Davis Polk

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RUSH SUMMARY
SUBJECT TO UPDATE AND CORRECTION

Congress Passes the CARES Act Fiscal Stimulus Package to Combat the Coronavirus Pandemic's Economic Impact

Introduction

Davis Polk has prepared two memos describing key portions of the bill just signed into law: the Coronavirus Aid, Relief, and Economic Security Act (**CARES Act**). In this memo, we cover tax relief for businesses and individuals. In a **companion memo**, we cover the economic stabilization and small businesses sections of the legislation, including Treasury's financial assistance to states, municipalities and businesses of all sizes affected by the coronavirus pandemic, the Paycheck Protection Program, the new Special Inspector General for Pandemic Recovery and consumer credit, mortgage and evictions protections.

The Senate passed the bill late on Wednesday night, and the House passed it on Friday afternoon. The President signed it shortly afterwards. The Department of the Treasury, the Federal Reserve and other federal agencies now face the mammoth task of carrying out their new responsibilities.

Tax Relief for Businesses

Employee Retention Credit

- The bill grants to certain employers a refundable credit against the employer portion of Social Security taxes equal to 50% of the eligible wages (including health plan expenses) paid by such employers from March 13, 2020 to December 31, 2020, up to a maximum of $10,000 of eligible wages per employee
- The credit is available to an employer for any calendar quarter:
    - during which the employer's operations were fully or partially suspended by a governmental authority due to the coronavirus (COVID-19) crisis; or
    - during the period beginning with the first calendar quarter in 2020 for which the employer's gross receipts declined by more than 50% when compared to the same quarter in 2019 and ending with the 2020 calendar quarter after the quarter for which such employer's gross receipts are in excess of 80% of gross receipts for the same quarter in 2019
- For employers with more than 100 full-time employees during 2019, eligible wages include only wages paid to employees not providing services due to the circumstances described above (i.e., the credit only applies to wages paid during a furlough of the employee)
- For employers with 100 or fewer full-time employees during 2019, eligible wages include all wages paid to employees during the periods described above (regardless of whether the employee is furloughed or actively working in support of the employer's business)
- Employers who take a small business interruption loan, as described in our companion memo, are not eligible for this credit

Delay of Employer Payroll Tax Payments

- The bill allows employers and self-employed individuals to postpone payment of the employer portion of Social Security taxes (or the equivalent portion of self-employment taxes) that they would otherwise be required to pay between the date of enactment and January 1, 2021
- The bill also includes liability protections for employer agents (including certified professional employer organizations)
- The deferred payments are required to be paid in two installments, with 50% of the deferred amount required to be paid by December 31, 2021 and the other 50% by December 31, 2022

Increased Ability for Corporations to Deduct NOLs

- The bill permits corporate net operating losses (NOLs) from 2018, 2019, and 2020 to be carried back five years (under current law, no carryback for NOLs in these years is permitted)
- The bill provides that such NOLs are not taken into account in determining the one-time “repatriation” toll charge under Internal Revenue Code Section 965 if carried back to a year in which such toll charge is determined, by deeming the taxpayer to have made the election under Internal Revenue Code Section 965(n) with respect to such taxable year. The bill also provides an election to exclude any such taxable year from the carryback period
- The bill also (a) for 2020 and prior years, allows corporate NOLs to fully offset income, free of certain taxable income limitations that would otherwise apply, (b) for 2021 and later years, relaxes in certain respects the taxable income limitations on the use of corporate NOLs that would otherwise apply and (c) provides special rules for life insurance companies
- These provisions will permit corporations to utilize their NOLs from 2018, 2019 and 2020 to obtain refunds of taxes paid in prior years (including taxes paid in pre-2018 years at the 35% corporate income tax rate then in effect) and/or to reduce their tax payments in 2020 and later years, and enhance corporate cash flow and liquidity

Increased Ability of Noncorporate Taxpayer to Deduct NOLs

- The bill defers until 2021 the application of certain rules that would limit the ability of noncorporate taxpayers, such as owners of pass-through businesses and sole proprietors, to deduct NOLs from 2018, 2019 and 2020, so that such NOLs are generally subject to the same rules as described above for corporate NOLs
- This will permit noncorporate taxpayers to claim refunds and/or reduce their tax payments in respect of their NOLs, enhancing cash flow and liquidity
- The bill also makes certain technical corrections to the operation of these rules in 2021 and later years

