CARES Act Implements Changes to the Tax Code; Provides Economic Relief in the War against COVID-19

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Coronavirus Legal Advisory

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On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was signed into law. The CARES Act is a $2 trillion economic aid package, which makes numerous changes to the federal tax laws to provide some relief to individuals and business as a result of the impact of COVID-19. This Alert summarizes some of the key tax provisions of the CARES Act generally applicable to individuals and businesses. Please visit our Coronavirus Resource Center for additional Alerts concerning the CARES Act, including provisions of the CARES Act relating to employee benefits.

Certain Provisions Applicable to Business

Employee Retention Credit. Eligible employers (including tax-exempt organizations) are entitled to a refundable payroll tax credit for 50% of the first $10,000 of wages (including the value of health benefits) paid to certain employees after March 12, 2020, and before January 1, 2021. The credit is available to employers if (a) their operations were fully or partially suspended due to a COVID-19 related governmental shut-down order limiting commerce, travel or group meetings, or (b) they suffered a greater than 50% reduction in quarterly receipts as compared to the same quarterly period last year. Employers who had more than an average of 100 full-time employees in 2019 can only get the credit with respect to wages of employees who are not providing services due to a shutdown or reduction in quarterly receipts as described above. Employers who had an average of 100 or fewer full-time employees in 2019 can include all employee wages for purposes of calculating the credit during the applicable period, whether or not the employee is then providing services. The legislation includes special rules designed to avoid double-counting of wages for purposes of other tax credits potentially applicable to the same wages (including certain credits available under the recently-enacted Families First Coronavirus Response Act). The credit is not available to any employer that receives a "covered loan" eligible for debt forgiveness under the CARES Act.

Deferred Payment of Employer Payroll Taxes. Employers may defer payment of the employer's share of certain payroll taxes with respect to employees through the end of 2020. Although the 6.2% employer share of Social Security tax is eligible for deferral, the 1.45% Medicare component is not eligible. Similarly, self-employed individuals required to make estimated tax payments of self-employment tax may defer 50% of amounts otherwise payable (but only with respect to the Social Security component). The deferred payroll/self-employment taxes are payable 50% by December 31, 2021 and 50% by December 31, 2022. This deferral is not available to any employer that receives certain debt forgiveness benefits under the CARES Act.

Net Operating Losses ("NOLs"). The CARES Act relaxes the restrictions on NOL carrybacks and carryforwards enacted by the Tax Cuts and Jobs Act of 2017 ("TCJA") by (i) permittingNOLs generated in 2018, 2019 and 2020 to be carried back 5 years preceding the loss year and (ii) allowing these NOL carrybacks to offset 100% of taxable income in the carryback years, without regard to the 80% limitation enacted by the TCJA. However, taxpayers expecting large losses in 2020 as a result of the COVID-19 pandemic must recognize that they will not be able to file a carryback refund claim for a 2020 NOL until the tax year has closed.

Excess Business Losses. The TCJA disallowed the deduction of excess business losses by non-corporate taxpayers for tax years beginning after 2017 and ending before 2026, with "excess business losses" being defined as the excess of a taxpayer's aggregate trade or business deductions over the sum of the taxpayer's aggregate trade or business income or gain plus $250,000 ($500,000 for a joint return). The CARES Act eliminates these limitations for excess business losses arising in 2018, 2019 and 2020, meaning that net business loss in any of those years can be fully offset against the taxpayer's other sources of income (and any excess may give rise to an NOL eligible for carryback under the relaxed NOL rules described above).

Corporate AMT Credits. The TCJA repealed the corporate alternative minimum tax, but permitted the recovery of outstanding minimum tax credits on a fully refundable basis, subject to certain limitations, over the 2018-2021 taxable years. The CARES Act accelerates a corporation's ability to recover such credits by allowing 100% of any remaining credits to be recovered for the corporation's 2019 taxable year (subject to a special rule under which the credits may be recovered for the 2018 taxable year).

Relaxing the Limitation on Business Interest Expense. Generally, the limitation on the deduction of business interest expense to 30% of adjusted taxable income (as established by the TCJA) has been temporarily and retroactively increased to 50% of adjusted taxable income for tax years beginning in 2019 and 2020. Further, taxpayers can elect for 2020 to use their 2019 adjusted taxable income as the base for determining their interest expense limitation (which may enable taxpayers to increase the allowable deduction, as 2019 income will probably be higher than 2020 income for many taxpayers due to the economic downturn). However, partnerships are subject to more complex rules.

