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Congress Battles COVID-19 Crisis with Tax Relief Provisions in Major Stimulus Legislation

As our country grapples with the health, economic, and social impacts of COVID-19, the U.S. Congress has weaponized the U.S. tax law to provide economic stimulus and soften the financial blow dealt by COVID-19 through two key pieces of legislation: (i) H.R. 6201, the Families First Coronavirus Response Act, or the "Families First Act" (signed into law on March 18) and (ii) H.R. 748, the Coronavirus Aid, Relief, and Economic Security Act, or the "CARES Act" (signed into law on March 27). Both the Families First Act and the CARES Act include tax provisions intended to assist businesses and individuals facing financial hardship due to COVID-19. The discussion below highlights the major tax relief provisions in the two pieces of legislation.

Coronavirus Aid, Relief, and Economic Security Act (The "CARES Act")

Key Takeaways for Businesses

- Net operating losses generated in 2018, 2019, or 2020 permitted to be carried back to the preceding five years and to fully offset income.
- Employers eligible for 50 percent credit for wages (capped at $10,000 wages, or a $5,000 credit, per employee) paid to employees who are unable to work as a result of certain COVID-19 disruptions. The credit is *not available* to employers with Small Business Interruption loans under the Payroll Protection Loan Program established under the CARES Act.
- Excess business loss limitation rules for non-corporate taxpayers delayed until 2021 (with retroactive effect).
- Temporary increase of business interest expense deduction limitations for 2019 and 2020.
- Employer share of Social Security taxes through the remainder of 2020

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are deferred until December 31, 2021 (one-half) and December 31, 2022 (one-half).

– Accelerated ability of companies to recover AMT credits.

– Retroactive correction of bonus depreciation provisions applicable to "qualified improvement property."

– Waiver of federal excise tax on any distilled spirits used to produce hand sanitizer.

Business Provisions

Net Operating Loss Carrybacks

The CARES Act amends the Internal Revenue Code of 1986 (the "Code") to permit taxpayers that have net operating losses in tax years beginning after December 31, 2017, and before January 1, 2021 (*e.g.*, for calendar year taxpayers, 2018, 2019 and 2020) to carry those losses back to the five prior years, and thereby obtain a refund of taxes paid in those prior years. Combined with the use of tentative carryback procedures under Code Section 6411, which permit a "quickie" refund of such taxes subject to subsequent review in the normal course, this may provide prompt financial relief for many taxpayers.

Prior to the Tax Cuts and Jobs Act of 2017 (the "2017 Tax Act"), if a taxpayer had a net operating loss for a tax year, it could carry that loss back two years and apply that net operating loss against its income in that earlier year. This permitted the taxpayer to obtain a refund of taxes it paid with respect to that earlier year, which was often of more immediate financial help than carrying that net operating loss forward to reduce taxes in subsequent years. Further, Code Section 6411 provided, and still provides, that a taxpayer may apply for a tentative refund (known colloquially as a "quickie" refund) of taxes paid in the prior year based on such tentative carryback, which would be subject to a limited initial review by the Internal Revenue Service (the "IRS") with a goal of issuing such tentative refund within 90 days. This "quickie" refund is then subject to more fulsome review and adjustment by the IRS according to the IRS's normal review procedures. The point of the "quickie" refund procedure under Code Section 6411 is to enable loss companies to receive quickly the financial relief that a tax refund would provide, subject to verification per the tax review employed by the IRS in the normal course.

The 2017 Tax Act eliminated the ability to carry back net operating losses to prior years effective for tax years beginning after December 31, 2017.

The CARES Act restores the ability to carry back net operating losses arising in tax years beginning after December 31, 2017, and before January 1, 2021 (*e.g.*, for calendar-year taxpayers, 2018, 2019, and 2020). Further, it permits such losses to be carried back five years rather than only the two

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years that was permitted immediately prior to the enactment of the 2017 Tax Act.

