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TRANSACTIONAL TAX PLANNING ADVISORY

The CARES Act Stimulus Bill: Tax Changes to Improve Liquidity for Businesses, Assist Employers and Stimulate the Economy

April 6, 2020

On March 27, the United States Congress passed the Coronavirus Aid, Relief, and Economic Security Act or CARES Act, and the President signed the bill into law. The CARES Act provides for $2 trillion in economic stimulus and is the third federal stimulus package in response to the outbreak of COVID-19.

HIGHLIGHTS

- **Business Losses.** The CARES Act expands the ability to use losses by removing the 80 percent income limitation on the use of losses for tax years beginning before 2021, and by permitting net operating losses (NOLs) arising in 2018, 2019 and 2020 to be carried back five years.

- **Business Interest Deductions**. The CARES Act increases the amount of deductible business interest expenses by easing the limitation from 30 percent to 50 percent of EBITDA for tax years beginning in 2019 and 2020, and by permitting businesses to elect to use their 2019 EBITDA to determine their 2020 business interest deduction. For partnerships, the 50 percent limitation will apply to income earned in 2020 (but not 2019), and for 2019, 50 percent of the excess business interest allocated from the partnership to the partner will be treated as business interest paid in 2020 (and not subject to the business interest deduction limitation) and the remaining 50 percent will continue to be subject to the 30 percent limitation but can be carried forward.

- **Bonus Depreciation: Fixing the "Retail Glitch"**. Congress inadvertently excluded improvements to the interior of a non-residential building from 100 percent bonus depreciation under the 2017 Tax Cuts and Jobs Act (TCJA). The CARES Act retroactively corrects this error.

- **Employer Assistance**. The CARES Act helps eligible employers by providing a refundable tax credit against payroll taxes equal to 50 percent of the first $10,000 in qualified wages paid from March 13, 2020 through the end of 2020, and by allowing employers to delay (for up to two calendar years) making payroll tax payments that otherwise would be due from the date of enactment of the CARES Act through the end of 2020.

- **Individual Tax Rebates**. The CARES Act gives up to $1,200 per individual ($2,400 for joint return filers), and $500 per child, in a one-time advance tax credit to be paid immediately. The rebates phase out for incomes above $75,000 and $150,000, for individuals and joint return filers, respectively.

Summary of Key Tax Changes

Expanded ability to use losses

The CARES Act repeals the 80 percent income limitation on losses for tax years beginning before 2021 and allows 100 percent of loss carryforwards and carrybacks to be used for those years. In addition, the CARES Act permits taxpayers (other than REITs) to carryback for up to five years NOLs arising in tax years beginning in 2018, 2019 and 2020. For corporations, NOLs carried back to tax years before 2018 will be particularly valuable because the corporate income tax rate was 35 percent.

To waive a carryback adjustment, for tax years that straddle 2017-2018, a taxpayer must file the application within 120 days of the enactment of the CARES Act, and for tax years beginning in 2018 and 2019, no later than the due date (including extensions of time) for filing the return for the taxpayer's first taxable year ending after March 27, 2020. For calendar year taxpayers, that is October 15, 2021. To obtain a refund due to NOLs arising in tax years beginning in 2018, corporations must file an amended tax return within three years after the due date (including extensions) of the return for the 2018 taxable year, while for NOLs arising in tax years beginning in 2019, if a return has already been filed for such year, an Application for Tentative Refund can be filed within 12 months following the end of that taxable year, or else an amended tax return must be filed. Businesses with NOL carrybacks would be able to obtain tax refunds for taxes paid within the five-year carryback period. As a result, these changes may provide many business with liquidity from accelerating the use of NOLs to reduce taxes and permitting immediate tax refunds for taxes paid in prior years.

Many businesses and former owners of businesses may benefit from a review of their firm's accounting and tax data to see if they are entitled to a tax refund due to the provisions of the CARES Act, including the ability to carryback NOLs. The management of C corporations and the owners of flow-through entities should engage in such a review of their currently owned businesses. Sellers of C corporation stock should also undertake such a review for corporations that they have sold after January 1, 2018.

Relaxing the limitation on business interest expense deductions

The CARES Act relaxes the limitation on business interest expense deductions from 30 percent of adjusted taxable income (ATI) to 50 percent of ATI for tax years beginning in 2019 and 2020, with any excess carried forward to future tax years. ATI is defined generally as EBITDA for tax years beginning before 2022. In addition, the CARES Act allows taxpayers to elect to use their ATI from their 2019 tax year for purposes of their business interest deductions in their 2020 tax year. This election will allow businesses that were more profitable in 2019 than 2020 to have a higher limit on deductible business interest than they otherwise would, which will provide a large benefit to businesses that will be in loss positions for 2020.

For tax partnerships (which include many LLCs), the increased limit from 30 percent to 50 percent applies for tax years beginning in 2020 (but not 2019). For excess business interest in tax years beginning in 2019, partners can elect to have 50 percent of that excess business interest treated as business interest paid in 2020 that is not subject to the business interest deduction limitation, and the remaining 50 percent of that excess business interest subject to the 30 percent business interest expense limitation can be carried forward. For tax partnerships, the election to use ATI from the 2019 tax year for purposes of business interest deductions in the 2020 tax year is made by the partnership. The increase in the business interest expense deduction (in addition to the expanded ability to use losses, as discussed above) may permit tax partnerships to reduce their outlays of cash for tax distributions to their partners.