TCJA Technical Correction re: Qualified Improvement Property. Due to a significant drafting error in the TCJA, certain types of improvements to an interior portion of a nonresidential building (including leasehold improvements, restaurant property, and retail improvement property) were inadvertently made ineligible for bonus depreciation. The CARES Act corrects this error so that such property is now eligible for bonus depreciation, enabling more retail and hospitality businesses (which are among the hardest hit by the pandemic) to benefit from bonus depreciation. This amendment applies retroactively to the original effective date of the TCJA, thereby creating significant refund claim opportunities on amended returns for eligible taxpayers.

Suspension of Certain Excise Taxes. The federal excise tax is waived for the calendar year 2020 on distilled spirits used in the production of hand sanitizer. Certain aviation excise taxes are suspended from the date of enactment of the CARES Act through December 31, 2020.

Increase in Limits on Business Contributions of Food Inventory. Solely for contributions made during 2020, the CARES Act increases the percentage limitations for charitable contributions of certain food inventory from a taxpayer's trade or business.

Certain Provisions Applicable to Individuals

Stimulus Payments for Individuals.

The CARES Act generally provides for individual taxpayers with adjusted gross income ("AGI") below specified levels to receive a direct payment from the Internal Revenue Service (the "IRS"), referred to in the legislation as a "recovery rebate." Technically, the legislation provides for a fully refundable credit on an eligible taxpayer's 2020 tax return, with the recovery rebate being applied as an advance against the credit ultimately determined on the taxpayer's 2020 return (but without requiring the taxpayer to return any portion of the rebate if it turns out that the 2020 credit exceeds the amount of the rebate).

The amount of the rebate payment to each eligible taxpayer is $1,200 for single individuals, $2,400 for married couples filing joint returns, and $500 for each of the taxpayer's "qualifying children." The amount of the rebate is reduced for higher income taxpayers, with phase-outs beginning at $75,000 for single taxpayers and $150,000 for married couples filing joint returns. The amount of the rebate is completely phased out (*i.e.*, reduced to zero) for single taxpayers whose AGI exceeds $99,000 and for married couples filing joint tax returns with AGI in excess of $198,000.

The IRS generally will determine a taxpayer's eligibility for a rebate by reference to the taxpayer's 2019 federal income tax return, if filed, and if not, by reference to the taxpayer's 2018 federal income tax return. For most Americans, no action will be required to receive a rebate. Rather, the IRS will deliver the payment via electronic direct deposit to any bank account that the taxpayer authorized on his or her 2018 or 2019 federal income tax return. If a taxpayer did not authorize a bank account on his or her federal income tax return, then the IRS will mail a physical check to the taxpayer's last known address (generally, the address used on the taxpayer's last-filed federal income tax return).

Taxpayers will receive a notice from the IRS no later than 15 days after the payment was distributed indicating the method by which the payment was made, the amount of the payment, and a phone number for the appropriate point of contact at the IRS to report any failure to receive the payment. As of the date of this Alert, the Secretary of the Treasury, Steven Mnuchin, has indicated that taxpayers could begin receiving stimulus checks within approximately three weeks. It remains to be seen whether this timeframe is realistic.

Charitable Contribution Deductions.

The CARES Act encourages taxpayers to donate to qualifying charitable organizations by permitting each taxpayer who does not itemize deductions to deduct up to $300 of cash donations for the 2020 tax year on an "above-the-line" basis. Some taxpayers have been unable to deduct charitable contribution deductions after the enactment of the TCJA because of an increased standard deduction, so this change is welcome relief for some taxpayers.

Prior to the enactment of the CARES Act, for cash donations, an individual was entitled to deduct only up to 50% of his or her AGI and a corporation was entitled to deduct only up to 10% of its taxable income (in each case by making certain modifications to AGI or taxable income, as the case may be). The CARES Act suspends the 50% limitation for individuals for the 2020 tax year and increases the limit applicable to corporations from 10% to 25% of the corporation's taxable income, in each case on an elective basis.

We would be happy to speak with you about the impact of the CARES Act on your particular situation and the opportunities it may present for you.