The CARES Act: Tax Relief Provisions

Monday, March 30, 2020

Overview

On March 27, 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"), the third and by far the largest stimulus package passed by Congress to respond to the COVID-19 outbreak. As discussed in our main alert, the $2 trillion CARES Act amounts to what will be the biggest economic stimulus package in American history.

The CARES Act includes several tax provisions intended to provide relief to businesses and individuals. These provisions address a variety of tax matters applicable to a wide range of taxpayers. While the provisions are aimed at business and taxpayers impacted by the COVID-19 pandemic, many apply regardless of whether a taxpayer has been directly impacted by the pandemic. In addition, although many of these provisions are effective for the COVID-19 outbreak period and the 2020 tax year, several provisions have retroactive effect that will impact tax years prior to 2020 (in some cases, entitling taxpayers to refunds or reductions of tax with respect to such prior years).

The following provides brief summaries of the more significant tax-related provisions applicable to businesses and individuals in the CARES Act. This summary does not address the provisions in the CARES Act relating to retirement plans, which are discussed in Foley Hoag's, "*The CARES Act: Provisions Affecting Retirement and Health Plans*."

Key Points

I. Business Tax Provisions.

Employee Retention Payroll Tax Credit. A refundable payroll tax credit with respect to the employer portion of Social Security taxes generally is available to any employer:

> (1) for each calendar quarter beginning after December 31, 2019 during which such employer is required to fully or partially suspend operations due to governmental orders issued in response to the COVID-19 pandemic; or
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> (2) for the period (i) beginning on the first calendar quarter that the employer suffers a more than 50% decline in gross receipts compared to the same quarter of the previous year and (ii) ending with the quarter that begins after the first quarter after the quarter described in (i) during which such employer's gross receipts are more than 80% of the employer's gross receipts for the same quarter in the previous year.

The refundable payroll tax credit is equal to 50% of the qualified wages paid to each employee for each such eligible quarter, up to a maximum of $10,000 of wages per employee. To the extent the available payroll tax credit exceeds the amount of the employer portion of Social Security taxes that would otherwise be payable for the quarter, such excess shall be treated as an overpayment by the employer and shall be refunded, on a tax-free basis, to the employer.

For employers with more than 100 employees, "qualified wages" generally are wages that the employer pays employees who are not providing services due to the suspension of the business or a drop in gross receipts. For employers with 100 or fewer employees, all wages paid to employees during the applicable period of a suspension of business or a drop in gross receipts generally are qualified wages. For this purpose, qualified wages also include certain health plan expenses. The refundable payroll tax credit only applies to qualified wages paid after March 12, 2020 and before January 1, 2021.

An employer that receives a small business loan pursuant to the Paycheck Protection Program under Section 1102 of the CARES Act (such loans referred to herein as "Stimulus Loans") is not eligible for this refundable payroll tax credit. (The Stimulus Loan program is discussed in more detail in Foley Hoag's "*COVID-19 Relief Loans for Small Businesses*." The CARES Act directs the Secretary of the Treasury to issue guidance relating to various aspects of the implementation of the refundable payroll tax credit, including advance payments of such credit and the recapture of any such credit when the employer subsequently receives a Stimulus Loan.

Employer Payroll Tax Deferral. Effective as of March 27, 2020, employers (including self-employed individuals) may defer the employer portion of Social Security taxes due between the enactment of the CARES Act and January 1, 2021. Employers will have until Dec. 31, 2021 to pay half of the amount deferred and until Dec. 31, 2022 to pay the remaining half. An employer that receives any loan forgiveness with respect to a Stimulus Loan under Section 1106 or Section 1109 of the CARES Act is not eligible for this tax deferral. Guidance has not yet been issued to clarify the mechanics and timing of any payment of payroll taxes that were deferred prior to any disqualifying loan forgiveness, including whether interest or penalties would be imposed on such previously unpaid payroll taxes.

