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Summary of Major Provisions of the Senate Passed Coronavirus Aid Relief and Economic Security Act

We've provided much information regarding the Senate's Coronavirus Stimulus Legislation in the past several days and now that is has finally passed the Senate and is on its way to the House of Representatives and then the President, we are providing another summary of the final bill with highlights to the main new provisions.

1. **"2020 recovery rebate for individuals:** The government will immediately begin cutting checks directly to individual taxpayers, putting nearly $507 billion in cash into the hands of most adult Americans, and ideally, right back into the struggling economy. The CARES Act does this via the tax law by adding new Section 6428 to the Internal Revenue Code, but the final version of the bill has some subtle, and not so subtle, changes from the proposal we examined on Friday. All things considered, however, the final stimulus package is much more generous and simple to compute. Here's how it will work:

   The payments will either be based on a 2019 tax return if filed or a 2018 return. If there is no return for either year the IRS will determine your check amount based on your Form SSA-1099,

   Once the IRS has either your 2019 return, 2018 return, or Social Security statement, the IRS will issue a check or direct deposit for $1,200 (if single/$2,400 if married filing jointly) PLUS $500 for each child under the age of 17. Unlike the initial version of the bill, the payment is in no way limited to your tax liability or dependent on you having earned a minimum amount of "qualifying income."

   Example. A is a single taxpayer. On A's 2019 tax return, A had gross income of $50,000 and an income tax liability of $1,000. Despite the fact that A's tax liability for 2019 A was only $1,000, A is entitled to receive a check for $1,200.

   Example. B is a single taxpayer who has not yet filed a 2019 return. In 2018, he had income of $10,000. As a result, he did not file a tax return because his income was less than the $12,000 standard deduction. The IRS will access B's Social Security statement for 2018, and issue a check to B for $1,200.

   Example. H & W are married with three children. On their 2019 tax return, they reported taxable income of $60,000 and had a tax liability of $5,000 before withholding and credits fully eliminated the liability and gave rise to a $3,000 refund. Nevertheless, H & W will receive a check for $3,900 from the government as part of the 2020 stimulus payment.

For those who do not have a valid social security number or those who are claimed as a dependent on another person's return, those individuals will not receive a check. yourself, your spouse and any qualifying children on your tax returns, and those who are claimed as a dependent on another's tax return also won't be receiving a payment.

For those on the higher end of the income scale will be shut out of the program because the payment phases out once your "adjusted gross income (AGI)" — think: total income minus a handful of deductions — exceeds $75,000 (if single, $150,000 if married). Once over those thresholds, you'll lose $5 of your payment for every $100 your AGI exceeds those thresholds. Therefore:

If you are single with no kids and would be due a payment of $1,200, it will be wiped out completely if your AGI exceeded $99,000 (($99,000 - $75,000) * 5% = $1,200).

If you are married with no kids and are due a payment of $2,400, it will be gone if your AGI exceeded $198,000 (($198,000-$150,000)*5% = $2,400).

Taxpayers with dependents have a higher phaseout amount. For example, a married couple with two children who is eligible for the maximum payment of $3,400 wouldn't lose all of their payment until AGI exceeded $218,000.

The payments will be made between now and December 31, 2020 — in many cases, it will be paid electronically if you have provided direct deposit information to the IRS on your 2018 or 2019 tax returns — but it's important to understand that any payment you receive acts as an advance payment of a credit you will compute AGAIN on your 2020 tax return.

That means that when 2021 rolls around and you prepare your 2020 tax return, you'll have to recompute the amount you're owed based on 2020 data and compute the payment owed to you based on 2020 data, and compare it to the advance payment you actually received. If the advance payment was less than what you are owed in 2020— for example, you were phased out in 2019 but not 2020 or you had another child — the excess will be treated as a credit that reduces your 2020 tax liability.

At this time, it is not known what will occur If the advance payment is GREATER than what an individual is owed on their 2020 tax return. The CARES Act does not explicitly require income recognition for any excess, as was required by its counterpart in the House. Nor is there a mechanism for a taxpayer to repay any excess advance payment. Thus it is entirely possible a taxpayer could, for example, receive an advance payment in 2020 based on 2019 or 2018 income, only to find themselves ABOVE the phase out threshold in 2020, giving rise to no credit on the 2020 return, and yet still not have to repay the excess amount to the IRS.

2. Small Business Loans

The CARES Act provides that businesses with fewer than 500 employees — including sole proprietors and nonprofits— will have access to nearly $350 billion in loans under Section 7 of the Small Business Act during the "covered period," which runs from February 15, 2020 through June 30, 2020.

