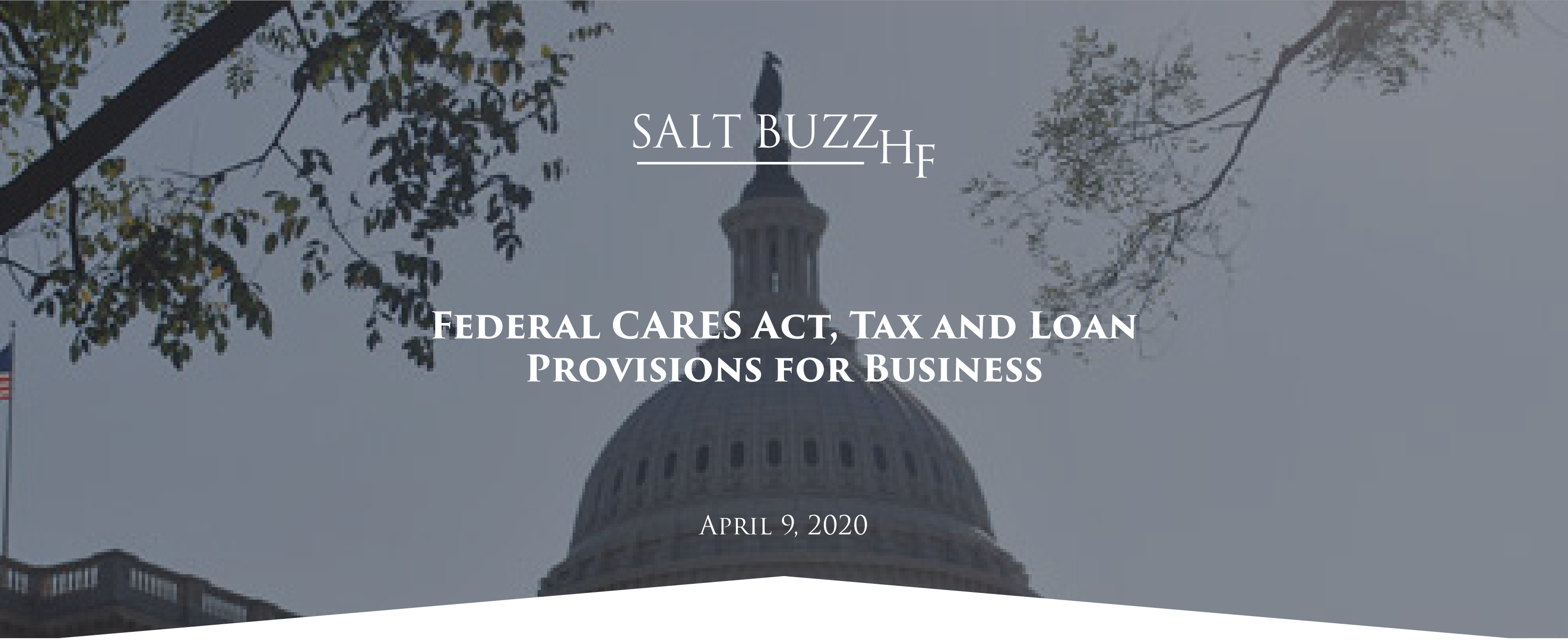

SALT BUZZ HF

Federal CARES Act, Tax and Loan Provisions for Business

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On Friday, March 27, in one of its most successful efforts at acronym-friendly bill naming, the federal government enacted the Coronavirus Aid, Relief, and Economic Security Act, P.L. 116-136, or “CARES Act.” The CARES Act provides roughly $2 trillion in economic relief in response to the COVID-19 coronavirus pandemic. The CARES Act contains provisions meant to help businesses and individuals survive the economic implications of the pandemic in the United States. It contains new business loan provisions, direct aid to individual taxpayers, unemployment insurance assistance to the states, and taxpayer-friendly changes to the Internal Revenue Code (“IRC”), as well as employee benefits provisions and support for the U.S. health care system. This Buzz will focus on the provisions meant to assist businesses by changing the IRC to enable some businesses to realize cash tax benefits, sometimes by amending prior year returns. The business loan provisions are an additional effort to help cash-strapped businesses and are discussed at the end of this Buzz.

Tax Provisions

Congress was feeling charitable and wants you to feel the same.

The CARES Act contains IRC revisions to help both businesses and individuals make charitable contributions in the year 2020. For a C-corporation, the limit on deductible charitable contributions is increased to 25% of the corporation’s taxable income for the year.

Individual taxpayers also receive a break for their personal charitable contributions. For those who itemize their deductions, the percentage of A.G.I. limitation is removed. The limit is now the taxpayer's A.G.I. reduced by the amount of other charitable contributions. For those who do not itemize, the CARES Act creates a new, "above the line" deduction for contributions of up to $300 made in cash.

Hold onto your employees.