Loan Forgiveness for Stimulus Loans. As described in more detail in Foley Hoag's "*COVID-19 Relief Loans for Small Businesses,*" the CARES Act created the Stimulus Loan program for small businesses. The CARES Act provides that Stimulus Loans made pursuant to this program may be partially or wholly forgiven and further provides that the forgiveness of such loans will not result in taxable cancellation of indebtedness income to the borrower. However, as described above under "**Employee Retention Payroll Tax Credit**," an employer that receives a Stimulus Loan is not eligible for the employee retention payroll tax credit. In addition, as described above under "**Employer Payroll Tax Deferral**," an employer that receives any loan forgiveness with respect to a Stimulus Loan is not eligible for the employer payroll tax deferral.

Increase in Deductible Portion of Business Interest. For tax years beginning in 2019 and 2020, the portion of business interest that may be deducted has been increased from 30% to 50% of adjusted taxable income. Additionally, for tax years beginning in 2020, taxpayers may elect to use their 2019 adjusted taxable income (adjusted in the event of a short 2020 tax year) for purposes of calculating the amount of their deductible business interest. For partnerships, the modification to the business interest limitation does not apply to tax years beginning in 2019; however, unless a partner elects otherwise, 50% of any excess business interest expense allocated to the partner for such a tax year will be treated as business interest paid by the partner that is not subject to any adjusted taxable income limitation and the remaining 50% will be subject to the usual limitations.

Net Operating Losses Limitation Lifted and Limited Carryback Permitted. The 80% taxable income limitation on the use of net operating losses ("NOLs") has been temporarily suspended to allow most businesses to use NOLs to offset 100% of their taxable income for tax years beginning in 2018, 2019 and 2020. For tax years beginning after 2020, NOLs are again subject to the 80% taxable income limitation. Additionally, the prohibition on the carryback of NOLs has been temporarily suspended to allow the carryback of NOLs arising in a tax year beginning in 2018, 2019 or 2020 to each of the five years preceding the tax year in which the NOLs arise. As a result, qualifying businesses may amend applicable prior year tax returns to obtain a tax refund from the carryback of 2018, 2019 and 2020 NOLs. The CARES Act also addresses the interaction of these new NOL rules with the deemed repatriation tax under Section 965 of the Internal Revenue Code.

Modification of Loss Limitations for Non-Corporate Taxpayers. Previously, non-corporate taxpayers (*i.e.*, pass-through entities and sole proprietorships) were not allowed a deduction for "excess business losses" pursuant to Section 461 of the Internal Revenue Code. The CARES Act provides that for the 2020 tax year, such taxpayers may deduct such losses.

Exclusion for Certain Employer Payments of Student Loans. The exclusion from an employee's taxable income for up to $5,250 of employer-provided educational assistance has been expanded to include an employer's payments made after March 27, 2020 and prior to January 1, 2021 on certain qualified education loans of the employee that were incurred for the employee's education. The payments must be made in accordance with the general requirements for employer-provided educational assistance programs, including (but not limited to) payments being made according to a written plan and not in lieu of other consideration provided by the employer. The payments can be made to either the employee or the employee's lender. Any payments made by the employer will be deductible as a business expense; however, employees may not deduct any interest paid by the employer.

Accelerated Deduction for Certain Facilities Improvements. As described in more detail in Foley Hoag's "*What the Real Estate Sector Needs to Know about the CARES Act*," the CARES Act fixes a technical error in the Tax Cuts and Jobs Act of 2017 (the "TCJA") regarding bonus deprecation as it applies to certain "qualified improvement properties" (which generally relates to certain aspects of non-residential real property). With this correction, taxpayers may now immediately deduct expenses for improvements to "qualified improvement properties." These changes apply retroactively, so taxpayers may file amendments to claim the deductions for tax years beginning in 2018 and 2019.

Modification of Credit for Prior Year AMT Liability. The TCJA eliminated the corporate alternative minimum tax ("AMT"), and AMT credits ("AMTCs") generated before the TCJA generally could be carried forward and refunded in tax years beginning in 2018 through 2021, subject to limitations in each year. Under the CARES Act, a corporation with an outstanding AMTC may now claim a full refund of this amount in 2019, or make an election to claim the refund for 2018. If a corporation elects to claim a refund of their outstanding AMTC in 2018, they must file an application with the Secretary of the Treasury (or the Secretary's delegate) by December 31, 2020. The CARES Act requires that such applications be processed within 90 days of filing.