It is similar to, but in some respects broader than, the lengthening of the carryback period (which at the time was also limited to two years) enacted with respect to 2008 and 2009 in connection with the Great Recession. While a "quickie" refund for net operating losses incurred in 2020 will not provide any immediate benefit, because it cannot be requested until after the end of the year, it can provide help shortly thereafter if the taxpayer survives the year. And if the taxpayer had net operating losses in 2018 and/or 2019, the allowance of a carryback under the CARES Act to earlier, profitable, times would also help the taxpayer's financial situation if it had net income during the applicable five-year carryback period.

Under Code Section 6411, a taxpayer must apply for a "quickie" refund within a certain period of time after the close of its taxable year. For taxpayers with a calendar tax year, there is ample time to apply for such a tentative refund with respect to 2019 net operating losses. The time do so with respect to net operating losses that arose in 2018 has expired, however. It is not clear whether the IRS will grant an extension of time within which to do so.

Special rules apply with respect to real estate investment trusts (REITs) and life insurance companies. With regard to REITs, net operating losses of a taxpayer may not be carried back to any year in which the taxpayer was a REIT and net operating losses of a REIT may not be carried back to any tax year, regardless of whether the taxpayer was a REIT in that tax year.

In the case of a corporation, the ability to carry back net operating losses from 2018, 2019 and 2020 to years before 2018 is especially helpful because of the higher corporate income tax rates applicable before the effective date of the 2017 Tax Act.

Example

Taxpayer corporation had net cumulative positive taxable income of $1 million in the years 2014 through 2018 and a net operating loss of $600,000 in 2019. The 2017 Tax Act would disallow any carryback of the net operating loss incurred in 2019 to prior years. As a result of the temporary changes in the CARES Act, taxpayer corporation may now carryback the 2019 loss to the five prior years, starting with the earliest first, and obtain a tax refund for the taxes saved on the $600,000 of reduced taxable income for those years as a result of the loss carryback.

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Modification of Excess Business Limitation on Losses for Taxpayers Other than Corporations

The CARES Act also modifies loss limitation rules for non-corporate taxpayers such as individuals, trusts and estates. The 2017 Tax Act limited non-corporate taxpayers' ability to deduct excess business losses—the excess of the aggregate business gross deductions over aggregate business gross income. Under the 2017 Tax Act, deduction of excess business losses by non-corporate taxpayers was limited to $250,000 per year (or $500,000 for joint filers), with unused excess business losses carried forward as net operating losses.

Under the CARES Act, however, the application of the excess business loss limitation is delayed until 2021. Thus, non-corporate taxpayers may be able to deduct all excess business losses created through the end of the 2020 year. Taxpayers with losses in 2018 and 2019 that were disallowed by the limitation may amend their tax returns and file for refunds.

Example

Individual taxpayer had excess business losses in 2018 of $1 million that were not permitted to be deducted under Code Section 461(l). As a result of the CARES Act, Section 461(l) no longer applies until 2021. Taxpayer may file an amended tax return for 2018 and obtain a refund for overpaid taxes resulting from the change to Section 461(l).

Modifications of Limitation on Business Interest Deductions.

The CARES Act temporarily increases the amount of interest expense that businesses are allowed to deduct on their tax returns. Under the 2017 Tax Act, for tax years beginning after December 31, 2017, the deduction for business interest for taxpayers with average gross receipts of $25,000,000 or more was limited to 30 percent of the taxpayer's "adjusted taxable income" ("ATI"). The CARES Act raises the ATI limitation from 30 percent to 50 percent for tax years beginning in 2019 and 2020.

In addition, to raising the limitation to 50 percent on a temporary basis, the CARES Act allows a taxpayer to elect to treat its 2020 ATI as if it were the same amount as its 2019 ATI for purposes of applying the interest expense limitation. Given that many businesses expect to have lower ATI in 2020, their ability to use 2019 ATI would increase the deduction for business interest that could be taken in 2020 beyond the amount that would otherwise be permitted. Additional net operating losses generated in 2020 could be carried back to previous tax years under the net operating loss modifications addressed above.

