Tax News Alert

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COVID-19 Update: Senate Passes CARES Act

On March 25, 2020, the United States Senate passed the Coronavirus Aid, Relief, and Economic Security ("CARES") Act, which addresses the economic fallout of the COVID-19 pandemic in the United States. The CARES Act is referred to as "Phase 3" of Congress's COVID-19 response, following the Coronavirus Preparedness and Response Supplemental Appropriates Act and the Families First Coronavirus Response Act ("FFCRA"). The House of Representatives still needs to approve the Senate bill and once the final bill is submitted by Congress, President Trump is expected to sign the CARES ACT into law quickly.

The CARES Act appropriates hundreds of billions of dollars for loan programs and support for the Federal Reserve programs to provide liquidity to the economy. While not the focus, the legislation provides various tax relief to individuals and businesses through rebate checks, payroll tax relief, and the easing of rules on the use of net operating losses and interest deductions, among others.

The below is a summary of the legislation's key elements most relevant to our clients.

Paycheck Protection Program ("PPP") – Loans to Small Businesses

The PPP is an expansion of the existing framework under the Small Business Administration's ("SBA") 7(a) program, which is a partnership between private financial lenders, which issue the loans, and the SBA, which guarantees them.

The PPP provides that small businesses and self-employed taxpayers are eligible (an "Eligible Recipient") for a potentially forgivable loan (a "Covered Loan"). Small businesses are defined as those with less than 500 full-time or part-time employees.

The maximum amount of the Covered Loan is the lesser of:

- $10,000,000, or
- The Eligible Recipient's average monthly payroll costs incurred during the 1-year period before the date on which the loan is made multiplied by 2.5.[1]

[1] This is the rule for Eligible Recipients that have a business which is not a seasonal business and has been in business for longer than one (1) year.

Payroll costs are defined as the sum of any compensation payments (e.g., wages, salary, health benefits including insurance premiums, etc.) with respect to employees and self-employed individuals, except to the extent the amounts are greater than $100,000 of compensation. In effect, it appears this means that any compensation (as defined above) paid to an employee in excess of $100,000 may not be counted at all in calculating the maximum amount of a Covered Loan. The specific dates, periods, calculations of payroll costs, and maximum Covered Loan amounts should be clarified when further guidance is provided. In addition, payroll costs do not include amounts paid for FICA, FUTA, compensation paid to employees who reside outside of the U.S. and for qualified sick and family leave for which a credit is provided under the FFCRA.

In general, an Eligible Recipient only has to make a good faith certification to lenders that the uncertainty of current economic conditions makes the loan request necessary to support its ongoing operations. As of the current draft, an Eligible Recipient does not need to demonstrate a minimum decline in revenue (or other declining economic measurements) to be approved for a Covered Loan. Lenders will determine eligibility based on whether the Eligible Recipient was in operation on February 15, 2020 and had employees to whom it paid salaries and payroll taxes or paid independent contractors.

The Covered Loan will be nonrecourse to the borrower to the extent the covered loan proceeds are used for compensation (as defined above), rent, utilities, mortgage interest, and interest on other debt obligations that were incurred before the covered period.

The interest rate on a Covered Loan cannot be greater than four (4) percent per annum. In addition, the Covered Loan must have an original deferment term of at least six (6) months (including interest, principal and fees) and not more than one (1) year. The term of the loan cannot be more than ten (10) years.

Most importantly, an Eligible Recipient is eligible for forgiveness of the principal on the Covered Loan in an amount equal to certain expenses paid during the “covered period”, which covers the eight (8) week period beginning on the date of the origination of a Covered Loan. The costs of an Eligible Recipient that qualify for loan forgiveness include payroll costs (as defined above), interest paid on a mortgage, rent, and utilities.

The Eligible Recipient is required to submit a forgiveness application to the lender with appropriate documentation verifying the costs incurred are consistent with the Covered Loan forgiveness rules. Any Covered Loan forgiven is not considered cancellation of debt income for the Eligible Recipient and shall be excluded from gross income.

The following are exceptions to the amount of forgiveness of the Covered Loan, even if the costs incurred are consistent with the Covered Loan forgiveness rules:

- The amount forgiven cannot exceed the principal amount,
- If the Eligible Recipient reduces the number of employees, or
- If the Eligible Recipient reduces certain employee compensation more than 25%.