In addition to the loan provisions discussed below devoted specifically to the new Payroll Protection Program loan, the CARES Act has two provisions specifically designed to help businesses retain their employees through the period of severely reduced cash flow that they may be experiencing.

T**he Employee Retention Credit** applies only to businesses that find themselves in one of two categories:

A Their operations have been fully or partially suspended during the calendar quarter due to orders from an appropriate governmental authority limiting certain activities due to COVID-19; or

B They experience a decline in quarterly gross receipts of 50% or more compared with what they experienced in the prior calendar year. The qualifying period will end when the gross receipts level returns to 80% of what it was in the same calendar quarter in the prior year.

Non-profits may also qualify, if they fall under category (A). This credit is taken against employment taxes and equals 50% of the amount paid to an employee during a quarter in which the business qualifies for the credit, up to a maximum of $10,000 in wages per employee for all quarters combined. The credit, therefore, maxes out at $5,000 per employee. If the amount of the credit calculated exceeds the amount of employment taxes paid by the business, the excess is treated as an overpayment and is refunded to the business. For businesses with more than 100 employees, there is a limitation in qualifying wages to those employees who are being paid but not working during the qualifying period. A further limitation is that wages only qualify up to the amount an employee would have been paid for working an equivalent duration during the 30 days immediately preceding the qualifying period. In other words, the government will not subsidize temporary pay raises for non-working employees.

Qualified health plan expenses that are properly allocable to the qualifying wages but are excluded from employees' gross income may also be included in the calculation of wages subject to the credit.

If the business obtains a Payroll Protection Program (PPP) loan (as discussed below), the business cannot claim this credit.

The Delay of Payment of Employer Payroll Taxes allows deferral of the employer's portion of employment taxes due under IRC 3111(a) or under 3211(a) or 3221(a) to the extent attributable to the rate in effect under 3111(a) (in other words, the 6.2% OASDI or RRTA tax), or for 50% of self-employment taxes otherwise due under IRC 1401(a). The deferral period begins on March 27, 2020 (the date of enactment) and ends on December 31, 2020. One half of the taxes deferred will be due on December 31, 2021, and the other half will be due on

December 31, 2022. Individuals making estimated tax payments for their self-employment-taxes will not have to make these estimated payments for the 50% of these taxes they are allowed to defer.

There is an important limitation on the deferral provisions with regard to the loan forgiveness provisions found in Sections 1106 and 1109 of the CARES Act, as discussed more below. If a taxpayer has had indebtedness forgiven under either of these sections (and loan forgiveness also relates to using the loaned money for payroll, although certain other expenses qualify too), the taxpayer is not allowed to use the Payroll Tax deferral provisions. Thus, a taxpayer who wants to take advantage of some of the CARES Act generosity to help keep its employees paid must decide whether to pursue a loan (if eligible) in expectation of loan forgiveness, or to utilize the payroll tax delay, if eligible. From a practical perspective, it may be impossible to know whether the payroll tax deferral will apply to a business, since the business may not know whether its loan under PPP was forgiven or not, at the time the payroll taxes would normally be due.

It's easier to realize the tax savings of Net Operating Losses (NOLs)

The CARES Act modifies the NOL provisions of IRC 172 by removing the limitation to 80% of taxable income for use of a current year NOL. Additionally, NOLs generated in tax years beginning after Dec. 31, 2018 and before Jan. 1, 2021 may now be carried back for up to five years. This means tax savings may be available by amending previously filed returns.

Excess Loss Limitation on non-corporate taxpayers temporarily repealed

The CARES Act temporarily repeals IRC 461(l), which disallowed the deduction of excess business losses by noncorporate taxpayers for years beginning after Dec. 31, 2017 and before Jan. 1, 2026. An "excess business loss" is when the business' deductions exceed the business' gross income or gain by more than $250,000. With the passage of the CARES Act, a taxpayer may deduct excess business losses arising in 2018, 2019, or 2020.

Corporate Minimum Tax Credit accelerated

The CARES Act amends IRC 53 to accelerate AMT credit refunds to corporations.

Section 163(j) Limitation on Business Interest is temporarily raised

The CARES Act raises the limitation on the deductibility of business interest in a single year from 30% to 50% of adjusted income. This increase in allowable interest is applicable only to tax years beginning in 2019 and 2020. The provisions apply to both corporations and partnerships. Corporations may elect out of this provision, while partnerships may only elect out for their 2020 tax year. If an excess business interest expense is allocated to a partner in a partnership during 2019, that partner may treat 50% of this excess expense as fully deductible in 2020. The remaining 50% is subject to the normal IRC 163(j) rules and is only deductible in a future year in which the partner has excess taxable income or excess business interest income passed through to the partner. One additional benefit the CARES Act has provided is that a corporate or partnership taxpayer may elect to use the limitation computed on 2019 income for taxable year 2020 as well. Presumably, income is higher in 2019 because businesses were not yet impacted by the COVID-19 pandemic.