The loans, which are referred to as **“paycheck protection loans**” and are fully guaranteed by the federal government through December 31, 2020 (returning to an 85% guarantee for loans greater than $150,000 after that date), are generally limited to the LESSER OF:

a. the average total “payroll costs” for the 1-year period ending on the date the loan was made (an alternative calculation is available for seasonal employers) multiplied by 2.5,
b. $10 million.

c. Payroll costs, in turn, **are the sum** of the following:
   1. wages, commissions, salary, or similar compensation to an employee or independent contractor,
   2. payment of a cash tip or equivalent,
   3. payment for vacation, parental, family, medical or sick leave,
   4. allowance for dismissal or separation,
   5. payment for group health care benefits, including premiums,
   6. payment of any retirement benefits, and
   7. payment of state or local tax assessed on the compensation of employees,

d. Payroll costs **do not** include, however:
   1. The compensation of any individual employee in excess of an annual salary of $100,000, payroll taxes,
   2. any compensation of an employee whose principal place of residence is outside the U.S., or
   3. any qualified sick leave or family medical leave for which a credit is allowed under the new Coronavirus Relief Act passed last week.

   Example. ABC Co. applies for a paycheck protection loan on May 1, 2020. The business had $1 million in payroll costs for the period May 1, 2019 through May 1, 2020. ABC Co. is entitled to a fully guaranteed federal loan —assuming it’s made before December 31, 2020 — equal to the LESSER OF:

   - $2.5 million ($1 million of payroll costs * 2.5), or
   - $10 million.

   The loans will have a maximum maturity of 10 years and an interest rate not to exceed 4%. **Proceeds may be used** to cover:

   - payroll,
   - mortgage payments,
   - rent,
   - utilities, and
   - any other debt service requirements.

   The standard fees imposed under Section 7 of the Small Business Act are waived, and no personal guarantee is required by the business owner.

An additional provision in the CARES Act provides for possible deferment of repayment of the loans for a period of at least six months, but not to exceed a year.

3. Loan Forgiveness of Paycheck Protection Loans

A separate section of the CARES Act calls for a portion of the aforementioned paycheck protection **loans to be forgiven on a tax-free basis.**

The amount to be forgiven is the sum of the following payments made by the borrower during the 8-week period beginning on the date of the loan:

a. payroll costs (as defined above)
b. mortgage interest,
c. rent,
d. certain utility payments.

To seek forgiveness, a borrower must submit to the lender an application that includes documentation verifying the number of employees and pay rates, and cancelled checks showing mortgage, rent, or utility payments.

Example. Continuing the previous example with ABC Co., in the first 8 weeks after the business borrows the $2.5 million, the business pays $250,000 in payroll costs, mortgage interest, and utility payments. ABC Co. is eligible to have $250,000 of the $2.5 million loan forgiven. The forgiveness will not create taxable income. In addition, because of the deferment rules in the CARES Act, any payments due on the $2.25 million of remaining loan will not be due for six months.

There is a provision, however, that reduces the amount that may be forgiven if the employer either:

a. Reduces its workforce during the 8-week covered period when compared to other periods in either 2019 or 2020, or
b. Reduces the salary or wages paid to an employee who had earned more than $100,000 in annualized salary by more than 25% during the covered period.

This reduction can be avoided, however, if the employer rehires or increases the employee's pay within an allotted time period.

4. Emergency Government Disaster Loan

The CARES Act also expands access to **Economic Injury Disaster Loans under Section 7(b) of the Small Business Act** to include not only businesses with fewer than 500 employees, but also sole proprietors and ESOPs.

For any loan made under this program before December 31, 2020, no personal guarantee will be required on loans below $200,000. Even better, under Section 1112 of the Act, the government will pay the principal and interest on a paycheck protection loan for the first six months for which payments are due. This government subsidy does NOT apply to the paycheck protection loans discussed above.

In addition, the Act creates a new Emergency Grant to allow a business that has applied for a disaster loan to get an immediate advance of up to $10,000. The advance can be used to maintain payroll, and is not required to be repaid, even if the borrower's request for a 7(b) loan is denied.

5. Tax Provisions in the CARES Act

Qualified Improvement Property Fix

As part of the 2017 Tax Cuts and Jobs Act, Congress intended to (greatly) speed up the depreciation on "qualified improvement property" (QIP); generally defined as any improvement made to the interior portion of a nonresidential building any time after the building was placed in service. The depreciable life of QIP was to be reduced from 39 to 15 years, and with 100% bonus depreciation being available for all assets with a life of 20 years or less, a taxpayer who, say, spent $3 million in 2018 renovating their chain of restaurants should have been entitled to an immediate $3 million tax deduction.