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Example

Taxpayer had ATI of $1 million in 2019, resulting in an interest expense deduction limitation of $300,000 prior to the enactment of the CARES Act. As a result of the CARES Act enactment, the limitation is increased to 50 percent of ATI, or $500,000. In addition, the taxpayer may use the 2019 ATI of $1 million for purposes of determining the deduction limitation for 2020.

Under the CARES Act, a real estate business may elect out of the interest expense limitation. An entity that elects out of the interest expense limitation would be required to depreciate certain types of property using the slower alternative depreciation system (ADS) and would forego the benefits of the enhanced bonus depreciation provision. It might be possible for a real estate business that made the election in 2019 to file an amended return and revoke its election and apply the new provisions of the CARES Act.

Employee Retention Credit for Employers Subject to Closure due to COVID-19

The CARES Act creates a new employee retention credit for employers whose business is suffering substantially in 2020 because of the COVID-19 pandemic. The employee retention credit is available for wages paid through December 31, 2020. The credit is refundable to the extent that it exceeds the employer portion of Social Security taxes (reduced by credit for paid sick leave and paid child care leave established under the Families First Act and discussed below).

"Eligible employers" are allowed a credit against employment taxes for each calendar quarter equal to 50 percent of "qualified wages" paid to each employee for that quarter. The credit is capped at $10,000 in wages for each employee for all quarters, and it is reduced by any credits discussed below for family and medical leave allowed under the Families First Act.

For purposes of the credit, "eligible employers" are those carrying on a trade or business during calendar year 2020 (1) whose operations were fully or partially suspended due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings due to COVID-19; or (2) whose gross receipts in a quarter are less than 50 percent of their gross receipts for the same quarter in the prior year. In the latter case, eligibility lasts until the business's gross receipts exceed 80 percent of their gross receipts for the same calendar quarter in the prior year.

In calculating the credit, which wages constitute "qualified wages" depends on the size of the employer. For eligible employers with 100 or fewer full-time employees, all employee wages qualify for the credit. For employers that have more than 100 employees, wages eligible for the credit are wages

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that the employer pays employees who are not providing services due to the suspension of the business or a drop in the business's gross receipts.

Tax-exempt entities may be considered eligible employers if their operations are fully or partially suspended due to the virus.

Importantly, the tax credit is ***not available*** to employers with Small Business Interruption loans under the Payroll Protection Loan Program established under the CARES Act.

Example

If an eligible employer paid $12,000 of qualified wages to an employee who was not able to work as a result of a government-mandated closure, the employer would be able to claim a credit of 50 percent of such wages, capped at $10,000 (or a $5,000 credit) against the employer's liability for Social Security taxes.

Delay of Payment of Employer Payroll Taxes

The CARES Act defers the obligation of employers and self-employed individuals to pay the employer share of the Social Security tax (imposed at a rate of 6.2 percent, up to a maximum wage base of $137,700 per employee for 2020) otherwise due with respect to wages paid from the date of the CARES Act through the end of 2020. The CARES Act also defers payment for one-half of the Social Security portion of self-employment taxes incurred through the end of 2020. Fifty percent of the deferred payroll/self-employment taxes are due by December 31, 2021, and the remaining amounts are due by December 31, 2022. In the case of a self-employed individual, the CARES Act specifically provides that the 50 percent deferred portion will not be treated as owed for purposes of calculating estimated tax underpayment penalties. Medicare taxes and the employee share of Social Security taxes are not subject to deferral.

Taxpayers who take covered loans under the Paycheck Protection Program set forth in the CARES Act and whose loans are forgiven under the terms of the CARES Act are not eligible for the deferral described above.

