The CARES Act: Summary of Tax Provisions

In response to the ongoing coronavirus public health crisis, the federal government has taken unprecedented steps to provide economic relief to individuals and businesses. Since the beginning of March, Congress has approved $8 billion in emergency funding and passed the Families First Coronavirus Response Act to help combat the effects of the coronavirus pandemic. The third and most impactful phase of this relief is the Coronavirus Aid, Relief and Economic Security Act (the “CARES Act”), a momentous $2 trillion infusion into the economy which was signed into law on March 27th.

The CARES Act will provide support to individuals and businesses through various policy measures, including significant changes to the tax law. Some of the provisions are designed to deliver immediate cash flow relief to individuals and businesses, while the benefits from others will be claimed by taxpayers either on amended returns or returns for the 2020 tax year. In some cases, taxpayers will need to make choices regarding how to best take advantage of the relief offered by this historic stimulus package. Below are some of the key tax provisions that may affect you or your business in 2020.

Provisions Offering Immediate Financial Relief

1. **2020 Recovery Rebates**

Individuals who are not a dependent of another taxpayer, not a nonresident alien, have a social security number and have income up to $75,000 ($150,000 if married) are eligible for a one-time rebate of $1,200 ($2,400 if married) under the CARES Act. Individuals with families are also entitled to an additional $500 rebate per child under 17 years old. The rebate is phased out by $5 for each $100 of income in excess of the threshold amount, with the rebate being completely phased out for individuals with income over $99,000 ($198,000 if married), with an additional $10,000 of income required to phase out the additional rebate for each child.

No action is required to claim the rebate, as the IRS will utilize individuals’ tax return information to determine if they are eligible and the amount of the rebate. For individuals who filed a 2018 or 2019 tax return, the rebate will be paid out between the effective date of the Act and December 31, 2020 using the income information from the most recent tax return. The IRS may make the rebate electronically if the taxpayer has authorized the delivery of a refund of federal taxes. Individuals who did not file a 2018 or 2019 return and do not receive a Form SSA-1099 are still eligible for the rebate but will not be able to claim it until they file a 2020 tax return.

The rebate is technically an advance payment of a tax credit and must be reconciled on the 2020 tax return to the payment that would have been due based on the taxpayer’s 2020 income. The advance rebate that taxpayers will receive is the amount that would have been allowed as a credit for 2019 had the credit provision been in effect for 2019. If the advance rebate is less than the credit to which the taxpayer is entitled for 2020, the taxpayer will claim the balance of the credit when filing the 2020 return. Further, an individual may not be eligible for the rebate based on their filing status or income level in 2019, but nevertheless qualify for the credit on their 2020 tax return. However, if the advance rebate received is greater than the credit to which the taxpayer is entitled, the taxpayer will not have to pay back the excess because the amount of the credit allowable for 2020 must be reduced (but not below zero) by the advance rebate received during 2020.

Example: Sarah and John are married with one child. Sarah and John recently filed a 2019 tax return reporting adjusted gross income of $200,000. Their 2020 recovery rebate amount is $400 ($2,900 preliminary rebate amount less (($200,000 – $150,000) / $100 * $5) = $2,500 phase-out amount).

2. **Employee Retention Credits**

The CARES Act provides for a refundable payroll tax credit for 50% of qualified wages (including healthcare benefits) paid to employees during the coronavirus health crisis. This credit is available to any employer, including non-profits, whose operations are fully or partially suspended due to a coronavirus-related shutdown order from a government authority, or whose gross receipts for any quarter in 2020 decline by more than 50% when compared to the same quarter in the previous year. For employers claiming the credit based on reduction in revenue, the period for claiming the credit ends following the quarter when gross receipts exceed 80% of gross receipts for the same calendar quarter in the prior year.

For businesses with more than 100 employees, qualified wages only include those paid to employees during the period when they are not providing services to the employer. Businesses with 100 or fewer employees affected by the coronavirus pandemic in one of the ways described above can include all wages paid to employees from March 13, 2020 through December 31, 2020. The employee count is based on the average number of full-time employees in 2019.

