

Memorandum

The Coronavirus Aid, Relief, & Economic Security Act: Tax Relief in the Wake of the COVID-19 Crisis

March 30, 2020

President Trump recently signed into law the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), a \$2 trillion economic relief package to aid businesses and individuals affected by the coronavirus disease 2019 (“COVID-19”). The CARES Act includes substantial changes to sections of the Internal Revenue Code of 1986, as amended (“Code”). Among these changes are several business tax provisions, including both temporary provisions aimed at ameliorating the economic effects of COVID-19 as well as certain long-sought technical corrections to the Tax Cuts and Jobs Act (“TCJA”). In addition, the CARES Act provides tax relief provisions to individual taxpayers. Below is a summary and explanation of key tax provisions in the CARES Act.

Business Provisions

NEW TAX PROVISIONS

- **Employee Retention Credit:** The CARES Act creates a quarterly refundable credit against employment taxes for retaining employees despite the negative economic effects of COVID-19. This credit is applied dollar-for-dollar (subject to the limitations below) for up to 50% of “qualified wages” paid between March 13, 2020 and December 31, 2020.
 - *Qualified Wages:* The term “qualified wages” is defined differently depending on the number of employees. For employers with 100 or fewer employees, the qualified wages includes all wages paid for the years the employer satisfies the eligibility requirements below. For employers with more than 100 employees, qualified wages only includes wages paid for employees *not* providing services due to COVID-19-related restrictions, while the employer satisfies the eligibility requirements below.
 - *Eligibility:* The credit is available for employers carrying on a trade or business during the 2020 tax year (i) the operation of which is fully or partially suspended during the quarter due to COVID-19-related governmental orders limiting commerce, travel, or group meetings or (ii) experience gross receipts for the quarter less than 50% of the gross receipts for the same quarter in the prior year. Eligibility will end when the employer earns more than 80% gross proceeds as compared to the prior calendar quarter. In addition, employers who receive “Small Business Interruption Loans” under the CARES Act are ineligible for the credit.

- *Limitations:* The credit is in the amount of 50% of qualified wages up to \$10,000 per employee. The credit is also limited to the amount of employment taxes on wages paid for the calendar quarter and is reduced by other credits claimed for employer-payroll taxes to prevent double benefits.
- **Small Business Loan Forgiveness:** The CARES Act provides for the forgiveness of certain loans under the Small Business Act. The corresponding cancellation of debt is excluded from gross income to the small business taxpayer.

CHANGES TO EXISTING TAX PROVISIONS

- **Net Operating Loss (“NOL”):** For tax years beginning in 2018, Section 172 of the Code previously disallowed all NOL carrybacks to tax years preceding the year of the loss. The TCJA further imposed an 80% limit on the amount of taxable income NOLs can be used to offset. The CARES Act contains two major revisions to these NOL rules:
 - First, Section 172 is revised such that NOLs arising in tax years 2018, 2019, or 2020 may now be carried back 5 tax years. This carryback rule does not apply to Real Estate Investment Trusts (“REITS”) and taxpayers cannot carry back NOLs to any year it was classified as a REIT, regardless of the taxpayer’s current status. For life insurance companies, if an NOL is carried back, such NOL is treated as an “operations loss carryback” as defined in Section 810. The carryback rule also cannot be used to offset income imposed under the Section 965 repatriation transition tax.
 - Second, the 80% limitation on offsetting taxable income is suspended for tax years 2018, 2019, and 2020. Now, NOLs may be used to fully offset taxable income for the relevant tax years.
 - Another benefit of this new rule is that losses earned during years where the corporate tax rate was 21% may be used to offset income earned during years where the corporate tax rate was 35%.
- **Business Interest Deductibility:** Section 163(j) of the Code disallows deductions for business interest expense in excess of the sum of a taxpayer’s business interest income and a percentage of the adjusted taxable income (“ATI”) of the business, which is generally its taxable income computed without regard to business interest income or expense and NOLs (and excludes depreciation and amortization for tax years before 2022). The CARES Act relaxes this limitation in two ways:
 - First, the limitation is increased from 30% to 50% of ATI for 2019 and 2020 tax years.
 - *Special Rules for Partnerships:* Under the CARES Act, partnerships are generally not eligible for the 50% limitation for a tax year beginning in 2019. However, separate rules apply to partners who are allocated any business interest expense unused at the partnership level. Unless the partner elects out of this treatment, a partner who has excess business interest for a tax year beginning in 2019 allocated to him will be able to deduct 50% of such interest in 2020, while the other 50% may not be used until such partner is allocated excess taxable income or excess interest income.
 - Second, for 2020, the taxpayer may elect to determine its limitation using its ATI from 2019, rather than 2020.