Example

Employer has paid $25,000 of wages in the first quarter of 2020 (prior to enactment of the CARES Act) to Employee A and employer pays $75,000 of wages to Employee A for the second, third and fourth quarter of 2020 (after enactment of the CARES Act). The employer share of Social Security taxes with respect to the $75,000 of wages paid in the second, third and fourth quarters is $4,650 (*i.e.*, 6.2 percent of $75,000). Of that amount, one-half ($2,325) will be due by December 31, 2021 and the other half ($2,325) will be due by December 31, 2022.

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Modification of Credit for Prior Year Minimum Tax Liability of Corporation

The CARES Act expands the ability of companies to claim refundable alternative minimum tax ("AMT") tax credits. The 2017 Tax Act repealed the AMT for corporate taxpayers effective for tax years beginning after December 31, 2017, but it made corporate AMT credits available as refundable credits over several years. The CARES Act accelerates the ability of companies to recover those AMT credits and provides expedited refund procedures designed to allow corporations to obtain additional cash flow.

Technical Amendments Regarding Qualified Improvement Property

The CARES Act contains a technical correction to the 2017 Tax Act with respect to "qualified improvement property" (such as leasehold improvement property, certain restaurant property, and certain retail improvements). The 2017 Tax Act inadvertently denied taxpayers the ability to claim bonus depreciation deductions relating to such qualified improvement property (which had previously been available to a lesser extent), requiring that such expenditures be depreciated over a 39-year period instead.

The CARES Act retroactively fixes this "glitch" by adding qualified improvement property to the list of items that is eligible for 100 percent bonus depreciation under the 2017 Tax Act. Given the retroactive nature of the provision, taxpayers who may have made expenditures during calendar year 2018 or 2019 and who have already filed U.S. tax returns for such years may be entitled to tax refunds.

Temporary Exception from Excise Tax for Alcohol Used to Produce Hand Sanitizer

Given heightened demand for hand sanitizers resulting from the COVID-19 pandemic, the CARES Act waives the federal excise tax on any distilled spirits that are used for, or contained in, hand sanitizer. However, the excise tax is waived only when the sanitizer is produced and distributed in a manner consistent with Food and Drug Administration guidance related to COVID-19. The provision only applies to distilled spirits removed after December 31, 2019.

Individual Provisions

Key Takeaways for Individuals

- Rebates of $1,200 ($2,400 for joint filers) plus $500 per child provided to eligible taxpayers with adjusted gross income of up to $75,000 ($150,000 for joint filers), subject to phase-out limits.
- Waiver of 10 percent early withdrawal penalty for distributions of up to $100,000 from qualified retirement accounts for COVID-19 related purposes.

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– Waiver of mandatory minimum distributions on certain retirement plans.

– Enhanced ability for taxpayers to take deductions for cash donations to charities (including limited "above-the-line" deductions for taxpayers who do not itemize deductions).

– Temporary tax-free student loan repayment benefit to employees.

Recovery Rebates to Individuals

Another key element of the CARES Act is the recovery rebates extended to eligible taxpayers. The term "eligible taxpayer" includes only U.S. residents who cannot be claimed as a dependent by another taxpayer (such as a college student for whom one or both parents provide more than 50 percent of the student's support). It does not include trusts or estates. Eligible taxpayers with an adjusted gross income of up to $75,000 ($150,000 for taxpayers filing a joint return) are eligible to receive a rebate in the amount of $1,200 (or $2,400 in the case of those filing a joint return). That amount will be increased by $500 for each child (under age 17 as of the end of 2020) of the taxpayer. The rebate amount is subject to a phase-out based on the taxpayer's adjusted gross income, with the payment amount completely phased-out for single filers with incomes above $99,000 and joint filers with incomes exceeding $198,000.

Most taxpayers will not need to take any steps to receive a rebate from the IRS. Instead, the IRS will use a taxpayer's 2019 tax return, if filed, and otherwise a 2018 tax return, to facilitate the payment. The rebate is not taxable income to the recipient. It is treated as an advance of the refund a taxpayer would normally receive when filing his or her 2020 tax return and may be received by those who would not otherwise have any tax liability.

Retirement Funds and COVID-19-Related Distributions.