An Improvement to the Provision on Qualified Improvement Property

A drafting error in the TCJA of 2017 removed a taxpayer's ability to take 100% bonus depreciation on "qualified improvement property," which includes qualified leasehold improvements, restaurant property and retail improvement property. Instead of the intended 15-year recovery period for qualified improvement property, which would have also allowed 100% bonus depreciation, these types of property were given a 39-year recovery period and were not allowed to be expensed in the year placed in service. The CARES Act corrects this error, making it subject to bonus depreciation, and giving it a 20-year class life for the Alternative Depreciation System. This provision is effective for property placed in service after December 31, 2017, so there maybe opportunities for cash tax savings via an amended 2018 return.

Loan Provisions

Paycheck Protection Program ("PPP") provides loans, in many cases forgivable

The CARES Act sets up a new loan program for businesses with up to 500 employees (generally) and the PPP is available to non-profits, self-employed persons, and independent contractors. There are complex affiliation rules that should be consulted regarding whether a business is considered to have more than 500 employees when the common ownership of multiple businesses is taken into account; however, the law and regulations specify that the affiliated group limitation regarding how to count to 501 employees will be waived for "any business concern with not more than 500 employees that, as of the date on which the covered loan is disbursed, is assigned a North American Industry Classification System code beginning with 72." Those NAICS codes relate generally to the food industry and hospitality industry. There is also an exception to the affiliation testing for 500 employees for "any business concern operating as a franchise that is assigned a franchise identifier code by the Administration" and for "any business concern that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958."

The PPP loans max out at $10 million but may be limited to a much smaller size based on the formula used to calculate the loan amount: the formula is 2.5 times the average monthly payroll costs during the prior 12 months (the law states the 1-year period beginning before the loan is originated). For individual employees earning more than $100,000 in the 12-month period, only $100,000 (for the year) may be included in arriving at the monthly average. Payroll costs, for the purpose of the calculation, include not only salaries or wages but commissions, tips, and benefits such as health insurance premiums and retirement benefits, as well as state and local taxes assessed on compensation of employees. Excluded from the calculation of "payroll costs" for determining the loan amount are any payments to foreign employees, and the payment of the employer's share of federal payroll taxes.

For a sole proprietor or independent contractor, qualifying payroll costs are generally wage, commissions, income, or net earnings from self-employment or similar compensation. The law and regulations regarding what "payroll costs" means for a self-employed applicant for calculating a PPP loan amount are somewhat circular, making it unclear which entity (the payor of an amount or the payee of an amount) the federal government intended to be permitted to use as an amount that was paid for purposes of calculating the maximum loan available under PPP. The law says that "payroll costs" includes "the sum of payments of compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment, or similar compensation * * *." The regulation, however, implies that, since a self-employed individual can get a PPP loan itself, that the payor to that self-employed individual may not count that payment as "payroll costs" for the payor's PPP loan computation. But what if a sole proprietor itself has payments to an independent contractor? Presumably, future regulations will provide guidance on this issue to prevent a double counting of the same amount.

The PPP loans, which have a maturity of two years, may be used to cover: payroll costs including benefits, interest on mortgage obligations, rent, and utilities. All these obligations must relate to agreements or services in place prior to February 15, 2020. The duration of the PPP loan is up to two years, with an interest rate of 1%. A total of $350 billion is being made available, guaranteed by the federal government. Therefore, although financial institutions handle the application process, these institutions bear no risk for the loans. The regulations state that these loans will be "first come first served."

The most striking and beneficial feature of the PPP loans is that they are intended to be forgiven if the proceeds are used for the intended purpose of keeping employees on the payroll of the borrower during the 8-week period after the loan. For a loan to be forgiven, the business must be able to document that the amount of the loan was used for the allowable expenses as discussed in the previous paragraph over the 8-week period beginning with the loan origination. The regulations also explain that, of the amount spent in that 8-week period, not more than 25% may be used on non-payroll expenses, for purposes of the loan forgiveness option. Also, the potentially forgivable amount of the loan may also potentially be reduced (meaning that it may not be forgivable, at least in part) if the recipient of the loan decreases its net number of full-time equivalent employees or if it decreases the salaries and wages by more than 25% for any employee that made less than $100,000. However, if those reductions are reversed, on or before June 30, 2020, the potential reduction in the forgivable amount mentioned above can be avoided. The policy appears to be that as long as the FTE and salary that were reduced during the pandemic period (which this test treats as commencing on February 15, 2020) are restored by June 30, 2020, the tests for potentially reducing the forgivable amount are ignored, and the amounts that would be forgiven can be forgiven without regard to a temporary reduction in FTE or salary.

If you would like to further discuss the tolling issue or any other state and local tax matter, please contact Tom Zaino, Steve Hall, Derek Heyman or one of our other ZHF professionals.

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