

April 1, 2020

Overview of the new CARES Act

On March 27, 2020, the House of Representatives passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The president signed the bill into law the same day.

The CARES Act is phase-three of the economic relief provided in response to the COVID-19 pandemic. This bill promises to make a significant impact on the economy by providing loan forgiveness, supporting small businesses and enhancing unemployment benefits.

The following are highlights of key tax provisions in this bill, along with other provisions aimed at providing economic relief to individuals and businesses.

Individual Tax Relief Provisions

Economic Impact Payment.

The CARES Act includes a stimulus tax payment program starting in April 2020 of \$1,200 (for single filers) and \$2,400 (for joint filers) plus \$500 for each dependent child under age 17. Children who are (or can be) claimed as dependents by their parents are not eligible. This includes college-age children claimed by parents. The amount of the payment is calculated based on your 2019 adjusted gross income, or 2018's tax return if 2019 has not yet been filed. The payment begins to phase out (reduce) once the taxpayer's adjusted gross income reaches \$150,000 for joint filers, \$112,500 for heads of household, and \$75,000 for all other filers. The payment completely phases out for joint filers with 2018 (or 2019, if applicable) adjusted gross income over \$198,000, heads of household over \$136,500, and all other filers over \$99,000.

Since the payment is in the form of a rebate, it will not be subject to income tax. In addition, it's treated as an advance credit against 2020 income, so there will be a "true-up" based on the actual 2020 tax filing. As such, those whose 2020 income is lower than 2018 or 2019 may get an additional rebate. No interest is due, and no repayment is required if excess rebates are issued.

Retirement Plan Changes.

Individuals that receive a "coronavirus-related distribution" during 2020 will not be subject to the 10% penalty on early withdrawals of up to \$100,000 from qualified retirement plans.

- A "coronavirus-related distribution" is one made during the 2020 calendar year to an individual, or spouse of an individual, diagnosed with COVID-19, or to an individual who experiences adverse financial consequences as a result of quarantine, business closure, furlough, layoff, or reduced hours due to the virus.
- These distributions are subject to regular income tax, although the tax may be spread over three years.
- Any "coronavirus-related distribution" may be treated as a non-taxable rollover contribution if the funds are repaid to the plan within three years of the date the distribution was received.

Required minimum distributions (RMDs) for IRAs and defined contribution plans, such as profit sharing and 401(k) plans, are waived for 2020, including the first RMD for individuals that reached age 70½ during 2019. These are waived regardless of whether the taxpayer has been impacted by the pandemic.

If an RMD has already been received during 2020, it may be rolled over or rolled back into the plan within 60 days in order to defer paying taxes on the RMD. (We expect that the IRS may extend the 60-day requirement.)

- *Why this matters?* An RMD is calculated using the balance of an individual retirement account on December 31st of the year prior to the date it must be distributed to a participant. The stock market closed significantly higher on December 31, 2019 than it is today. An RMD calculated based on a December 31, 2019 value could lead to a disproportionate RMD relative to today's account values.
- The limit on loans from a qualified employer plan to a qualified individual is increased from \$50,000 to \$100,000 through December 31, 2020.

Charitable Donations.

- Individuals are allowed an above-the-line deduction of up to \$300 for charitable contributions for tax years beginning in 2020. This is allowed for individuals that do not itemize deductions.
- Individuals that itemize in 2020 may elect a 100% of AGI limitation (rather than 60%) for cash charitable contributions.
- The limit on deductible contributions for C Corporations has been increased from 10% to 25% of taxable income.

(Contributions to supporting organizations or donor advised funds (DAFs) are not eligible for either of the above enhanced deductions.)

Business Tax Relief Provisions

Employee Retention Credit.

The CARES Act provides a refundable payroll tax credit equal to 50% of certain wages paid by “eligible employers” to certain employees during the COVID-19 crisis, with a maximum tax credit of \$5,000 per employee.

