



APRIL 2020

## Tax-Related Provisions of the CARES Act

The Coronavirus Aid, Relief, and Economic Security (CARES) Act—the \$2 trillion economic stimulus package aimed at combatting the economic damage caused by the COVID-19 pandemic and the largest in U.S. history— provides a host of tax benefits, employer incentives, loan programs and other assistance to U.S. individuals and businesses adversely affected by the global health crisis. This client alert summarizes the material tax aspects of the Act.

### Net Operating Losses

Section 172 of the Internal Revenue Code addresses a taxpayer's ability to deduct from its taxable income a net operating loss (NOL) that has been generated in another tax year. Prior to the Tax Cuts and Jobs Act of 2017 (TCJA), an NOL arising in any given tax year could have been carried back to the two previous tax years and forward 20 years (or the taxpayer could have elected to waive any carryback of the NOL).

The TCJA eliminated the option to carry back an NOL to a previous tax year. Instead, taxpayers are now permitted to carry forward their NOLs indefinitely. The TCJA also limited the deduction of NOL carryforwards against a taxpayer's taxable income to 80% of this income in any given tax year. These new NOL rules became effective Jan. 1, 2018.

The Act temporarily suspends the TCJA's changes to the NOL rules for NOLs incurred in 2018, 2019 or 2020 by (1) repealing the rule that limits NOL

carryforward deductions to 80% of the taxpayer's taxable income for the year, effectively allowing taxpayers to fully offset any NOL carryforwards against taxable income for each tax year; and (2) providing taxpayers with an election to carry back these NOLs to each of the five taxable years preceding the year of the NOL. The carryback of these NOLs may be particularly beneficial to corporate taxpayers that may be entitled to a refund of taxes paid in previous years. The TCJA lowered the federal corporate income tax rate from a maximum rate of 35% to 21% for tax years beginning in 2018. Accordingly, the Act allows corporate taxpayers a carryback of these NOLs to previous tax years to offset income taxed at a higher rate. For tax years beginning in 2021, the 80% NOL limitation added by the TCJA will again apply, albeit with certain modifications that may increase the amount of taxable income that can be offset by an NOL carryforward.

While the modification to the TCJA's NOL rules is generally expected to be favorable for many taxpayers and could provide a potentially significant refund of taxes paid in previous, profitable years, there could be unexpected consequences to certain multinational corporations with significant operations and/or business activities abroad. Multinational corporations should review and analyze the overall tax consequences of carrying back NOLs with their tax advisors prior to making such an election.

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## Individual Losses

The TCJA also introduced Section 461(l) of the Code, which prohibits individuals from deducting more than \$250,000 (\$500,000 in the case of a married couple filing jointly) of net business losses against nonbusiness income (e.g., income from passive investments) for tax years beginning after 2017 and before 2026.

The Act suspends the application of Section 461(l) until tax year 2021. As a result of this change, individual taxpayers, including partners of partnerships and shareholders of S corporations, who had excess business losses in tax years 2018 or 2019 may be entitled to a refund and should consider filing amended returns. Individuals who expect to have significant business losses that exceed their business income in the 2020 tax year should generally be able to offset the excess against any nonbusiness income for the year without regard to the limitations under Section 461(l). These losses may be subject to other limitations applicable to the taxpayer under the Code, however.

## Paycheck Protection Loan Forgiveness

The Act authorizes the allocation of \$349 billion to the Small Business Administration's new Paycheck Protection Program, which offers loans to eligible small businesses to assist with meeting payroll and other operational obligations. (Read our alert on the Paycheck Protection Program [here](#). As part of the loan program, all or a portion of these loans may be forgiven. The Act expressly provides that any loan forgiveness will not constitute taxable income.

## Business Interest Expense

The TCJA revised Section 163(j) of the Code by imposing a new limitation on the ability of certain taxpayers to deduct from taxable income interest payments attributable to business debt. Generally, under the TCJA, business interest expenses are deductible for federal income tax purposes to the

extent they do not exceed 30% of a taxpayer's "adjusted taxable income" for the tax year. For purposes of Section 163(j), as revised by the TCJA, "adjusted taxable income" effectively means earnings before interest, taxes, depreciation and amortization for tax years beginning before Jan. 1, 2022, and earnings before interest and taxes for tax years beginning on or after that date. Any disallowed business interest deductions are carried forward. Special rules apply under new Section 163(j) to partnerships and their partners.

The Act temporarily increases the 30% limitation to 50% for tax years beginning in 2019 or 2020. For the 2020 tax year, taxpayers may elect to use their 2019 adjusted taxable income in calculating the limitation. For those taxpayers whose 2019 adjusted taxable income is higher than their 2020 adjusted taxable income, this election will effectively increase their 50% limitation for deductions of business interest expenses.

For entities classified as partnerships for federal income tax purposes, the new 50% limitation applies only for the 2020 tax year. Where a partnership was subject to the 30% limitation under Section 163(j) in the 2019 tax year, however, half of the disallowed amount allocated to a partner will be treated as business interest paid or accrued by that partner in the tax year beginning in 2020, without being subject to any further limitation under Section 163(j) at the partnership level. The rest of the disallowed amount from the 2019 tax year will be carried forward and subject to any limitation that may otherwise apply to that partner under Section 163(j).

