Updates
March 31, 2020

Summary of Tax Provisions of the CARES Act

In response to the ongoing coronavirus (COVID-19) pandemic, U.S. Congress, the executive branch, and the Internal Revenue Service (IRS) have taken several actions intended to provide immediate relief to taxpayers. In a prior update, we summarized some of the actions taken in the last two weeks, including postponing federal income tax return and tax payment deadlines, providing businesses with tax credits to the extent that such businesses are subject to new paid sick and paid family and medical leave requirements, and declaring COVID-19 a national emergency and declaring "major disasters" in several states.

Following the Families First Coronavirus Response Act, on March 27, 2020, Congress enacted the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) to further address the economic impact of COVID-19. The CARES Act includes several federal income tax provisions, and this update summarizes the key provisions that are intended to benefit businesses.

Income Tax: Applying for Refunds and Reducing Current Year Taxes

Eligible businesses may obtain or preserve liquidity by applying for income tax refunds and reducing current income taxes payable.

- Since enactment of the Tax Cuts and Jobs Act of 2017, net operating losses (NOLs) arising in a tax year beginning after December 31, 2017, may only be carried forward, and are subject to an annual deduction limitation of 80% of taxable income. Under the CARES Act, NOLs arising in a tax year beginning after December 31, 2017, and before January 1, 2021, generally may now be carried back five years. The CARES Act also suspends the application of the 80% taxable income limitation for tax years beginning before January 1, 2021. To secure these benefits, taxpayers may need to amend prior year returns or request refunds. Any such refunds may be delayed by Joint Committee review procedures. For corporate taxpayers acquired since enactment of the Tax Cuts and Jobs Act of 2017, the ability to carry back NOLs, which may have been caused by transaction deductions, to secure tax refunds for pre-acquisition tax periods will likely be affected by the terms of the acquisition agreement. Those agreements may provide that any refunds received be paid over to the former shareholders of the taxpayer or the buyer may have paid the seller for the right to carry the NOLs forward.
- Businesses may be able to deduct additional interest expenses in taxable years beginning in 2019 and 2020. Since the enactment of the Tax Cuts and Jobs Act of 2017, the interest deduction for businesses has been limited to 30% of adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA). For tax years beginning in 2019 (except for partnership taxpayers) and 2020, the CARES Act increases the limitation to 50% of adjusted EBITDA. The revised limitations apply differently to partnerships. In addition, taxpayers may elect to apply the adjusted EBITDA for a tax year beginning in 2019 to determine the deductibility of interest in 2020. This change is intended to reduce the cost of raising cash through debt, allowing companies to finance continued operations.
- The corporate alternative minimum tax (AMT) was repealed as part of the Tax Cuts and Jobs Act of 2017, and as a result, corporate AMT credits were made available as refundable credits over several years, ending with tax years beginning in 2021. Under the CARES Act, corporations may recover those AMT credits immediately, either in the form of a refund or credit to offset current year tax.

- The CARES Act suspends the application of the "excess business loss" limitation applicable to pass-through businesses and sole proprietors until tax years beginning after December 31, 2021. This should allow small business owners to utilize such excess business losses in the current year and, for the 2018 and 2019 tax years, submit amended returns and request refunds.
- Small business loans guaranteed under Section 7(a) of the Small Business Act (Paycheck Protection Program) that were originated during the period beginning February 15, 2020, to June 30, 2020, but not repaid will be excluded from gross income for federal income tax purposes to the extent the loan proceeds were used for payroll, qualified mortgage, rent, or utility expenses.
- When amending the bonus depreciation rules, the Tax Cuts and Jobs Act did not include certain interior improvements to nonresidential property. This was widely regarded as a "technical glitch". Under the CARES Act, businesses that make or have made such improvements can apply the new bonus depreciation rules to such costs. This technical correction is effective as of the enactment of the Tax Cuts and Jobs Act, allowing businesses to amend prior year returns and request refunds.

Non-Income Tax: Payroll Tax-Related Credits and Payment Deferral

Employers may defer payment of the employer's share of FICA taxes over two years, as well as take advantage of certain refundable payroll tax credits.

- The CARES Act defers payment of the employer's share of Social Security tax. Employers generally are responsible for paying a 6.2% Social Security tax on employee wages. The tax will be deferred for over two years, with half of the amount required to be paid by December 31, 2021, and the other half by December 31, 2022.
- Certain employers may be eligible for a refundable Social Security tax credit for up to 50% of qualified wages paid during the COVID-19 crisis. The credit is provided for the first $10,000 of qualified wages, including health benefits, paid to an eligible employee. If the tax credit exceeds the amount of the employer's portion of Social Security tax due for the applicable quarter, the employer may treat the excess as a refundable overpayment. The credit is available to employers whose operations are fully or partially suspended due to a COVID-19-related shutdown order. The credit is also fully or partially available to employers who experience a significant reduction in gross receipts. Employers with more than 100 full-time employees may only claim the credit for employees that are not actively providing services. The credit only applies to wages paid or incurred from March 13, 2020, through December 31, 2020.
- Certain Social Security tax credits enacted last week in the Families First Coronavirus Response Act can now be refunded in advance. This credit is discussed in more detail in our prior update.

Incentives for Good Deeds: Charitable Contributions and Financial Support for Employee Education

Businesses are given additional tax incentives to do good deeds, such as contribute to charities and assist employees with student loan payments.

- Charitable contribution deductions by corporations ordinarily are limited to 10% of their adjusted gross income. For taxable years ending after December 31, 2019, this limit is increased to 25% of the corporation's adjusted gross income for cash contributions made during the 2020 calendar year. The CARES Act also increases the deduction limits for contributions of food inventory from 15% to 25%.
- Under the CARES Act, employers may contribute up to $5,250 annually toward payment of an employee's qualified student loans, and such payment is excluded from the employee's income. The $5,250 limit also factors in existing payments towards other education costs. This exclusion applies to student loan payments made by an employer (whether paid to the employee or a lender) on behalf of an employee

between March 27, 2020, and January 1, 2021.

- The CARES Act authorizes a new "coronavirus-related distribution" from retirement plans, including 401(k) plans, of up to $100,000 that is exempt from the 10% early distribution penalty that normally applies to distributions prior to the attainment of age 59 1/2. Plans are not required to offer such distributions. Accordingly, taking advantage of this provision may require the cooperation of the employer, including adding this distribution option to the plan. The CARES Act also increases loan limits from $50,000 to $100,000 for the next 180 days, which similarly may require the employer's cooperation. Perkins Coie's benefits group will be releasing a more detailed discussion of the impact of these and other related provisions in the next few days.

As noted in the prior update, we expect that the IRS will issue guidance addressing at least some of the above-described federal income tax considerations related to COVID-19. We will continue to monitor federal income tax developments related to COVID-19, and we encourage you to reach out to any member of Perkins Coie's federal income tax group with any questions you might have regarding these new provisions and initiatives.

Authors

Minkeun Woo

Counsel
MWoo@perkinscoie.com 206.359.6017

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