- The term "wages" includes health benefits and is capped at the first \$10,000 in wages paid by the employer to an eligible employee after March 12, 2020, and before January 1, 2021. Wages do not include required paid sick leave or required paid family leave under the Families First Coronavirus Act, or wages utilized for the Code Sec. 45S employer credit for paid family and medical leave.
- “Eligible employers” are employers, including non-profits, whose operations have been fully or partially suspended because of a government order limiting commerce, travel, or group meetings. Eligible employers also include those who have experienced a greater than 50% reduction in quarterly receipts, measured on a year-over-year basis. *NOTE: For most employers, this will be the second quarter of 2020 compared to 2019. In addition, eligible employers do not include employers that receive the new Paycheck Protection Program loan.*

- For eligible employers who had an average number of full-time employees in 2019 of 100 or fewer, all employee wages are eligible for the credit, regardless of whether the employee is furloughed.
- For eligible employers who had *more than* 100 full-time employees in 2019, only the wages of employees who are furloughed or face reduced hours as a result of their employers' closure or reduced gross receipts are eligible for the credit. *NOTE: No credit is available with respect to an employee for any period for which the employer is allowed a Work Opportunity Credit with respect to the employee.*
- Eligible employers who pay qualified wages eligible for the employee retention credit may retain an amount of the employment taxes equal to the employee retention credit, rather than depositing these amounts with IRS. *NOTE: Proceed with caution prior to reducing payroll tax deposits. The employee retention credit is not available to employers receiving assistance through the Payroll Protection Program (PPP) loan forgiveness provisions (see below).*
 - If there aren't sufficient employment taxes to cover the employee retention credit, employers can obtain an advance payment of the credits by filing Form 7200, Advance Payment of Employer Credits Due to COVID-19. *NOTE: The IRS released a DRAFT Form 7200 on March 31, 2020. This form is not yet available for filing.*
 - Form 7200 can be used to request advance payments of the employee retention credit along with qualified sick and family leave credits. *NOTE: Form 7200 cannot be used to an advance payment of the credits for sick and family leave for self-employed individuals.*
 - **Form 7200 filing rules**
 - Employers can file the form for advance credits anticipated for a quarter at any time before the end of the month following the quarter in which they paid the qualified wages.
 - If necessary, an employer can file Form 7200 several times during each quarter.
 - Employers should not file the form to request advance credits for any anticipated credit for which they already reduced their deposits.
 - Employers cannot file a corrected Form 7200. If they make an error on Form 7200, the error will be corrected when they file the quarterly payroll tax report for 2020.
 - Form 7200, once available, may be faxed to the IRS for quicker processing.
- The credit is available through December 31, 2020. *NOTE: This credit is not available to employers receiving assistance through the new Paycheck Protection Program's loan forgiveness provisions.*

Payroll Tax Deferral for Employer Portion of Social Security Taxes.

- The Act allows employers and self-employed individuals to defer over two years the payment of the employer's portion of the 6.20% Social Security payroll tax imposed on employee wages paid between the March 27, 2020, and December 31, 2020. As noted, self-employed individuals also qualify for the deferral and should consider reducing their quarterly estimated tax payments. Taxpayers must pay one-half of the deferred amount by December 31, 2021, and the other half by December 31, 2022. *NOTE: This credit is not available to employers receiving assistance through the new Paycheck Protection Program's loan forgiveness provisions.*

Temporary Reinstatement of Net Operating Losses (NOLs) Carryback.

- The 2017 Tax Cut and Jobs Act (TJCA) eliminated NOL carrybacks starting in 2018. The CARES Act now reinstates and expands the NOL provisions by allowing NOLs incurred in 2018, 2019, and 2020 to be carried back five years (to 2013 to 2015) for a refund of previously paid taxes.
- The new Act also temporarily removes the 80% of taxable income limitation on the use of NOLs incurred in those years, so they can once again fully offset taxable income.

Suspension of Excess Business Loss Rule.

- The 2017 TCJA generally limited business losses on individual income tax returns to \$250,000 (unmarried) and \$500,000 (married). For 2018, 2019, and 2020 the excess business loss limitation has been suspended. It appears that affected taxpayers must amend their 2018 return or 2019 returns to claim the higher loss.