Acceleration of Recovery of AMT Tax Credits

- The 2017 tax reform act repealed the corporate alternative minimum tax (AMT), and allowed corporate taxpayers to recover certain AMT taxes paid prior to repeal as refundable credits against their regular tax liability, but only over four years starting in 2018
- The bill allows corporate taxpayers to recover these AMT tax credits over the years 2018 and 2019, or, at the taxpayer’s election, entirely in 2018

Relaxation of Limits on Business Interest Deductions

- The ability of a taxpayer to deduct business interest expense is subject to a limitation that is generally equal to 30% of its "adjusted taxable income" for the year, the definition of which is currently roughly analogous to EBITDA
- The bill increases the limitation from 30% to 50% of adjusted taxable income for 2019 and 2020, except for taxpayers who elect out of such increase, and provides special rules for partnerships
- The bill also permits a taxpayer to elect to determine its deductible interest expense for 2020 based on its adjusted taxable income for 2019. This will allow a taxpayer whose adjusted taxable income in 2020 has taken a hit as a result of the pandemic to use a more "normalized" amount of adjusted taxable income for purposes of determining its deductible interest expense for 2020
- These provisions are expected to increase many taxpayers' ability to deduct interest in 2019 and 2020

Amendments to 2017 Tax Reform Provisions

- The bill permits taxpayers to immediately write off costs associated with improving their facilities, rather than having to depreciate such improvements over 39 years. The provision is described as a fix to the 2017 tax reform law and is retroactive to the enactment of that law
- The bill does not include amendments in a prior version of the bill relating to (a) refunds of overpayments relating to the one-time "repatriation" toll charge, or (b) the treatment of certain foreign corporations as "controlled foreign corporations"

Tax Relief for Individuals and Families

Recovery Rebates for Individuals

- The bill provides for an immediately refundable credit for 2020 to eligible taxpayers equal to $1,200 (or $2,400 for married taxpayers filing jointly), plus $500 for each child, subject to income limits. The credit is generally phased out for single taxpayers whose income exceeds $99,000 ($136,500 for heads of household and $198,000 for joint filers). Specifically, $5 of the credit is reduced for each $100 that a taxpayer's adjusted gross income exceeds (a) $75,000 in the case of single taxpayers, (b) $112,500 in the case of heads of households and (c) $150,000 in the case of joint filers
- The credit amount will be calculated based on a taxpayer's 2019 tax return (or 2018 tax return if the taxpayer's 2019 tax return has not been filed)
- Treasury is directed to issue "refunds" for such credits "as rapidly as possible"

Special Rules for Use of Retirement Funds

- The bill waives the 10% early withdrawal penalty for certain coronavirus-related distributions, up to $100,000, made during 2020 from an eligible retirement plan
- Any income inclusion attributable to such distributions would be subject to tax only over a three-year period. The amount distributed may be recontributed to an eligible retirement plan within three years after the date of such distribution, without regard to the annual cap on contributions
- The bill also provides flexibility for loans from certain retirement plans for coronavirus-related relief

Temporary Waiver of Required Minimum Distribution Rules for Certain Retirement Plans and Accounts

- The bill includes a temporary waiver of the minimum distribution requirements for 2020 for IRAs and certain employer-provided defined contribution plans, including 401(k) plans, 403(a) plans, 403(b) plans and certain 457(b) plans
- This allows taxpayers who are typically required to drawdown on their benefits under their IRAs and defined contribution plan accounts after age 70-½ (after age 72 for taxpayers who were not 70-½ as of the beginning of this year) to forgo any required drawdown for 2020 and resume the normal annual required drawdowns in 2021, avoiding taking a proportionally large slice of their account this year based on a deflated account value and hampering a recovery in their retirement savings balance

Allowance of Partial Above-the-Line Deduction for Charitable Contributions

- The bill allows for a 2020 tax deduction of $300 for eligible charitable contributions, such as contributions to churches and charities, for taxpayers who do not itemize their deductions

Modification of Limitations on Charitable Contributions During 2020

- The bill modifies the limitations on deductions for charitable cash contributions in 2020 by individuals that itemize their deductions and corporations. For an individual, the normal limit on certain charitable deductions of 50% of adjusted gross income will not apply. For electing corporations, the normal limit on charitable deductions of 10% of taxable income is increased to 25% of taxable income
- The bill also increases the limitation on deductions for contributions of food inventory in the case of C corporations, from 15% of taxable income to 25% of taxable income

Exclusion for Certain Employer Payment of Student Loans

- The bill allows an employer to make payments toward an employee’s student loan expenses on a tax-free basis if such payments are made before January 1, 2021

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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