The CARES Act provides special rules for the use of retirement funds due to reasons related to COVID-19. The CARES Act enables individuals to withdraw retirement funds for coronavirus-related distributions, without incurring the 10 percent early withdrawal penalty they would otherwise incur. The aggregate amount of distributions that can be treated as coronavirus-related distributions for any taxable year is capped at $100,000. Additionally, income attributable to such distributions is subject to tax over three years, and the taxpayer may recontribute the funds to an eligible retirement plan within three years, without regard to that year's ceiling on contributions.

For these purposes, a "coronavirus-related distribution" is defined as any distribution from an eligible retirement plan made on or after January 1, 2020, and before December 31, 2020, to an individual:

1. Who is diagnosed with COVID-19 by a test approved by the Centers for Disease Control and Prevention (CDC);

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2. Whose spouse or dependent is diagnosed with COVID-19 by a CDC approved test; or
3. Who experiences adverse financial consequences as a result of being quarantined, being furloughed or laid off, or having work hours reduced due to COVID-19, or due to lack of child care because of COVID-19, or as a result of the closing or hours reduction of a business owned or operated by the individual because of COVID-19, or other factors determined by the Treasury Secretary.

The provision protects individuals forced to tap into their retirement account funds because of financial hardship resulting from the pandemic.

Waiver of Minimum Distribution Rules

The CARES Act temporarily waives the required minimum distribution rules under Code Section 409(a)(3) for calendar year 2020 for certain defined contribution plans and individual retirement plans. It also waives the minimum distribution rules for individuals who would otherwise be required to withdraw funds for the first time from their retirement accounts during 2020. The waiver is only effective for calendar years beginning after December 31, 2019 and ending on December 31, 2020 provided that such distribution had not been made before January 1, 2020.

Deductions for Charitable Contributions

To encourage Americans to contribute to charitable organizations during the COVID-19 economic slowdown, the CARES Act permits a charitable contribution deduction for individuals who do not itemize their deductions (for whom a tax deduction would not otherwise be permitted). The CARES Act provides a new “above the line” charitable contribution deduction of up to $300 to individuals who do not itemize their deductions. As a result of limitations on itemized deductions imposed by the 2017 Tax Act, many individuals who had previously itemized their deductions do not currently do so.

The CARES Act also encourages individuals who do itemize their deductions to contribute to charitable organizations by increasing the limitation on charitable contribution deductions. The CARES Act permits a charitable contribution deduction of up to 100 percent of the donor’s adjusted gross income rather than the usual 50 percent limit.

Both the above the line deduction and the increased limitation require the contribution to be made in cash, in 2020, and to a public charity or foundation described in Code Section 170(b)(1)(A). Contributions made to a supporting organization or a donor-advised fund do not qualify for either the above the line deduction or the increased limits.

Exclusion for Certain Employer Payments of Student Loans

The CARES Act permits employers to provide a tax-free student loan repayment benefit to employees under Code Section 127. The provision

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allows an employer to contribute during the 2020 taxable year up to $5,250 toward an employee's student loans without the employee having to include the payment in the employee's gross income. The annual limit applies to both the student loan payment as well as other educational assistance traditionally provided under a Section 127 plan. The provision disallows the employee's deduction for interest paid on the student loan.

Families First Coronavirus Response Act

Key Takeaways for Employers

- Employers eligible for 100 percent tax credit for paid sick leave (up to $511 per day, for up to 10 days) and family leave (up to $200 per day, and up to $10,000 per employee).
- Credit is available as an immediate offset against payroll taxes that would otherwise be required to be deposited (including income, Social Security, and Medicare taxes withheld from employees, as well as the employer share of Social Security and Medicare taxes), with excess amounts eligible for refund on an accelerated basis.

Payroll Tax Credit for Paid Sick Leave and Family Leave

The Families First Act requires businesses with fewer than 500 employees to provide paid time off to certain employees when the employees are unable to work or telework for designated COVID-19 virus reasons, discussed in depth in our prior client alert **which can be found here**.

