Coronavirus: Overview of tax provisions in the Coronavirus Aid, Relief, and Economic Security Act

Tax Alert

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On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act (the "Act"). In addition to providing economic support for hospitals and testing for coronavirus disease 2019 (COVID-19), the Act provides over $2 trillion of relief for the US economy, including individual stimulus payments, small business loans, and several business tax provisions. This update outlines the business tax provisions in the Act.

Employer cash flow and employee retention

A primary goal of the Act is to free up cash flow for employers experiencing significantly diminished receipts, thereby permitting them to retain and pay their employees. In furtherance of this goal, the Act grants employers an "employee retention credit" and allows employers to defer payment of payroll taxes due in 2020.

Employee retention credit. Businesses are generally responsible for matching an employee's Social Security payroll taxes (the "employer portion"). The Act provides a one-year-only credit to businesses against the employer portion for any calendar quarter in 2020 in which (i) the business continues to pay its employees despite being forced to fully or partially suspend operations due to governmental order or (ii) the business continues operations but experiences at least a 50 percent decline in gross receipts as compared to the same calendar quarter in 2019 (until such time as the business' gross receipts have recovered to equal at least 80 percent of the gross receipts for the same quarter in 2019). The credit against the employer portion which may be claimed on a quarterly basis, subject to certain limitations (described below), is equal to 50 percent of "qualified wages" paid to each employee for the relevant quarter.

The term "qualified wages" (i) includes payments by an employer of "qualified health plan expenses" to cover employees and (ii) is limited to $10,000 in aggregate per employee for all quarters in 2020. If an eligible employer has 100 or fewer employees, all employee wages are considered qualified wages. For employers with more than 100 employees, qualified wages are limited only to those wages paid to employees who are not providing any services due to operations being suspended by governmental order. The employee retention credit is refundable if the amount of the credit exceeds the employer's portion of the payroll taxes for that quarter.

The credit applies to wages paid after March 12, 2020, and before January 1, 2021. Employers can also elect not to have the credit apply to any particular quarter during that period.

Payroll tax deferral. In order to further free up employers' cash flow, the Act permits employers to defer payment of the employer portion of payroll taxes due from the period beginning on March 27, 2020, and ending on December 31, 2020. The entirety of payroll taxes incurred by employers, and 50 percent of payroll taxes incurred by self-employed persons, qualify for the deferral. Half of the deferred payroll taxes of an employer or a self-employed person are due on December 31, 2021, with the remainder due on December 31, 2022.

In effect, the employee retention credit and the payroll tax deferral provide employers with credits in 2020 for the employer portion, but allow deferment of actual payment of the employer portion until 2021 and 2022.

Paycheck protection loans*.* The Act also provides businesses with fewer than 500 employees access to certain "paycheck protection loans" fully guaranteed by the federal government. While the provision of paycheck protection loans is not a tax change, it is important to note that any business receiving a paycheck protection loan is not eligible for the employee retention credit, and any business which has had a payroll protection plan forgiven (as described in the Act) is not eligible for payroll tax deferral.

Modification of certain revenue raisers and other provisions in the 2017 Tax Cuts and Jobs Act

In December 2017, sweeping tax reform was enacted in the form of the Tax Cuts and Jobs Act (the "TCJA"). In order to offset cuts in individual and corporate income tax rates, the TCJA included a number of provisions designed to increase revenue. Without intervention, the perilous economic situation brought on by the COVID-19 pandemic is expected to magnify the effect of these revenue raisers to the detriment of taxpayers; the Act therefore contains a number of provisions designed to ameliorate, albeit temporarily, the effect of these TCJA provisions.

Net operating losses ("NOLs")*.* Prior to the TCJA, a company with NOLs generally could (i) carry back those losses to the preceding two tax years, and (ii) carry forward those losses 20 years and offset up to 100 percent of taxable income in those later years. For losses arising after 2017, the TCJA eliminated carrybacks of NOLs and allowed indefinite carry-forwards, but limited the use of those losses in later years to 80 percent of taxable income.