## Immediate Expensing of Qualified Improvement Property

The TCJA eliminated, for tax depreciation purposes, separate property classifications for "qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property" and replaced them with a single classification,

“qualified improvement property” (QIP). Generally, QIP is defined as any improvement to an interior portion of nonresidential real property. Examples include the installation or replacement of drywall, ceilings, interior doors, and electrical, mechanical and plumbing components. Improvements attributable to elevators or escalators, changes to the internal structural framework, or enlargement of a building are excluded.

The legislative history of the TCJA confirms that Congress intended to reclassify QIP placed in service after 2017 from “39-year property” to “15-year property.” Under the TCJA, certain categories of property with a depreciable life of 20 years or less are eligible for immediate expensing for federal income tax purposes, commonly known as “100% bonus depreciation.” As a result of a drafting error, however, QIP was not designated as 15-year property under Section 168 of the Code. Accordingly, QIP remained subject to a depreciable life of 39 years, rendering it ineligible for bonus depreciation. This error became generally known as the “retail glitch” in the TCJA.

The Act contains a technical correction of the retail glitch by including QIP placed in service beginning in 2018 in the definition of 15-year property under Section 168, making it eligible for 100% bonus depreciation. The Act clarifies that this correction applies retroactively with the enactment of the TCJA. Eligible taxpayers may be entitled to a refund and should consider filing an amended tax return, though certain eligible taxpayers may be required to request an administrative adjustment to take advantage of this favorable treatment. Taxpayers should review and analyze the overall tax consequences of adjusting their depreciation expense in light of their specific facts and circumstances prior to filing an amended return or requesting an administrative adjustment. Eligible corporate taxpayers in particular should evaluate the overall impact of filing amended tax returns to immediately expense QIP in the year it was placed in service. Such expenses may generate

(additional) NOLs for 2018, 2019 and 2020, which can be carried back to previous tax years under the Act to offset income taxed at a higher rate. (See above for a discussion on changes to the NOL rules under the Act.)

### Employee Retention Tax Credit

The Act establishes a tax credit for the 2020 tax year against an eligible employer’s 6.2% share of Social Security payroll taxes (but not the 1.45% employer share of the Medicare tax). An employer is eligible for the credit if (i) its business operations were fully or partially suspended during any calendar quarter of 2020 as a result of a government order related to COVID-19, or (ii) its gross receipts for any 2020 calendar quarter were less than 50% of its gross receipts for the same quarter in 2019. In the latter case, the employer will continue to be eligible for the tax credit for each calendar quarter in 2020 until it has a quarter when receipts exceed 80% of what they were for the same quarter in 2019. Tax-exempt organizations under Section 501(c) may also be eligible for this tax credit.

The tax credit equals 50% of the “qualified wages” paid to each employee for each eligible quarter during 2020. The total amount of qualified wages taken into account for each employee may not exceed \$10,000 for the year. Accordingly, the credit is essentially capped at \$5,000 (i.e., 50% of the first \$10,000 of qualified wages per employee). For an employer with more than 100 employees during 2019, qualified wages include only the following wages paid to employees when they are not providing any services as a result of business operations being fully or partially suspended or a decline in gross receipts (as described above): wages (1) paid to furloughed employees and (2) paid to employees operating on a reduced work schedule, but only to the extent of the difference between the total amount of wages actually paid to these employees and the amount the employer would have otherwise paid for the

reduced hours or services actually provided by such employees. For an employer with fewer than 100 employees in 2019, qualified wages include wages paid to all employees.

Qualified wages include any “qualified health plan expenses” allocable to these wages (e.g., amounts paid to maintain a group health plan). Wages taken into account in determining the new payroll tax credit for family medical leave or sick leave as part of the Families First Coronavirus Response Act, signed into law on March 18, may not be taken into account in determining qualified wages for the employee retention credit. Also, employers may receive a tax refund if the tax credit exceeds the business’s liability for payroll taxes, an outcome that is expected for numerous employers, considering that there are two other new payroll tax credits created as part of the Families First Coronavirus Response Act. Finally, an employer that receives a Paycheck Protection Program loan under Section 7(a) of the Small Business Act is not eligible for the credit.

### Employer Payroll Taxes

The Act allows employers to defer their 6.2% share of the Social Security payroll tax (but not the 1.45% employer share of the Medicare tax) that would otherwise be due for the time period beginning with the date of enactment through Dec. 31, 2020. An employer that elects to defer will have to pay half of the deferred taxes by Dec. 31, 2021, and half by Dec. 31, 2022.

This deferral is not available to any employer that receives a Paycheck Protection Program loan that is partially or fully forgiven.

Self-employed individuals may elect to defer paying 50% of their self-employment taxes that would be due for the time period beginning from the date of enactment through the end of 2020. Half of the deferred self-employment taxes are payable by the

end of 2021 (25%) and half are payable at the end of 2022 (25%).

