-year business loan administered by the U.S. Small Business Administration. In some cases, the loan is forgivable. Some key provisions are:

- The maximum loan is the lesser of $10 million or 2.5 times the average monthly payroll. It's limited to $100,000 in annual compensation per employee.
- If the loan is used to maintain payroll for the eight weeks after the loan disbursement, the total of payroll, business mortgage interest, rent and utility payments is forgiven, which would reduce or eliminate the loan repayment. The forgiven amount would not be treated as taxable income.
- Payroll must be at least 75% of the 8-week expenditure to qualify for loan forgiveness.

The program proved so popular that the 1.6 million accepted loan applications exhausted the initial $350 billion CARES Act budget allocation by mid-April. But there's broad congressional agreement for an additional allocation of $300 billion or more. Although applications are suspended while the new funding gets approved, business owners and 501(c)(3) public charities, as well as independent contractors and people who are self-employed, can continue to seek an approved bank lender for a low cost (no fees and 1% interest) and a flexible (six-month repayment delay) loan that does not require collateral or personal guarantees from the borrower.

While waiting for the next round of PPP funding, the CARES Act deferral of the payroll tax provision for the remainder of 2020 can also help with cash flow management:

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- An employer can delay their Social Security tax (6.2%) deposit and make it in two 50% increments: the first by December 31, 2021 and the second by December 31, 2022.
- It's not possible to have PPP loan forgiveness in tandem with the Social Security tax deferral. But any Social Security tax deferral claimed prior to qualifying for the PPP loan forgiveness will not be subject to penalty and will retain the deferred deposit terms above.[1]

Coronavirus-related distribution for individuals

The Coronavirus Related Distribution (CRD) is a special retirement distribution for 2020 only. If permitted by the employer plan, qualified retirement plan participants can take this distribution as can IRA account holders. Employers who want to offer the CRD can do so at once, and they have until December of 2022 to amend their plan document. Employers should check with their recordkeeper or third-party administrator about their readiness.

The CRD can be taken by anyone who self-certifies COVID-19 illness or has been quarantined, furloughed, laid off, has reduced work hours, owns a business that is closed/operating at reduced hours or is unable to work due to lack of childcare. The 10% early withdrawal penalty is waived as is the required 20% withholding by qualified plans. Pretax dollars are treated as ordinary income for federal income taxes, but with a special provision.

A CRD withdrawal can be spread pro rata across three years for federal tax purposes. A $30K CRD taken in 2020 can be treated as three distinct withdrawals of $10K each for tax years 2020, 2021 and 2022. The withdrawal can be repaid in an IRA or qualified plan at any time until December 31, 2022. If it's repaid, income included in a prior tax year filing can be exempted by filing a corrected tax return.

Investors with access to other resources should consider using them prior to withdrawing retirement assets. But if retirement assets are needed, this is a flexible distribution option available only in 2020.

Bottom line: Understand how you could benefit from the CARES Act

There are many other provisions in the CARES Act to support individuals and businesses. Investors should meet jointly (by phone or video conference) with their financial and tax advisors to review them carefully.

Learn more about Covid-19 legislation affecting individuals and small businesses (PDF)

DISCLOSURES

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[1] IRS Q&A; Deferral of employment tax deposits and payments – April 19, 2020

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