Congress inadvertently forgot to give QIP a 15-year life. As a result, the life remained 39 years, and thus the property was not eligible for 100% bonus depreciation. As a result, that taxpayers had to depreciate expenses over 15 years.

The CARES Act provides a much-needed technical correction to the QIP problem by giving it its intended 15-year life, while making the change retroactive to January 1, 2018. Thus, taxpayers should be entitled to file amended returns to reap the benefits of accelerated depreciation in 2018 and 2019

Example. Assume a client claimed only $75,000 of depreciation related to the $3 million of improvements made to their fast-food chain in 2018. Client may file an amended return to take an additional deduction of $2.925 million in 2018, and under rules discussed below, any net operating loss generated by the additional depreciation may be carried back for up to five years to recover taxes previously paid.

Special Rules for Using Retirement Funds for Coronavirus Costs

If you take money out of a qualified retirement plan before age 59 1/2, you not only pay income tax on the distribution, but Section 72(t) generally imposes a 10% penalty as well. There are several exceptions to the penalty, of course, and the CARES Act adds a new one, allowing a taxpayer to take a "coronavirus-related distribution" of up to $100,000 in the year 2020 free from penalty.

A "coronavirus-related distribution" is a distribution made during 2020:

a. To an individual who is diagnosed with SRS-COV-2 or COVID-19 by a test approved by the CDC,
b. whose spouse or dependent is diagnosed with one of the two diseases, or
c. who experiences adverse financial consequences as a result of being quarantined, furloughed or laid off or having work hours reduced, or being unable to work due to lack of child care.

While the distribution escapes the 10% penalty, it doesn't escape the income tax. The Act, however, allows the taxpayer to spread the income over a 3-year period beginning with 2020. The taxpayer also has the choice to avoid any income recognition by repaying the distribution to the retirement plan within three years of receiving it.

In addition, the amount an individual may borrow from his or her retirement plan is increased from $50,000 to $100,000 for the 180-day period beginning after the enactment of the Act.

For those required to withdraw a "required minimum distribution" from their retirement plan in 2020, the CARES Act temporary waives the requirement for this year only.

Changes to Charitable Contributions

Charitable contributions are itemized deductions; when combined with items like mortgage interest, real estate taxes and medical expenses, if the sum of itemized deductions exceeds the "standard deduction" — $12,400 for a single taxpayer; $24,800 for married filing jointly in 2019 — the taxpayer gets a benefit from charitable contributions. If they don't, they don't.

The TCJA nearly doubled the standard deduction, while at the same time, limited or eliminated many itemized deductions. As a result, in 2018 only 8% of taxpayers itemized. To accommodate for this new reality, the CARES Act allows an individual to make a cash contribution of up to $300 made to certain qualifying charities and deduct the contribution "above-the-line" in computing adjusted gross income. Thus, the taxpayer receives the deduction in addition to the standard deduction. This above-the-line deduction is here for 2020 and beyond, but is available only to a taxpayer who does not itemize their deductions.

Example. A does not itemize his deductions, but makes a $250 cash payment to a public charity in 2020. A may claim the $250 deduction in computing his adjusted gross income. The deduction is in addition to A's standard deduction.

Example. B itemizes her deductions and makes a $250 cash payment to a public charity. B may deduct the payment as a charitable contribution on her Schedule A as an itemized deduction, but may not claim the deduction as an above-the-line deduction.

For those who DO itemize, the new law temporarily lifts the limits on charitable giving for 2020. After passage of the TCJA, cash contributions to public charities are generally limited to 60% of a taxpayer's adjusted gross income (AGI). The CARES Act allows such contributions to be deducted up to 100% of AGI for 2020, with any excess contributions available to be carried over to the next five years. For corporate donors, the limit would increase from 10% of adjusted taxable income to 25%.

Exclusion from Income of Employer Payment of Employee Student Loan Debt

As a general rule, if someone pays a debt on your behalf, you have taxable income. As part of the CARES Act, an employer can pay up to $5,250 in 2020 of an employee's student loan obligation on a tax-free basis. Note, however, that this provision modifies existing Section 127, which permits an employer to pay up to $5,250 of an employee's qualified educational expenses.

This is now a combined limit; thus, an employer could pay $3,000 towards an employee's degree and another $4,000 of the same employee's student loan payments in 2020, but the maximum amount that will be tax-free to the employee is $5,250.

To the extent an employee's student loan is paid on a tax-free basis under new Section 127 by his or her employer, the employee cannot deduct the interest on the student loan under Section 221.

Employee Retention Credit

New to the final version of the CARES Act is a one-year only credit against the employer's 6.2% share of Social Security payroll taxes for any business that is forced to suspend or close its operations due to COVID-19, but that continues to pay its employees during the shut-down.

