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UPDATE: CARES ACT TAX PROVISIONS IMPACTING BUSINESSES

by Dan Kroll, Austin Carlson, Brian Clark and Cindy Pridgen
April 6, 2020

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief and Economic Security (CARES) Act, the largest economic stimulus package in the history of the U.S., providing up to $2 trillion dollars of economic stimulus meant to combat the economic fallout caused by COVID-19. The Act provides for immediate benefits to businesses through a number of provisions including (1) a new SBA loan program called the Paycheck Protection Program (PPP), which provides a pool of up to $349 billion for loans the principal amount of which may potentially be forgiven with no tax consequences, and (2) both immediate refundable payroll tax credits and payroll tax deferral for a significant portion of employer payroll taxes. Additionally, the Act made a number of significant taxpayer-friendly changes to the Internal Revenue Code. Some of these changes are retroactive, meaning a taxpayer may be able to amend a prior year tax return and receive a refund.

Taxpayers should consult with their advisors to determine their eligibility for these programs, and the actions needed to receive these benefits. Some of these benefits, such as the PPP, are on a "first come first served" basis thus requiring immediate action in order to ensure availability of the benefit.

PAYCHECK PROTECTION PROGRAM

One of the most significant provisions of the CARES Act is an appropriation of $349 billion to fund small business loans. PPP loans are available through June 30, 2020. These loans are generally limited to sole proprietors, independent contractors, and small businesses with 500 or fewer employees (or in the case of hospitality businesses or franchises, 500 or fewer employees at each location). Some businesses with more than 500 employees may be eligible for PPP loans if the Small Business Act (SBA) has established a larger size standard for the specific industry of the business.

The amount of the loan available to a borrower is based on a formula that takes double the employer's average monthly payroll costsduring the prior year plus an additional 25 percent of that amount (but limited for each employee to an annualized first $100,000 of payroll costs). Payroll costs for employees include salary, wages, tips, commissions, vacation pay and paid time off, severance payments, retirement benefits, and state or local taxes. The SBA has not provided guidance on exactly how and in what circumstances the net income of a self employed individual, including a sole proprietor and partner in a partnership, should be included in the definition of payroll costs.

Importantly, the portion of the loans used to cover payroll costs (subject to the limitations in the preceding paragraph) and certain other operating expenses (such as mortgage interest payments, rent and utilities) for the first eight weeks after the origination date of the loan are eligible for tax-free loan forgiveness. However, guidance released by the Department of the Treasury on March 31, 2020 suggests that due to high anticipated PPP loan subscription volume, non-payroll costs will be limited to 25 percent of the loan forgiveness amount. In order to get the full amount of loan forgiveness, the employer must keep its workforce employed at substantially the same pay rate during the eight-week period. Reduction of salary by more than 25 percent and reduction in headcount during the eight-week period will proportionately reduce the total amount of loan forgiveness; however, forgiveness will not be decreased due to layoffs or reductions in salary occurring between February 15, 2020 and April 26, 2020, so long as the business restores employee levels and salaries to February 15, 2020 levels by June 30, 2020. If all these requirements are met, the borrower can apply for loan forgiveness through their lender.

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To the extent a PPP loan is not used for forgivable purposes during the eight week period, it will continue to be guaranteed by the SBA and have a term of not more than 2 years, with a maximum interest rate of 1.0 percent. Payments on loans offered under this program are deferred for 6 months. A comprehensive overview of the PPP is available here.

PAYROLL TAX BENEFITS

If a taxpayer applies for and receives a PPP loan, they are ineligible for the payroll tax credits discussed below and will have some restrictions on the payroll tax deferral. Thus, taxpayers should consult with their advisors to determine which of the CARES Act provisions will be more beneficial, since electing some CARES Act benefits now may preclude electing other benefits later.

Payroll Tax Deferral

Employers of all sizes and self-employed individuals may now delay remittance of the 6.2 percent employer portion of social security taxes starting on March 27, 2020 until the end of the year. Half of the deferred payroll taxes must be paid by December 31, 2021, and the remaining balance is due by December 31, 2022. If an employer participates in the PPP, this deferral does not apply during the eight-week forgiveness period provided for the PPP loan.

