Business Tax Provisions in the CARES Act

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act" or the "Act") to support individuals and businesses affected by COVID-19 pandemic was signed into law on March 27, 2020. This Client Alert summarizes the various tax provisions in the CARES Act. Please note that there may be additional legislation from Congress addressing COVID-19, which could introduce further tax law changes.

For additional Chapman Insights addressing legal and regulatory developments related to the COVID-19 crisis, please visit our COVID-19 Legal and Regulatory Developments webpage.

Interest Disallowance

Taxpayers generally are permitted to deduct interest expense allocable to a trade or business, but generally only to the extent of the sum of the taxpayer's business interest income and 30% of the taxpayer's adjusted taxable income ("ATI") for the year. ATI, which is comparable to EBITDA, generally means the taxable income of the taxpayer computed without regard to (i) business interest income or expense; (ii) income, gains, deductions, or losses not allocable to a trade or business; (iii) NOLs; and (iv) for taxable years beginning before 2022, deductions allowed for depreciation, amortization, or depletion.

In the case of a partnership, the interest expense limitation is applied first at the partnership level. Any net interest expense of the partnership that is disallowed will be allocated to its partners. This disallowed interest expense can only be used by a partner in a subsequent taxable year for which 30% of the partnership's ATI exceeds its net interest expense; for such years, the previously disallowed interest expense can be used to offset the partner's allocable share of the partnership's excess ATI.

Pursuant to the CARES Act, the general ATI limitation on the deductibility of net interest expense described above is increased from 30% to 50% of the taxpayer's ATI for taxable years beginning in 2019 or 2020. Where the relevant taxpayer is a partnership, this increase only applies to taxable years beginning in 2020. With respect to any interest expense disallowed at the partnership level for the taxable year beginning in 2019, however, a partner in such partnership can deduct 50% of such disallowed interest expense in 2020 without regard to the limitations on deduction of business interest (with respect to a partner in a partnership or otherwise), and 50% of such disallowed interest expense will be subject to the general limitations on excess business expense.

Taxpayers can elect out of each of the above rules. In addition, taxpayers can affirmatively elect to calculate their interest expense limitation for taxable years beginning in 2020 using their ATI from the 2019 taxable year. This election, which would permit taxpayers to claim additional interest expense deductions in 2020, would benefit taxpayers whose ATI was lower in 2020 due to the economic downturn caused by the COVID-19 pandemic (although the election is available regardless of the reason for any decline in ATI).

Disallowed Losses

The CARES Act temporarily reinstates certain rules regarding taxpayer losses that were repealed by the Tax Cuts and Jobs Act in 2017:

- The Act allows corporations (other than REITs) to carry back any unused NOLs generated in 2018, 2019, or 2020, to offset income from the five taxable years preceding the relevant loss year.
- The Act removes the 80% cap (initially instituted for taxable years beginning in 2018) on the amount of taxable income that can be offset by NOL deductions, for taxable years beginning in 2018, 2019 and 2020.
- The Act allows noncorporate taxpayers, such as individual owners of pass-through businesses, to fully deduct excess business losses for 2018, 2019 and 2020 (removing the limitation initially imposed for taxable years beginning in 2018).

- In each case, a taxpayer may be required to amend an already-filed tax return in order to claim a refund.

Other Notable Tax Provisions

In addition to the above changes, the CARES Act:

- provides a refundable payroll tax credit equal to 50% of qualified wages and health benefits paid between March 12, 2020, and December 31, 2020, up to a maximum credit of $5,000 per employee, by employers that either (i) had business suspended in 2020 by government orders due to the COVID-19 pandemic, (ii) experienced at least a 50% decline in gross receipts for one or more calendar quarters of 2020 on a year-over-year basis, or (iii) are described in section 501(c)(3) and exempt from taxation under Section 501(a) of the Internal Revenue Code. For employers that have more than 100 full-time employees, this tax credit only applies to wages paid to employees when they were not providing services. Neither governmental entities nor employers who received loans pursuant to the Paycheck Protection Program are eligible for this tax credit.

- allows employers to defer the payment of Social Security payroll taxes for the period beginning after March 26, 2020 and ending on December 31, 2020 until (i) December 31, 2021, with respect to 50% of such taxes, and (ii) December 31, 2022, for the remainder. Employers who received loans pursuant to the Paycheck Protection Program that were forgiven pursuant to the CARES Act are not eligible for this deferral.

- allows corporations to accelerate the recovery of any non-refunded AMT credits to 2018 – previously, such credits did not become fully refundable until 2021 – with tentative refunds to be paid within ninety days of the relevant filing.

- ensures that any loan guaranteed under the Paycheck Protection Program that is forgiven pursuant to the CARES Act will not give rise to cancellation of indebtedness income.

- with limited exceptions, increases to 25% of a corporation's adjusted gross income (from 10%) the limit for deductions for charitable contributions made in cash during calendar year 2020 for tax years beginning after 2019.

- with conforming rules to avoid duplicating the benefits of existing educational assistance programs, allows an employer to contribute up to $5,250 to the repayment of qualified student loans from March 28, 2020 to December 31, 2020 without the payment being included in the employee's gross income.

For More Information

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