### Charitable Contributions in 2020

The Act temporarily suspends certain limitations on cash contributions to certain charitable organizations. Generally, a deduction for contributions by an individual to certain charitable organizations is limited to 60% of the individual’s adjusted gross income for the taxable year. In the case of a corporation, the deduction is limited to 10% of its taxable income.

The Act provides that cash contributions to public charities and certain private foundations, including private operating foundations, during the 2020 calendar year will not be subject to these limitations. Instead, individual taxpayers will be permitted to fully deduct the amount of these cash contributions against adjusted gross income. This benefit effectively permits individuals to offset their adjusted gross income for the 2020 calendar year with such charitable cash contributions, after taking into account any other deductible contributions to charities. To the extent that an individual makes additional cash donations, the excess amount will be carried over into the subsequent year and will not generate a tax refund.

For corporations, a deduction for cash contributions to charitable organizations will be limited to 25% of the corporation’s taxable income. As with individuals, excess contributions will be carried over into subsequent years.

The Act requires that taxpayers specifically elect the benefits of this provision. Contributions to donor-advised funds, supporting organizations and private grant-making foundations do not qualify for this favorable treatment. The Act also reduces the limitation on the charitable deduction for contributions of food inventory by trades or businesses.



## Above-the-Line Charitable Deductions

Individuals are generally allowed to take income tax deductions for charitable contributions only if they itemize deductions on their income tax returns. Beginning with 2020, the Act allows individuals who do not itemize their deductions to deduct up to \$300 for cash contributions to public charities and certain private foundations, including private operating foundations. Contributions to donor-advised funds, supporting organizations and private grant-making foundations do not qualify for this deduction. For individuals who itemize deductions, the general rules on charitable contributions will continue to apply.

## Early Use of Retirement Funds and Retirement Plan Loans

The Act allows certain individuals to withdraw up to \$100,000 from qualified retirement plans, such as 401(k), 403(b) and 457(b) plans, in 2020 for financial needs related to the COVID-19 pandemic without being subject to the 10% tax penalty on early withdrawals. Early-Use Distributions are permitted only if (i) the individual, or the individual's spouse, was diagnosed with COVID-19, or (ii) the individual experienced adverse financial consequences as a result of being quarantined, furloughed, or laid off or otherwise having work hours reduced; being unable to work due to lack of child care; the closing or reduction of hours of a business owned or operated by the individual; or other factors caused by the COVID-19 pandemic, as determined by the Department of the Treasury. Early-Use Distributions are available only with respect to distributions from March 27, 2020, through the end of the 2020 calendar year.

Early-Use Distributions may be recontributed to qualified retirement accounts over the following three years, notwithstanding any cap on contributions imposed by the account. A retribution will be treated as a tax-free rollover. Any Early-Use Distribution not recontributed may be included in

taxable income over the following three years (rather than all in 2020).

Employer-sponsored retirement plans are not required to allow Early-Use Distributions. If employers want to make these distributions available to their employees, they must amend their plans to allow them.

The Act also raises the maximum loan amount that may be received by an eligible individual from qualified retirement plans from 50% of a participant's vested balance (up to a maximum amount of \$50,000) to 100% of a participant's vested balance (up to a maximum \$100,000). This temporary increase is available only for eligible loans entered into during the 180 days following the passage of the Act. In addition, these loans will not require repayments for the first year.

## Required Minimum Distribution Rules

The Act temporarily waives the required minimum distribution (RMD) rules applicable to individual retirement accounts and certain defined contribution plans maintained by employers for the 2020 tax year. Individuals do not have to withdraw any RMDs from these accounts in 2020.

Employer-sponsored plans may set RMDs, notwithstanding the provisions of the Act. Employers that wish to provide their employees with the option to forgo an RMD in 2020 must amend their sponsored plans.

## Student Loans

The Act allows an employer to pay up to \$5,250 of an employee's student loan obligation in the 2020 tax year on a tax-free basis. This provision modifies for the 2020 tax year existing Section 127, which permits an employer to pay up to \$5,250 of an employee's qualified educational expenses on a tax-free basis (i.e., expenses incurred for education qualifying the employee for an existing position with the employer). To the extent an employee's student loan is paid on a

tax-free basis by the employer in tax year 2020, the employee may not also deduct any related interest payments from her taxable income. To prevent an employee's loss of the interest deduction, employers can target their student loan repayment assistance to the principal amount, allowing the employee to pay the interest and thus get the interest deduction. The existing rules under Section 127 will presumably apply to this new student loan assistance in tax year 2020, including a prohibition against favoring highly compensated employees (those who earned more than \$125,000 in 2019).

For information on the business impacts of COVID-19, please visit our COVID-19 Resource Center, which we continue to update as the situation evolves. If you have questions about COVID-19's impact on your business, please reach out to your Loeb relationship partner or email us directly at [COVID19@loeb.com](mailto:COVID19@loeb.com).

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