The Families First Act permits employers a refundable tax credit if they continue to pay employees who are absent from work due to any of the designated COVID-19-related reasons set forth in the Families First Act. An employer that provides qualified sick leave to an employee is allowed a tax credit equal to 100 percent of the qualified sick leave wages the employer paid (up $511 per individual per day, depending on the reason for being out, and for up to 10 calendar days). If, for any given quarter, the amount of the credit exceeds the amount of the employer's share of any Social Security taxes due in that quarter, the excess is treated as an overpayment that is refundable to the employer.

The tax credit is also available to certain self-employed individuals who are unable to work because of COVID-19. An eligible self-employed individual is allowed as a credit against self-employment tax, for the taxable year, an amount equal to the qualified sick leave equivalent amount for up to 10 days. The CARES Act requires that self-employed individuals maintain documentation establishing their eligibility for the credit. The statute does not specify what documentation is required but instead provides that the IRS shall issue guidance on this topic. In the absence of such guidance, we recommend that self-employed individuals who may seek to avail themselves of this credit maintain a daily diary to establish their inability to work due to COVID-19.

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Employers are also eligible for a refundable tax credit when they pay employees who are on leave because of certain caretaking duties that result from COVID-19. Eligible employers may take a tax credit in each calendar quarter for 100 percent of the qualified family leave wages paid (which is two-thirds of the employee's compensation), up to $200 per employee per day, by such employer with respect to that calendar quarter. A similar credit is also available for self-employed individuals.

The aggregate tax credit that may be taken by an employer in all calendar quarters with respect to such paid family leave is capped at $10,000 per employee (*i.e.,* up to 50 days for an employee eligible for the maximum $200 payment per day).

Sick leave and child care leave paid by the employer pursuant to the Families First Act will not be considered wages or compensation for purposes of Sections 3111(a) and 3221(a) of the Code. Accordingly, payments of such amounts should not be subject to the employer share of Social Security taxes that ordinarily apply to payments to employees.

Subsequent to the enactment of the Families First Act, the IRS provided guidance clarifying that the tax credit rules described above would be interpreted in a manner that would effectively provide immediate relief to employers. Pursuant to IRS News Release 2020-57, eligible employers who pay qualifying sick or child care leave will be able to retain an amount of the payroll taxes with respect to all employees equal to the amount of qualifying sick and child care leave that the employer paid, rather than deposit the payroll taxes with the IRS. The IRS News Release further specifies that the amount that employers may retain is not limited to the employer's share of Social Security and Medicare taxes, but also includes income, Social Security, and Medicare taxes withheld from employees that would otherwise be required to be deposited by the employer.

EXAMPLE

If an eligible employer paid $5,000 in qualified sick leave and is otherwise required to deposit $8,000 in payroll taxes, including taxes withheld from all its employees, the employer could use up to $5,000 of the $8,000 of income taxes or FICA taxes it was going to deposit for making qualified leave payments. The employer would only be required under law to deposit the remaining $3,000 on its next regular deposit date.

If, on the other hand, the eligible employer paid $10,000 in sick leave and was required to deposit $8,000 in taxes, the employer could use the entire $8,000 of taxes in order to make qualified leave payments and file a request for an accelerated credit for the remaining $2,000.

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If the payroll taxes (including federal taxes withheld from employees as well as the employer share of Social Security and Medicare taxes) are not sufficient to cover the cost of qualified sick and child care leave paid, employers will be able file a request for an accelerated payment from the IRS that is expected to be processed in under two weeks' time, according to the IRS. The IRS News Release advises that the details of the accelerated payment process will be announced shortly.

The global pandemic that is the COVID-19 virus has left many businesses and individuals on financially shaky ground. Many of the tax incentives described above can be utilized immediately, and taxpayers should consider now how to best position themselves to take advantage of these tax benefits. To discuss how the provisions described above may affect your business, please contact the tax professionals of Arent Fox LLP.

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