The amount of qualified wages is limited to $10,000 per employee for the entire year, meaning the credit is limited to $5,000 per employee. Any credit in excess of the employer’s liability for the 6.2% Social Security tax will be paid out as a refund. The credit is calculated on a quarterly basis and can offset payroll tax liability (and potentially be issued as a refund) for each quarter of 2020, beginning with the quarter ending on March 31st.

Note: Two additional payroll tax credits were previously created by the Families First Coronavirus Response Act, signed into law on March 18, to compensate employers for paid sick leave and family leave. Any wages considered in calculating these tax credits **cannot** also be used for the new employee retention credits. Additionally, wages paid to any employee for which the employer is allowed a work opportunity tax credit cannot be included in the calculation of qualified wages. Finally, note that the employer’s wage expense must be reduced by the amount of credit claimed.

Planning Consideration: This credit is not available to employers receiving loans through the new SBA 7(a) Loan Program (“Paycheck Protection Program”), created by the CARES Act.

Example: XYZ Corp. has remained open during the coronavirus crisis, but its gross receipts for the quarter ending March 31, 2020 are more than 50% lower than they were in the first quarter of 2019. XYZ has 10 employees, each of whom receives $12,000 in qualified wages for the quarter ending March 31, 2020, but only $4,000 of which relates to the period on or after March 13, 2020. Assuming XYZ meets other eligibility requirements, the company is entitled to a $20,000 employee retention tax credit to be claimed on its first-quarter payroll tax return (10 employees * $4,000 qualifying wages per employee * 50%).

3. **Deferred Payment of Payroll Taxes**

Businesses are required to pay the employer Social Security tax of 6.2% (OASDI) of employee wages (up to an annual limit) to the federal government on a monthly or semi-weekly basis. To immediately help businesses with their cash flow, the CARES Act allows employers to defer payment of the taxes incurred from the date of enactment (March 27, 2020) through the end of 2020 over the following two years, with the first half of the deferred amount due on December 31, 2021, and the second half due on December 31, 2022. Under this provision self-employed taxpayers are also entitled to defer the same tax (i.e., 50% of 12.4% OASDI portion of self-employment tax) owed over the following two years.

Note: Medicare taxes, which cost employers an additional 1.45% on all employee wages, are not addressed in the Act.
Note: Individuals will not be required to pay estimated tax payments for the 2020 tax year on the portion of self-employment tax deferred.
Planning Consideration: A taxpayer who receives a loan through the new SBA 7(a) Loan Program ("Paycheck Protection Program"), created by the CARES Act, is eligible for the deferred payment of payroll taxes. However, this provision will **not** apply if a taxpayer has such a loan forgiven pursuant to the Act.

4. **Retirement Plan Distributions**

The CARES Act relaxes the rules for distributions from qualified retirement accounts such as IRAs and 401(k)s for individuals affected by the coronavirus. Anyone who is diagnosed with COVID-19 with a CDC-approved test (or whose spouse or dependent is diagnosed) or experiences adverse financial consequences because of coronavirus (such as being quarantined, laid off, having work hours reduced, being unable to work due to lack of child care or closing or reducing hours of a business owned or operated due to such virus) is eligible to withdraw up to $100,000 from a qualified retirement account before December 31, 2020 without incurring the 10% early distribution penalty.

Individuals have the option of repaying the amount distributed and not incurring tax. If the taxpayer does not repay it, the income from these distributions will be subject to tax ratably over three years, beginning with the year of the withdrawal. In addition, individuals affected by the disease can loan themselves up to $100,000 from a qualifying retirement account within the 180-day period after passage of the Act and repay the loan over five years, with the first loan repayment able to be delayed for up to one year. Qualified plans can be amended to allow loans of up to $100,000 to eligible individuals.

Planning Consideration: Drawing down retirement funds should generally be done as a last resort, but this change will potentially provide individuals affected by the coronavirus with much-needed liquidity.