Charitable Contributions by Corporations. For corporations, the deduction for charitable contributions generally is limited to an amount equal to 10% of the corporation's taxable income. For the 2020 tax year, the CARES Act permits corporations to deduct the amount of any "qualified contributions" to the extent that the aggregate of such contributions by the corporation does not exceed the excess of 25% of the corporation's taxable income over the amount of all other charitable contributions so allowed, with any excess generally being eligible for a 5 year carryover. To be a "qualified contribution," the contribution generally must be made in cash to a qualifying organization and must not be for the establishment or maintenance of an existing donor advised fund or be attributable to a contribution carryover from a prior year.

II. Individual Tax Provisions.

"Recovery Rebates" for Individuals. Certain eligible individuals (other than dependents, nonresident aliens, estates or trusts) will receive a "recovery rebate" of up to $1,200 for adult individuals and up to $2,400 for adult individuals filing a joint return, plus an additional $500 for each qualifying child under the age of 17. Eligibility for the recovery rebate will begin to phase out to the extent the adjusted gross income ("AGI") of individuals exceeds $112,500 for individuals filing as a head of household, $150,000 for married individuals filing a joint return, and $75,000 for all other individuals (including single filers). Determinations of AGI for this purpose will be made based on the individual's AGI reported on their 2019 income tax return (or 2018 income tax return if the 2019 income tax return is not available).

The "recovery rebate" payments, in fact, are an advance payment of a 2020 refundable tax credit. As such, individuals who exceed the phase out amounts in 2019 or 2018, as applicable, but are below the phase out amount in 2020 will receive the payment in the form of a refundable tax credit on their 2020 tax return. The recovery rebates will not be taxable income for federal tax purposes. In addition, it appears that individuals who receive a recovery rebate (based on 2019 or 2018 income tax returns, as applicable) but ultimately have an AGI in excess of the phase out amounts for 2020 may not be required to return any portion of a recovery rebate received.

If an eligible individual filed a federal income tax return in 2018 or 2019, payment processing will be based on payment or address information already on file with the IRS. Electronic payments will be automatic and made to an account the individual authorized for the 2018 tax year or later. The CARES Act provides the IRS with additional tools to locate and provide rebates to low-income seniors who normally do not file a tax return by allowing the IRS to rely on other information, such as the Form SSA-1099, Social Security Benefit Statement. However, seniors (as well as other non-filers) are encouraged to file a 2019 tax return to ensure they receive their recovery rebate as quickly as possible. Treasury Secretary Mnuchin has also indicated that there will be a Web-based portal for non-filers to submit the information needed to receive a recovery rebate. In addition, the CARES Act instructs the IRS to engage in a public campaign to alert all individuals of their eligibility for the rebate and how to receive it if they have not filed either a 2019 or 2018 tax return.

Charitable Contributions by Individuals. For the 2020 tax year, individuals who elect not to itemize deductions may claim a deduction of up to $300 for certain "qualified contributions." To be a "qualified contribution," the contribution generally must be made in cash to a qualifying organization and must not be for the establishment or maintenance of an existing donor advised fund or be attributable to a contribution carryover from a prior year.

In addition, for individuals, the deduction for charitable contributions generally is limited to 50% of the individual's AGI. For the 2020 tax year, the CARES Act permits individuals to deduct the amount of any "qualified contribution" to the extent that the aggregate of such contributions by the individual does not exceed the excess of 100% of the individual's adjusted gross income (as defined for this purpose) over the amount of all other charitable contributions so allowed, with any excess generally being eligible for a 5 year carryover.

Looking Ahead

We anticipate that Treasury and the IRS will provide additional guidance regarding the CARES Act provisions and that Congress will likely pass additional tax legislation in the months to come to address the COVID-19 pandemic. Foley Hoag will continue to monitor and provide updates with respect these tax matters.

Foley Hoag has formed a firm-wide, multi-disciplinary task force dedicated to client matters related to the novel coronavirus (COVID-19). For more guidance on your COVID-19 issues, visit our Resource Page or contact your Foley Hoag attorney. For guidance on CARES Act tax matters, please contact Nicola Lemay, Nicholas Romanos, Chasse Osborn or other members of Foley Hoag's Tax Practice Group.