Payroll Tax Credits

Employers and self-employed individuals (i) with businesses severely economically affected by COVID-19, and (ii) that do not receive a PPP loan, are eligible for payroll tax credits to offset the ongoing payroll costs of employees who remain on the business' payroll (the CARES Payroll Tax Credits). A business is eligible for these credits if its operations were at least partially suspended due to the country's social distancing measures or it suffered at least a 50 percent decline in gross receipts in a calendar quarter compared to the same quarter in the prior year as a result of those measures. If those criteria are met, a business can claim a refundable tax credit against its portion of social security taxes equal to 50 percent of qualified wages paid from March 12, 2020 through December 31, 2020. The credit is limited to $5,000 per employee.

The CARES Payroll Tax Credits are different than, and in addition to, the payroll tax credits made available under the recently passed Families First Coronavirus Response Act (the Families First Payroll Tax Credits), which provided that payroll tax credits could be applied for all payroll taxes, including federal income tax withholding, and all social security taxes and medicare taxes, for payments of sick leave due to COVID-19 related issues. A significant difference between the two credits is that, unlike the CARES Payroll Tax Credits, the Families First Payroll Tax Credits are available even if the taxpayer takes a PPP loan. The CARES Act amended the Families First Payroll Tax Credits to make them refundable, just like the CARES Payroll Tax Credits.

OTHER BENEFICIAL TAX CHANGES

As discussed above, the Act made a significant number of taxpayer friendly changes to the Internal Revenue Code. Taxpayers should discuss with their tax advisor to determine if any of these changes may change their taxable income for a prior year allowing the taxpayer to file an amended return and obtain a refund.

Net Operating Losses

The current rules for net operating losses (NOLs) are amended by (i) allowing NOLs from tax years 2018 through 2020 to be carried back up to five years, and (ii) limited to tax years beginning before January 1, 2021, the limitation that NOLs may only be used to offset up to 80 percent of pre-NOL taxable income is eliminated. In other words, for tax years 2018 through 2020, an NOL may be used to fully offset taxable income for the current and any of the previous five prior tax years.

Increased Ability to Deduct Business Losses

Prior law provided that individuals who were allocated business losses by pass-through entities they owned could only offset non-business income (i.e., W-2 wages as well as portfolio income such as interest, dividends and capital gains) up to either $250,000 for single filers or $500,000 for joint filers. The CARES Act allows those losses for tax years 2018 through 2020 to be fully recognized.

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Increased Interest Deductions

The interest deduction limitation is increased from 30 percent of adjusted taxable income to 50 percent for 2019 and 2020, but for companies taxed as partnerships, this change only applies in 2020. Taxpayers can elect out of the increase, but that election is irrevocable absent consent from the Secretary of the Treasury. Individual partners are provided some relief though, because they can treat 50 percent of any excess business interest expense allocated to them from a partnership during 2019 as fully deductible in 2020. This means that some interest that would normally require an allocation of excess income is presently deductible. Finally, for tax years beginning in 2020, a taxpayer can elect to calculate its interest deduction limitation using adjusted taxable income from its last tax year (beginning in 2019). For partnerships, this election is made by the partnership, not its partners.

Technical Correction of the "Retail Glitch"

A drafting error in the Tax Cuts and Jobs Act (TCJA) caused retailers who placed qualified improvement property (QIP) in service beginning in 2018 to depreciate those improvements over a long period instead of immediately deducting using bonus depreciation. The CARES Act corrects the glitch, and allows immediate expensing of QIP placed in service in 2018, subject to the normal phase-down rules beginning in 2023.

Acceleration of Corporate AMT Credit Refunds

The TCJA repealed the corporate alternative minimum tax (AMT). As part of the TCJA overhaul, a credit of AMT paid in prior years could be used against the corporation's normal tax liability in 2018 through 2021, with the credits being 50 percent refundable in 2018, 2019, and 2020, and 100 percent refundable in 2021. The CARES Act accelerates the AMT credit recovery period. Now 100 percent of an AMT credit can be treated as refundable for taxable years beginning in 2019. The CARES Act also allows a special election to take the whole refundable credit in 2018.

If you have any questions about the tax provisions of the CARES Act or what steps are needed to confirm your eligibility to obtain any of these benefits, or how to apply for them, please contact us.

ABOUT THE AUTHORS

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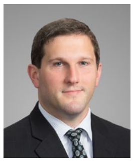

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