The CARES Act also temporarily waives required minimum distributions (RMDs) from IRAs and 401(k) plans in 2020, and no distribution is required to be made in calendar year 2020 if the distribution would have otherwise been required due to the death of a participant. Amounts distributed from a plan in 2020 that would have been RMDs are “eligible rollover distributions” that can be rolled on a tax-free basis to other retirement plans.

Provisions Offering Deferred Financial Relief

5. **Expanded Use of Business Losses**

Under current law, net operating losses (“NOLs”), when business deductions exceed income for a given tax year, can only be carried forward and are only allowed to offset 80% of taxable income in a profitable tax year. The CARES Act allows NOLs for tax years beginning in 2018, 2019 or 2020 to be carried back up to five years, and temporarily removes the taxable income limitation to allow NOLs to fully offset taxable income. For tax years after 2020, the 80% limitation will be restored, although some changes to the calculation that are taxpayer-friendly will take effect.

Example: ABC Co. filed an initial tax return in 2017 showing taxable income of $50,000 and a 2018 tax return showing a net operating loss of $100,000. In 2019, ABC had taxable income before the NOL deduction of $100,000. Previously, ABC Co. could only carry forward the 2018 NOL to offset $80,000 of taxable income in 2019 (80% of $100,000). Under the CARES Act, ABC can carry back the $100,000 NOL to fully offset 2017 taxable income of $50,000 and carry forward the remaining $50,000 to reduce 2019 taxable income to $50,000. Alternatively, ABC can elect out of the carryback period and reduce 2019 taxable income to zero.

Planning Consideration: Many businesses that were profitable in 2018 and 2019 may generate a net operating loss in 2020 due to the coronavirus pandemic. This provision will not help in the short term for cash flow as generally businesses will need to wait until 2021, when taxable losses reported on 2020 tax returns can be carried back to a previous tax year.

Planning Consideration: While most taxpayers will not receive immediate relief from this provision, there may be exceptions. For example, a C corporation that generated a loss in 2018 or 2019 can now carry back that loss to a year in which the corporate tax rate was at 35% and receive a larger tax break than they would by carrying the loss forward to a later year under the current 21% rate.

Businesses structured as sole proprietorships, partnerships or S corporations are also subject to the excess business loss provisions, which prevent business losses exceeding $250,000 for a single taxpayer ($500,000 if married) from being used to offset other sources of taxable income on the business owner’s personal tax return. The new law retroactively suspends the excess business loss provision for 2018 through 2020, allowing for the unlimited use of business losses in those years. However, the Act clarifies that wages are not treated as business income for purposes of the limitation, which will negatively affect the ability of taxpayers to utilize business losses for tax years after 2020.

6. **Expanded Deductibility of Business Interest**

The Tax Cuts and Jobs Act of 2017 (“TCJA”) created a limitation on the deductibility of interest expense for large businesses by disallowing amounts exceeding 30% of taxable income (adjusted for certain items). Under the CARES Act, businesses (other than partnerships) may deduct business interest expense up to 50% of adjusted taxable income instead of 30% for both 2019 and 2020. In addition, all businesses can elect to use 2019 adjusted taxable income in calculating their deductible interest expense in 2020.

While partnerships are not eligible for the increased limit in 2019, their partners can carry forward any disallowed interest expense allocated to them in 2019 and deduct 50% of that amount on their 2020 tax returns provided they are not otherwise subject to the business interest expense limitation. The remaining 50% will remain suspended until the partnership allocates the partner excess taxable income or excess business interest income, or the partnership is no longer subject to the business interest limitation rules.

Planning Consideration: This change could allow a business suffering a loss in 2020 due to the coronavirus pandemic to increase their taxable loss by claiming an interest expense deduction based on 2019 taxable income and carry back that loss to a profitable tax year under the new NOL provisions.

7. **Charitable Incentives**

Under previous law, charitable donations were deductible only as itemized deductions – meaning that they provided no tax benefit to individuals who used the standard deduction. The CARES Act provides an additional incentive for charitable giving by allowing taxpayers who do not itemize their deductions to deduct up to $300 of charitable contributions in 2020. As drafted, the legislation makes this above-the-line deduction for non-itemizers permanent for all taxable years beginning after December 31, 2019.

