

TRUMP SIGNS CARES ACT – FEDERAL TAX LAW CHANGES

Hodgson Russ Federal-International Tax Alert
March 27, 2020

Earlier today the House of Representatives passed what was, in effect, the Senate version of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) previously passed by the Senate on March 25, 2020. Shortly thereafter, President Trump signed the CARES Act into law.

The first two COVID-19 federal legislative responses passed earlier this month focused largely on healthcare related funding, unemployment benefits and paid sick leave. This “phase 3” legislation known as the CARES Act attempts to address financial stability and liquidity issues, in part, through various federal tax law changes impacting businesses, employers and individuals.

The highlighted CARES Act tax law changes include the following:

- **CORPORATIONS/BUSINESSES**

Modifications for net operating losses (“NOLs”) – CARES Act Section 2303

Suspension of the 80% taxable income limitation

The Tax Cuts and Jobs Act (the “TCJA”) imposed a limitation on the amount of NOLs that a taxpayer may deduct in a tax year equal to the lesser of the available NOL carryovers or 80% of a taxpayer’s pre-NOL deduction taxable income. The CARES Act temporarily suspends, for tax years 2018 through 2020, the taxable income limitation to allow a taxpayer’s NOLs to fully offset taxable income.

Temporary reinstatement of NOL carrybacks

For NOLs arising in tax years after December 31, 2017, the TCJA eliminated a taxpayer’s ability to carryback an NOL to reduce taxable income in a prior tax year. The CARES Act provides for a modified NOL carryback. Specifically, the CARES Act allows NOLs arising in tax years 2018 through 2020 to be carried back to each of the five tax years preceding the loss year. A taxpayer may elect to forgo the carryback, and instead treat losses arising in those years as NOL carryovers.

Deductibility of interest expense temporarily increased – CARES Act Section 2306

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For tax years beginning after December 31, 2017, Internal Revenue Code (“Code”) section 163(j) generally limits the amount of business interest expense allowed as a deduction to 30% of adjusted taxable income (“ATI”). The CARES Act makes three temporary but significant changes to these rules, which are designed to allow many taxpayers to deduct a greater amount of business interest expense.

1. The CARES Act temporarily and retroactively increases the general limitation on the deductibility of interest expense from 30% of ATI to 50% of ATI for tax years beginning in 2019 and 2020. For partnerships, however, this change only applies to tax years beginning in 2020.
2. The CARES Act provides partners a different benefit for the 2019 tax year. Specifically, unless they elect not to, partners of partnerships subject to the business interest expense limitation rules would be able to treat 50% of any allocated excess business interest expense from the partnership during 2019 as fully deductible in tax year 2020. The remaining 50% of excess business interest expense remains subject to the normal rules under Code section 163(j), meaning it generally remains suspended until the same partnership allocates excess taxable income or excess business interest income to the partner in a later year.
3. For a tax year beginning in 2020, a taxpayer may elect to calculate the interest limitation using its ATI from its last tax year beginning in 2019 in lieu of its current-year ATI. For partnerships, this election must be made by the partnership.

Modification of limitation on losses for non-corporate taxpayers – CARES Act Section 2304

For tax years beginning after December 31, 2017 and ending before January 1, 2026, the TCJA implemented a new rule that disallowed the deduction of “excess business losses” (generally, significant business losses in excess of \$500,000 (joint filers) or \$250,000 (other filers)) by non-corporate taxpayers, and instead forced such taxpayers to carry forward such losses as NOLs. The CARES Act retroactively defers the effective date of this rule to tax years beginning after December 31, 2020, meaning a non-corporate taxpayer now can recognize those losses for the 2018, 2019, and 2020 tax years. If a taxpayer had an excess business limitation on their 2018 return, a taxpayer should file an amended return to claim the additional loss and receive a refund.