- Real estate operating entities may wish to reconsider the need to elect out of Section 163(j) taking into account this higher limitation and the new shortened life for qualified improvement property.
- **Excess Business Loss Rule:** The CARES Act suspends Section 461(l) of the Code through December 31, 2020. Pursuant to the TCJA, Section 461(l) disallowed the deduction of “excess business loss” by non-corporate taxpayers (such as pass-through businesses) for tax years beginning in 2018 through January 1, 2026. Section 461(l) defines excess business loss as the excess of the taxpayer’s aggregate trade or businesses deductions for the taxable year over the sum of the taxpayer’s aggregate trade or business gross income or gain for the taxable year plus \$250,000 (or 200% of such amount if filing a joint return), which is adjusted for inflation each year. Accordingly, such taxpayers will now be able to deduct excess business losses against other income (such as wages) arising in 2018, 2019, and 2020.
- **Corporate Alternative Minimum Tax (“AMT”):** The CARES Act accelerates the time in which corporations may recover credits previously earned under the corporate AMT regime. The TCJA previously eliminated the AMT for corporations, but allowed credits already earned to be recovered over a certain period of time between 2018 and 2021. Under the CARES Act, taxpayers may recover 100% of such credits for tax year 2019 or may elect to take the credit in 2018.
- **Qualified Improvement Property:** The CARES Act contains a technical correction to the TCJA, allowing immediate expensing for improving facilities related to the hospitality industry. The TCJA allows a 100% depreciation deduction in the first year of use for certain qualified property. However, due to a drafting error, the TCJA had excluded certain improvement property from this 100% deduction, subjecting it to a 39-year depreciable life instead. The CARES Act fixes this error and allows for immediate expensing of such property.
- **Payroll and Self-Employed Tax Deferral:** The CARES Act allows employers to defer their portion of payroll taxes due between the March 27, 2020 and January 1, 2021. Instead, 50% of payroll taxes owed is due on December 31, 2021 and the other 50% is due on December 31, 2022. The CARES Act similarly allows self-employed taxpayers to defer 50% of self-employed taxes, ultimately due in two equal parts to the same postponed dates, on December 31, 2021 and December 31, 2022 (each in the amount of 25% of total taxes due). These deferrals are not available for taxpayers with forgiven indebtedness under certain provisions in the CARES Act and Small Business Act.
- **Corporate Charitable Contributions:** The CARES Act increases the limit on charitable contributions for corporations to 25% of taxable income, from 10%. In addition, the limitation on charitable contributions of food inventory is similarly increased to 25% of taxable income from 15%.

Individual Provisions

- **Retirement Withdrawals:** The CARES Act waives the 10% penalty on early withdrawals of up to \$100,000 for a “coronavirus-related distribution.” The CARES Act defines a coronavirus-related distribution as a distribution from a retirement plan to a taxpayer diagnosed with COVID-19, a taxpayer

with a spouse or dependent diagnosed with COVID-19, or a taxpayer who experiences financial hardship due to quarantine, furlough, reduction in work hours, or having been laid off due to COVID-19 containment measures. Income tax on the withdrawals will be due over a period of three years, beginning the tax year of the withdrawal. Taxpayers can further recontribute withdrawn amounts tax-free, even if yearly contribution limits are already reached.

- **Retirement Minimum Distribution Rules:** The CARES Act waives minimum distribution rules for retirement plans in calendar year 2020. Previously, retirement plan owners who reach age 72 were required to take minimum distributions out of their respective plans.
- **Student Loan Income Exclusion:** The CARES Act excludes from an individual taxpayer's income payments upon student loans made by such taxpayer's employer either to or on behalf of the taxpayer. This provision applies to payments made before January 1, 2021 and up to \$5,250 annually. If the taxpayer takes advantage of this relief, the taxpayer may not deduct the interest expense on the portion of such tax-free loan payments by the employer.
- **Individual Charitable Contributions:** Under the CARES Act, certain charitable contributions of up to \$300 may be deducted above-the-line on a taxpayer's return, regardless of whether the taxpayer itemizes. Donor-advised funds are ineligible for this temporary relief. In addition, for individual taxpayers who itemize, the CARES Act suspends the limit of 50% of adjusted gross income for charitable deductions.

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