Qualified Improvement Property (QIP) Technical Correction.

- The new Act finally corrects a technical error from the 2017 TCJA. Qualified Improvement Property (generally costs associated with improving the interior portion of a non-residential building) is now classified as 15-year depreciable property and is eligible for 100% bonus depreciation. (Under TCJA, this property was required to be depreciated over 39-years.)
- This change is retroactive to 2018 so that 2018 and 2019 returns can be amended to take advantage of the shorter life. An alternative to amending may be to request an automatic change in accounting method on the taxpayer's 2019 or 2020 tax returns.

Other Noteworthy Provisions

Paycheck Protection Program Loan.

- This new SBA loan program allows businesses with fewer than 500 employees to borrow money for a variety of qualified costs related to employee compensation and benefits including (1) payroll costs (2) continuation of health care benefits (3) employee compensation for wages less than \$100,000 per year (4) mortgage interest obligations (5) rent (6) utilities and (7) interest on debt incurred before the covered period.
- The program greatly expands the number of businesses and non-profits that are eligible for SBA loans and raises the maximum amount of the loan to 250% of the average total monthly payroll costs, up to \$10 million, without the need for collateral or personal guarantees.
- The interest rate on these loans may not initially exceed 4% and is payable over 10 years.
- For eligibility purposes, lenders are required to determine whether a business was operational on February 15, 2020 with paid employees or independent contractors.
- All or a portion of the loan may be forgiven (see below), and debt service payments may be deferred for up to one year.
- This new expanded SBA loan is effective from February 15, 2020, through June 30, 2020.
- All current SBA 7(a) lenders are eligible lenders for PPP. The Department of Treasury is tasked with authorizing new lenders.
- Please contact your bank for additional information regarding the loan application process.

Loan Forgiveness.

- Under the new Paycheck Protection Loan Program (see above), borrowers are eligible for loan forgiveness equal to the amount spent by the borrower during the 8-week period after the loan date on the total of (1) rent (2) payroll costs of workers, excluding compensation exceeding \$100,000 per year (3) interest on a mortgage and (4) utility payments. The portion forgiven may not exceed the loan amount and is reduced if salary reductions exceed 25%.
- This program provides an incentive for companies to retain employees. Forgiveness amounts are reduced if there's a reduction in either the number of employees or compensation for lower-paid employees when compared to the prior year.
- Employers may re-hire employees who have already been laid off due to the COVID-19 crisis. Borrowers will not be penalized for a reduced payroll at the beginning of the period provided they re-hire employees who have previously been laid off.
- Forgiveness of the loans will not give rise to cancellation of debt income.
- Other restrictions and limitations apply.

Expanded Unemployment Insurance.

- The Act expands the scope of individuals who are eligible for unemployment benefits and include those who are furloughed or out of work as a direct result of COVID-19, such as the self-employed, independent contractors, and those who have exhausted existing state and federal unemployment benefits.
- Individuals excluded from coverage are those who can telework with pay and those who are receiving paid sick leave or other paid benefits (even if they otherwise satisfy the criteria for unemployment under the new Act).
- The Act provides unemployment benefit assistance to covered individuals who are not otherwise entitled to benefits under existing state or federal law for weeks of unemployment, partial unemployment or inability to work caused by COVID-19 during the period January 27, 2020, through December 31, 2020.
- The Act provides a supplemental payment of \$600 per week over the amounts available for unemployment under state law. The increase applies for unemployment payments made from March 27, 2020, through July 31, 2020 (approximately four months). The additional unemployment compensation is not considered income for the purpose of Medicaid and Children's Health Insurance Program (CHIP).

(Please contact your employment law attorney for more information and guidance regarding expanded unemployment insurance).

BeachFleischman PC • beachfleischman.com

1985 E. River Rd., Suite 201, Tucson, AZ 85718-7176 • 520.321.4600

2201 E. Camelback Rd., Suite 200, Phoenix, AZ 85016-3431 • 602.265.7011