Please keep in mind that further guidance and regulations for the Covered Loan program should be forthcoming which may also provide additional limitations to the available benefits under the PPP and loan forgiveness program.

Economic Injury Disaster Loans – Loans to Small Businesses through Small Business Association (SBA)

The CARES Act expands eligibility for access to Economic Injury Disaster Loans (EIDL) to include any business with fewer than 500 employees, Tribal businesses, cooperatives, and ESOPs with fewer than 500 employees or any individual operating as a sole proprietor or an independent contractor during the covered period (January 31, 2020 to December 31, 2020). Private non-profits are also eligible for both grants and EIDLs.

Some of the expanded provisions include:

- Raising the maximum loan available under the existing SBA Express Loan Program from $350,000 to $1,000,000.
- Requires that for any SBA EIDL loans made in response to COVID-19 before December 31, 2020, the SBA shall waive any personal guarantee on advances and loans below $200,000, the requirement that an applicant needs to have been in business for the one (1) year period before the disaster, and the credit elsewhere requirement.
- Establishes an Emergency Grant to allow an eligible entity who has applied for an EIDL loan due to COVID-19 to request an advance on that loan, of not more than $10,000, which the SBA must distribute within three (3) days.

Tax Provisions – For Individuals

One-Time Rebate Checks

The CARES Act provides for a rebate check of $1,200 (or $2,400 for married filing jointly) for each adult who is not someone’s dependent and $500 for each qualifying child. The amount of the rebate is subject to a phase out beginning at $75,000 of adjusted gross income (“AGI”) (or $150,000 for married filing jointly). The rebate amounts are completely phased out for single filers with AGI of $99,000, head of households with AGI of $136,500, and married filing joint filer with AGI of $198,000.

Charitable Contribution Deduction

The CARES Act provides for the 2020 tax year an above-the-line charitable deduction of $300 for individuals who take the standard deduction. For individuals who itemize deductions, the CARES Act removes the 50% limitation on AGI for charitable cash contributions for tax year 2020. However, contributions to certain private foundations and to donor advised funds do not qualify.

Excess Business Losses/Net Operating Losses (NOL)

The CARES Act provides that the limit on deducting business losses in excess of $250,000 (single) or $500,000 (married filing jointly) is temporarily repealed retroactive to tax year 2018 and not fully taking effect until tax year 2021. In addition, the CARES Act clarifies some technical uncertainties, providing that net operating losses are not considered excess business losses and that business income does not include income from services as an employee (i.e., wages). Non-corporate taxpayers who were subject to the excess business loss limitation in tax year 2018 should consider amending their tax returns to obtain a potential refund.

Retirement Plan Changes

The CARES Act provides taxpayers who have tested positive for COVID-19, spouses or dependents tested positive for COVID-19, or have experienced certain adverse, work-related financial consequences as a result of quarantine, work closures and other circumstances favorable distribution rights from tax-favored retirement accounts. The 10% penalty for early withdrawals is waived for coronavirus related withdrawals of up to $100,000 taken in 2020. In addition, required minimum distributions for individual account plans (but not defined benefit plans) are waived for 2020.

Exclusion for Certain Employer Payment of Student Loans

The CARES Act excludes from income any payment made by an employer before January 1, 2021 (up to $5,250) to an employee (or the employee's student loan lender) for purposes of paying principal or interest on any qualified student loan.

Tax Provisions – For Businesses

Employer Payroll Tax Deferral

The CARES Act provides that employers (and self-employed individuals) can defer paying the employer portion of the social security payroll tax (6.2% of employee salary up to $137,700 for tax year 2020) otherwise due. The deferral period starts when the CARES Act is signed by President Trump and will be effective through December 31, 2020. The deferred amounts of social security tax will be due in two equal installments, half will be due on December 31, 2021 and the remaining half will be due December 31, 2022. Any Eligible Recipient who is forgiven on an amount under a PPP Covered Loan described above is ineligible for the employer payroll tax deferral.

Employer Payroll Tax Credit

The CARES Act provides that certain employers who have been affected by COVID-19 due to a government mandated suspension of operations or that experience a 50% decrease in revenue compared to the same calendar quarter in the prior year are eligible for a refundable credit against the employer portion of the social security payroll tax. For purposes of the payroll tax credit, qualified wages vary depending on whether the employer has more than 100 full-time employees.