Management of businesses should evaluate whether this change, or other changes generally, would mean that it would be appropriate to adjust estimated tax payments and/or tax distributions to equity owners of their firms.

100 percent bonus depreciation for interior improvements to nonresidential buildings

The 2017 TCJA generally permits taxpayers to take 100 percent bonus depreciation on property with a recovery period of 20 years or less if that property is placed in service before 2023. In what is commonly called the "retail glitch," the 2017 TCJA mistakenly excluded from 100 percent bonus depreciation business expenses for improvements to an interior portion of an existing nonresidential building ("qualified improvement property" or QIP). The CARES Act fixes this error by extending 100 percent bonus depreciation to QIP and by permitting taxpayers to retroactively claim 100 percent bonus depreciation on QIP placed in service in 2018 and 2019. Qualifying taxpayers should consider filing amended returns to take advantage of this benefit.

Suspension of "excess business loss" limitations on noncorporate taxpayers

An individual's ability to use business losses arising to offset nonbusiness income is limited to $250,000 for individuals ($500,000 for joint return filers) prior to 2026, and such losses that are disallowed as "excess business losses" are carried forward and treated as NOLs in future tax years. The CARES Act suspends these excess business loss limitations for tax years beginning in 2018, 2019 and 2020. Qualifying taxpayers should take advantage of these additional deductions to reduce taxes for 2019 and 2020, and should consider filing amended returns for excess business losses that arose in 2018.

Expedited refunds for remaining corporate AMT credits

Before the 2017 TCJA, certain corporations paid a 20 percent alternative minimum tax (AMT) and that paid AMT generated a tax credit that could be carried forward and used to offset regular income tax paid by those corporations in future tax years. The CARES Act provides that a corporation can claim a full refund of these AMT credits in its 2018 and 2019 tax years. To take advantage of this immediate refund, corporations must apply by the end of 2020 and the IRS will process the application within 90 days.

Refundable payroll tax credit for affected employers

The CARES Act gives eligible employers a refundable payroll tax credit equal to 50 percent of "qualified wages" (including health benefits) paid to each employee from March 13, 2020 through the end of 2020 (the "COVID-19 Crisis Period"), with a maximum credit limited to 50 percent of each employee's qualified wages (which includes the value of health plan benefits) up to the first $10,000 (i.e., a credit of up to $5,000 per employee). To be eligible, an employer's (i) operations must be fully or partially suspended during the COVID-19 Crisis Period, due to a COVID-19-related shut-down order; or (ii) gross receipts must have declined by 50 percent or more when compared to the same quarter in 2019. For employers with more than 100 full-time employees in 2019, "qualified wages" are wages paid to employees that are not providing services due to the COVID-19 crisis. For eligible employers with 100 or fewer full-time employees in 2019, all employee wages are "qualified wages."

Deferral of social security payroll tax payments

The CARES Act allows employers (including self-employed individuals) to defer payment of the employer's share of Social Security taxes on wages that accrue from the date of enactment of the CARES Act until the end of 2020 (the "Deferral Period"). Half of the deferred amount must be paid by the end of 2021, and the other half must be paid by the end of 2022. In the case of self-employed individuals, the payroll tax that may be deferred is the 6.2 percent "employer portion" of the Social Security taxes in the Deferral Period.

Increased charitable contribution deductions

The CARES Act increases the charitable deduction limit from 10 percent to 25 percent of a corporation's taxable income for cash contributions in 2020. For individuals, the CARES Act removes the 50 percent of adjusted gross income limit on charitable deductions for cash contributions in 2020, and allows individuals who take the standard deduction to receive an above-the-line deduction for charitable contributions up to $300.

Tax rebates to individuals

The CARES Act gives advance tax rebates for the 2020 tax year of up to $1,200 per individual (or $2,400 for joint return filers), plus $500 per child. The rebates phase out for single individuals with incomes between $75,000 and $99,000, and joint return filers with incomes between $150,000 and $198,000, and are not available for single individuals and joint return filers (with no children) with incomes exceeding $99,000 and $198,000, respectively. The IRS will use tax return information provided on the taxpayer's 2019 tax return (or alternatively the taxpayer's 2018 tax return) to issue the advance tax rebate. If a taxpayer initially does not receive the full rebate but qualifies for a larger amount based on the 2020 tax return, the taxpayer would be eligible for the difference.

This advisory is summary of certain changes to the federal tax laws and is not intended to and does not constitute legal or tax advice.

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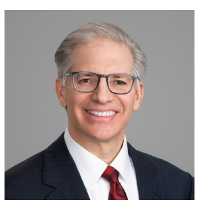

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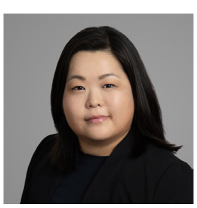

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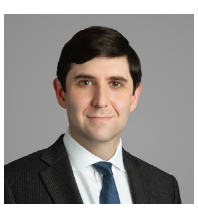

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