Since it is expected that many businesses will generate tax losses in 2020, the Act in effect temporarily repeals the NOL limitations in the TCJA. Specifically, businesses will be permitted to carry back losses generated in 2018, 2019, and 2020 for up to five years. Thus, businesses will be able to amend or modify tax returns for tax years dating back to 2013 in order to take advantage of the NOL carryback, and potentially receive cash refunds for taxes paid in those prior years. The NOL limit of 80 percent of taxable income is further suspended for tax years through 2020, so businesses may use 100 percent of their NOLs to offset their taxable income in prior years.

Individual losses. Section 461(*l*) of the Code, enacted as part of the TCJA, limits the amount of "net business loss" an individual may use in a year to offset other sources of income to $250,000 (or $500,000 if married filing jointly). Any loss in excess of this limit is converted into an NOL and subject to the TCJA's more stringent limitations on the use of NOLs. The Act suspends Section 461(*l*) not only for 2020, but retroactively for 2018 and 2019 as well. However, Section 461(*l*) would be reinstated for 2021 and future years.

Business interest expense limitation. The TCJA made significant changes to the ability of businesses to deduct business interest expense from taxable income. For post-2017 tax years, the TCJA limited the allowable deduction for business interest to 30 percent of the taxpayer's adjusted taxable income for the year (plus business interest income), with any disallowed interest expense carried forward to future years (akin to an NOL). This limitation does not apply to taxpayers with average annual gross receipts for the prior three years below an inflation-adjusted amount (which, for 2020, is $26 million). The Act increases the limitation to 50 percent of the taxpayer's adjusted taxable income for 2019 and 2020. A taxpayer can elect out of this increased limitation for either tax year. Further, in calculating its limitation for 2020, a taxpayer may elect to use adjusted taxable income for 2019, since it is expected that many taxpayers will have significantly lower taxable income in 2020, which could significantly reduce their ability to deduct interest expense. There are additional special rules for *partnerships.*

Qualified improvement property. The TCJA provided for full expensing in the first year of all "MACRS property" with a prescribed recovery period of 20 years or less. Throughout the drafting process, it was clear that Congress intended to make all "qualified improvement property" (which generally had, with certain exceptions, a 39-year recovery period) eligible for this 100 percent bonus depreciation, but when the TCJA was finalized, Congress failed to make this change, with the result that all "qualified improvement property," including the categories that had been excepted, was ineligible for full expensing. This mistake is known as the "retail glitch," as it overwhelmingly affected small retail business and restaurants.

The Act defines "qualified improvement property" as 15-year property, thereby allowing for full expensing of improvements in the year made and making this change retroactive to January 1, 2018. This change will permit taxpayers negatively affected by the retail glitch to amend their tax returns and capture the benefits of full expensing of improvements made in 2018 and 2019. According to the Senate Finance Report that accompanied the Act, this technical amendment "increases companies' access to cash flow [and] incentivizes them to continue to invest in improvements as the country recovers from the COVID-19 emergency."

In conclusion

This alert is a high-level overview of the business tax provisions of the Act. Those provisions are more complex than as described and are subject to many limitations and exceptions that are not addressed in this alert. We also encourage taxpayers to consider the impact of rapidly changing economic conditions on their global legal entity structure, including foreign losses and intercompany pricing. For additional information or questions concerning this alert or the Act, please contact your DLA Piper relationship partner or any member of the DLA Piper Tax team.

As the impact of COVID-19 continues to evolve, DLA Piper is available to assist in helping companies manage the various legal implications of the outbreak. Please visit our Coronavirus Resource Center and subscribe to our mailing list to receive alerts, webinar invitations and other publications to help you navigate this challenging time.

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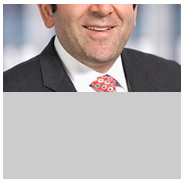

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