- For employers with more than 100 full-time employees, qualified wages will be those wages paid to employees who are not providing services as a result of COVID-19 circumstances stated above.
- For employers with less than 100 full-time employees, all wages paid will qualify for a credit of up to $5,000 credit per quarter per employee (based on wages up to $10,000 per employee).

The payroll tax credit is refundable to the employer to the extent that it exceeds total social security taxes otherwise payable in the quarter. The payroll tax credit is not available to Eligible Recipients who qualify for and receive loan proceeds under a PPP Covered Loan described above.

Net Operating Loss ("NOL") Rule Modification

The CARES Act allows any NOL incurred by a C corporation arising in tax years 2018 through 2020 to be carried back to each of the five (5) taxable years preceding the tax year. Such C corporations with unused NOLs created in 2018 through 2020 and federal tax liability in one or more of the five preceding years may utilize this provision to file an amended return seeking a refund of taxes paid. In addition, an NOL that is carried forward will be able to offset 100% of taxable income in tax year 2021. Beyond 2022, any NOL carryforwards will return to offsetting 80% of taxable income.

Business Interest Expense Limitation Rule Modification

The CARES Act increases the business interest expense limitation to 50% of adjusted taxable income (which is comparable to EBITDA) for tax years 2019 and 2020. For 2019, this provision does not apply to partnerships and instead partners may deduct 50% of their distributive share of the partnership's excess business interest in 2020 without regard to I.R.C. Section 163(j). In addition, affected taxpayers can use 2019 adjusted taxable income for tax year 2020, which should allow the limitation to be calculated on a more normalized tax base before the impact of COVID-19.

Immediate Refund of Carryforward Corporate Alternative Minimum Tax ("AMT") Credits

The CARES Act accelerates the refund of any remaining corporate AMT credits carried forward by a corporation after the corporate AMT was repealed beginning in tax year 2018.

Correction of Bonus Depreciation "Glitch" regarding Qualified Improvement Property

The CARES Act changes retroactively the definition of eligible bonus depreciation property to include qualified improvement property (essentially improvements to the interior of a non-residential building) by changing its recovery period to fifteen (15) years, as was originally intended. Only property with a recovery period of twenty (20) years or less is eligible for bonus depreciation. Taxpayers should consider amending prior year tax returns to take advantage of bonus depreciation for qualified improvement property or wait until further guidance which may permit the automatic filing of Form 3115, *Application for Change in Accounting Method.*

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Contact Information

For more information and a discussion on how this may affect you individually and your business, please contact the FLSV professional with whom you work or any of the below FLSV professionals:

Business Tax Professionals

Alan Frankel
Founding Partner
W: +1 (516) 874-8815
M: +1 (917) 359-4092
alan@flsv.com

Charles Vallone
Founding Partner
W: +1 (516) 874-8825
M: +1 (917) 359-2566
charles@flsv.com

Hyejin Tak
Partner
W: +1 (516) 874-8824
M: +1 (917) 509-5236
hyejin.tak@flsv.com

Iraida Strokovskaya
Partner
W: +1 (516) 874-8830
M: +1 (917) 715-8262
iraida@flsv.com

Adam Fisher
Principal
W: +1 (516) 874-8910
M: +1 (516) 838-0784
adam.fisher@flsv.com

Robert Altieri
Principal
W: +1 (516) 874-8871
M: +1 (724) 516-0864
robert.altieri@flsv.com

Individual Tax Professionals

Seth Starr
Founding Partner
W: +1 (516) 874-8835
M: +1 (917) 359-2749
seth@flsv.com

Patty Bo
Partner
W: +1 (516) 874-8845
M: +1 (917) 693-9129
patty@flsv.com

Erik Gary
Principal
W: +1 (516) 874-8836
M: +1 (917) 763-7395
erik.gary@flsv.com

Gregg Martorella
Principal
W: +1 (516) 874-8840
M: +1 (516) 640-1981
gregg.martorella@flsv.com

Mary Beth Tarter
Principal
W: +1 (561) 770-1490
M: +1 (917) 715-0677
marybeth.tarter@flsv.com

For additional information, including any comments, contact Frankel Loughran Starr & Vallone LLP at (516) 874-8800, 1475 Franklin Avenue, Garden City, New York 11530.