Corporate alternative minimum tax credit is accelerated – CARES Act Section 2305

For tax years beginning after December 31, 2017, the TCJA repealed the corporate alternative minimum tax (“AMT”). Corporate AMT credits generated pre-TCJA, however, were refundable in tax years beginning in 2018 through 2021, with the amount limited each year. The CARES Act accelerates the refundable AMT credits so that corporations will take the entire amount in 2018 and 2019. Alternatively, a corporation can elect to claim the entire refundable credit in 2018.

Bonus depreciation technical correction for qualified improvement property – CARES Act Section 2307

Due to a drafting error by Congress, the TCJA did not assign a recovery period to “qualified improvement property” (“QIP”), which generally includes improvements made by the taxpayer to the interior of a non-residential building. As a result, the statute treated QIP as nonresidential real property with a 39-year recovery period, thereby making QIP ineligible for 100% bonus depreciation. Practitioners frequently referred to this as the “retail glitch”. The CARES Act provides much needed relief to the restaurant, hospitality, and retail industries by fixing the retail glitch to treat QIP as 15-year property, meaning it allows taxpayers to claim 100% bonus depreciation for such property. This fix is retroactive to property placed in

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service after December 31, 2017, meaning it will allow businesses to amend a prior year return to take advantage of the correction and receive a refund.

Temporary exception from excise tax for alcohol used to produce hand sanitizer – CARES Act Section 2308

The CARES Act temporarily waives the federal excise tax on any distilled spirits used for, or contained in, hand sanitizer that is produced and distributed in a manner consistent with guidance issued by the Food and Drug Administration. This waiver applies for the 2020 calendar year.

Exclusion for certain employer payments of student loans – CARES Act Section 2206

For payments made for the remainder of 2020 only, employers may provide a student loan repayment benefit to employees on a tax-free basis with such benefit excluded from the employee's income. This provision expands the categories of educational assistance already available under Code section 127 in order to include student loan payments. Importantly, it does not increase the already existing cap of \$5,250 which applies to both the new student loan repayment benefit as well as other educational assistance (e.g., tuition, fees, books) provided by the employer under existing law.

Employee retention credit for employers subject to closure due to COVID-19 – CARES Act Section 2301

With qualifications, this provision makes available a refundable payroll tax credit for 50 percent of qualified wages paid or incurred by employers to employees from March 13, 2020 through December 31, 2020. The credit is limited to the first \$10,000 of compensation, including health benefits, paid to an employee during such period.

The credit is generally available to employers (1) whose operations were suspended in full or in part, due to the COVID-19 related shut-down order, or (2) whose gross receipts declined by more than 50 percent when compared to the same quarter in the prior year.

For employers with a 2019 average of more than 100 full-time employees, qualified wages are wages paid to employees who are not working due to COVID-19 related shut-down orders. For smaller employers, all wages qualify for the credit, regardless of whether the employee is providing services for which the wages are paid.

Special rules apply to tax-exempt entities and otherwise eligible employers are denied the credit if they receive a small business interruption loan authorized under Section 1102 of the CARES Act.

Delay of payment of employer payroll taxes – CARES Act Section 2302

Allowing for some liquidity aid, this provision allows employers and self-employed individuals to defer payment of the employer share of the Social Security tax obligation (6.2%) for the remainder of 2020. One-half of the deferred employment tax is required to be paid in each of the following two years ending December 31, 2021 and December 31, 2022.

- **INDIVIDUALS**

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Advance Payments of Refundable Tax Credits to Certain Individuals – CARES Act Section 2201

The CARES Act provides for advance payments of refundable tax credits to some individuals. In order to receive this payment, individual taxpayers must meet certain criteria, including having provided a valid social security number and not exceeding the applicable income thresholds. Both (a) single individuals making \$75,000 or less (determined by your 2019 or, if 2019 is not yet filed, your 2018 tax return adjusted gross income) and (b) individuals filing jointly and making \$150,000 or less are eligible to receive the full benefit or \$1,200 or \$2,400, respectively. In addition, qualifying individuals will receive a \$500 payment for each child under the age of 17. For taxpayers with adjusted gross income above the aforementioned levels, the payment is reduced by \$5 for every \$100 that their adjusted gross income is in excess of the applicable threshold.