Note: This incentive, along with several other provisions, was aimed at helping charities assist families impacted by the coronavirus pandemic. Nonprofit organizations are saying that the $300 limit is insufficient to address the expected decline in charitable donations but hope that establishing the principle that nonitemizers can claim charitable deductions will lead to additional tax measures to help the nonprofit sector.

In addition, taxpayers with charitable intent will have a greater incentive to give because the income limitations on charitable contributions are modified for 2020 by the CARES Act. Individuals are allowed a deduction for cash contributions to public charities up to 60% of adjusted gross income, but the Act suspends this income limitation for the 2020 tax year. For 2020 an individual may elect to deduct such contributions up to the amount of their adjusted gross income, and any excess is added to the individual's carryover amount. Corporations can also take advantage of an increased charitable deduction limit of 25% of taxable income for 2020, compared to the 10% limitation under previous law, and the cap on charitable contributions of food inventory is temporarily raised from 15% to 25% of taxable income.

Planning Consideration: An individual can reduce taxable income to zero through charitable giving in 2020, but the donations will need to be made in cash to public charities, excluding certain supporting organizations and donor advised funds. The income limitations on gifts to private foundations and gifts of appreciated stock remain unchanged.

8. **Qualified Improvement Property**

As defined by the TCJA "qualified improvement property" includes almost any improvement to the interior of leased or owned space. However, due to an error in the drafting of that legislation, known as the "retail glitch", under current law qualified improvement property is depreciated as 39-year property and does not qualify for bonus depreciation. The CARES Act includes a technical correction to the TCJA by defining qualified improvement property as 15-year property and eligible for bonus depreciation, thereby allowing businesses to write off the costs of improving facilities immediately rather than depreciating them over 39 years. This change is retroactive and made as if included in the TCJA.

Note: Absent additional relief from the IRS, real property trades or businesses that elected out of the business interest limitation provisions will not be able to benefit from this provision.
Planning Consideration: This provision is especially important for retailers, restaurants and other businesses in the hospitality industry. Although we need additional guidance from the IRS, taxpayers will likely be able to claim the benefit either by amending prior year returns or filing their next return with an accounting method change.
Note: Businesses formed as partnerships generally cannot file amended returns due to the centralized partnership audit regime which became effective for the 2018 tax year. The audit regime requires partnerships subject to it to file administrative adjustment requests instead of amended returns. Without an amended return option, partnerships seeking to benefit from the changes made to qualified improvement property will need to apply for an accounting method change or adhere to the administrative adjustment requests procedures and recognition timing of favorable adjustments.
Planning Consideration: Given the favorable tax provisions included in the CARES Act, businesses that extended the filing of their 2019 tax return to September 15, 2020 should opportunistically use this time to vigorously evaluate favorable automatic tax accounting method changes and elections regarding revenue recognition, accelerated deductions and employment of tangible property depreciation and cost recovery deductions. For example, a partnership with taxable income in 2018 and 2019 that made improvements to leased or owned real estate that are qualified improvement property, could immediately benefit from a favorable automatic change in tax accounting method adjustment. The latter could generate a 2019 NOL for the partners that can be carried back to previous years, and potentially to a year in which the individual's tax rate was at 39.6%

Beyond the tax provisions of this unparalleled stimulus package, the CARES Act includes a range of non-tax relief measures including increased unemployment benefits for workers, low-cost loans for businesses of all sizes, and emergency funding for the country's health infrastructure. Almost all taxpayers will be affected by one or more of the Act's provisions, although implementation may require additional guidance and clarification. If you have questions regarding the changes included in the CARES Act and how they may affect you, please contact your Bennett Thrasher tax advisor.

Contact Us

Bennett Thrasher is dedicated to providing you with the strategic guidance and resources your business needs. We are continuing to monitor developments and updates that affect your business and will continue to provide you with alerts on a regular basis to ensure you are informed on how to respond to tax and regulation changes as they occur. Please contact your Bennett Thrasher advisor with additional questions by calling 770.396.2200.