Removal of Early Retirement Plan Distribution Penalty for COVID-19 Related Payments – CARES Act Section 2202

Normally, distributions from a qualified retirement plan are subject to a 10% penalty if they occur before the taxpayer reaches the age of 59 1/2. The CARES Act eliminates this penalty when taxpayers take a 2020 distribution from the retirement plan that is “related” to the Coronavirus, up to an amount of \$100,000. A distribution is a “Coronavirus-related distribution” if it is to an individual that either (a) is diagnosed with COVID-19, (b) has a spouse or dependent diagnosed with COVID-19, or (c) experiences adverse financial consequences as a result of being quarantined, laid off, furloughed, or having their work hours reduced due to COVID-19.

Crucially, while qualifying distributions avoid a penalty, they remain taxable to the individual. This tax liability can be paid over a three-year period starting from the year of the distribution, and the individual may repay the amount to the plan to avoid this tax liability. Finally, the CARES Act also increases the amount an individual can borrow from their retirement plan to \$100,000 for the 180-days following the date that the CARES Act is enacted.

Waiver of Certain Retirement Plan Minimum Distribution Rules – CARES Act Section 2203

The CARES Act waives, for 2020, any minimum distributions required for certain retirement plans and accounts (such as IRAs). Note that this waiver is only applicable for calendar year 2020.

New Above-the-Line Charitable Contribution Deduction for Non-Itemizers – CARES Act Section 2204

The CARES Act amends how charitable deductions function for non-itemizers. Normally, charitable contributions are itemized deductions, which can only be utilized by taxpayers who do not utilize the standard deduction. Typically, only a very small percentage of taxpayers itemize. Section 2204 of the CARES Act provides that individuals can make charitable contributions and get a deduction for this contribution, even if the individual does not itemize. While there are certain restrictions (the contribution must be made in cash, the new deduction cannot exceed \$300 and is only available to taxpayers who do not itemize, etc.), this new law represents a change from the previous rules.

Increased Charitable Contribution Deduction for Individual Itemizers and Corporations – CARES Act Section 2205

Although those individuals who do itemize are not able to take advantage of Section 2204, the CARES Act also provides a charitable benefit to those taxpayers. Previously, individual taxpayers who itemized could only utilize charitable deductions in the amount of 60% of their adjusted gross income. Section 2205 provides that for individual taxpayers, 2020 charitable

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contributions may be deducted in the amount of 100% of the taxpayer's adjusted gross income for 2020 (with any excess amount eligible for a carry forward of 5 years). For corporate taxpayers, Section 2205 increases the 2020 charitable deduction limit to 25% of taxable income, as opposed to the previously applicable 10% limit.

- **UPDATE AND REMINDER**

Distinct from the CARES Act, the IRS, on March 27, 2020, released Notice 2020-20, which builds on other Notices released earlier this month. Notice 2020-20 extends, until July 15, 2020, the tax return and tax payment due date for all taxpayers who have a federal gift (and generation-skipping transfer) tax return filing and tax payment obligation due on April 15, 2020. As a reminder, earlier this month the IRS issued Notice 2020-17 and Notice 2020-18. These Notices extended the due date for all Federal income tax payments from April 15 to July 15, 2020 and extended the filing deadline for certain returns to the same July 15 date. While a variety of Forms have had their deadlines extended (including certain Forms 1040, 1041, and 1120), note that many other Forms have **not** had their filing deadlines extended (including Forms 990 and 990-PF, estate tax returns, etc.).

The tax professionals at Hodgson Russ LLP will continue to monitor COVID-19 legislative responses and IRS updates and publish additional client alerts and updates as information becomes available. For questions or for further information please contact one of the tax attorneys at Hodgson Russ LLP.

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