A business is eligible for the credit in one of two ways:

1. The operation of the business was fully or partially suspended during any calendar quarter during 2020 due to orders from an appropriate government authority resulting from COVID-19, or

2. The business remained open, but during any quarter in 2020, gross receipts for that quarter were less than 50% of what they were for the same quarter in 2019. The business will then be entitled to a credit for each quarter, until the business has a quarter where it's recovered sufficiently that its receipts exceed 80% of what they were for the same quarter in the previous year.

For each eligible quarter, the business will receive a credit against its 6.2% share of Social Security payroll taxes equal to 50% of the "qualified wages" paid to EACH employee for that quarter, ending on December 31, 2020.

The business's qualified wages depend on its size; if there were more than 100 employees during 2019, the qualified wages are limited ONLY to those wages that were paid by the employer during the quarter for the period of time the business was shut down.

If there were less than 100 employees for 2019, however, qualified wages include not only those paid to employees during a shut-down, but also wages paid for each quarter that the business has suffered a sharp decline in year-over-year receipts, as described in #2 above.

In both cases, qualified wages include any "qualified health plan expenses" allocable to the wages, such as amounts paid to maintain a group health plan. In either case, however, the amount of qualified wages for EACH employee for ALL quarters may not exceed $10,000.

Any wages taken into account in determining the new payroll tax credit for family medical leave or sick leave as part of the Coronavirus Relief Act may not be taken into account in determining qualified wages for the employee retention credit.

The credit is refundable if it exceeds the business's liability for payroll taxes, a likely outcome given the two new payroll tax credits mentioned immediately above that were created as part of the Coronavirus Relief Act late last week.

If an employer takes out a payroll protection loan under Section 7(a) of the Small Business Act as detailed above in this article, no employee retention credit will be available.

Delay of Payment of Employer Payroll Tax and Self-Employment Tax

In addition to the various new payroll tax credits created by the Coronavirus Relief Act and the CARES Act, the new law would again seek to alleviate the burden on employers struggling to make payroll by allowing the employer's share of the 6.2% Social Security tax that would otherwise be due from the date of enactment through December 31, 2020, to be paid on December 31, 2021 (50%) and December 31, 2022 (50%).

Similarly, a self-employed taxpayer can defer paying 50% of his or her self-employment tax that would be due from the date of enactment through the end of 2020 until the end of 2021 (25%) and 2022 (25%).

This means an employer that incurs its 6.2% share of Social Security tax in 2020 may 1) defer payment of that tax until 2021 and 2020, but 2) receive an immediate credit against those yet-to-be paid payroll taxes via the sum of the emergency medical leave credit, sick leave credit, and new employee retention credit.

DETAILS of how this will be administered have NOT been provided yet in practice on 2020 income and payroll tax filings.

Also note, this deferral is not available to any business that takes out a payroll protection loan forgiven as discussed earlier in this article.

Changes to the Net Operating Loss Rules

Prior to 2018, net operating losses of a business or individual could be carried back two years and forward 20, and when carried forward, they could offset 100% of taxable income. The TCJA altered these rules, disallowing all carrybacks related to post-2017 losses, providing for an indefinite carryforward period, and limiting the use of post-2017 losses when carried forward to 80% of taxable income.

Congress temporarily reversed the TCJA changes:

a. Losses from 2018, 2019 and 2020, will be permitted to be carried back for up to five years. As was previously the case, a taxpayer will be permitted to forgo the carryback, and instead carry the loss forward.

b. Losses carried TO 2019 and 2020 will be permitted to offset 100% of taxable income, as opposed to 80% under the TCJA.

    Example. In 2015 and 2016, X Co. broke even. In 2017, X Co. reported taxable income of $1 million and paid federal income tax of $350,000. In 2018, X Co. reported taxable income of $2 million and paid tax of $420,000. In 2020, X Co. recognizes a net operating loss of $3 million. X Co. may carry $1 million of the loss back to 2017 and recover the taxes paid (subject to the alternative minimum tax), and then carry the remaining $2 million loss to 2018 and recover that $420,000 as well.

    Temporary (and Retroactive) Removal of Section 461(l):

    As part of the TCJA, Congress added a fourth (yes, fourth) limitation on an individual's ability to use losses from a business. New Section 461(l) provides that the amount of "net business loss" an individual may use in a year to offset other sources of income is capped at $250,000 (if single; $500,000 if married filing jointly). Any excess loss is converted into a net operating loss, which as we discussed above, was — prior to the passage of the CARES Act — subject to more stringent utilization rules than prior to the TCJA.

The latest legislation, however, puts a temporary halt on Section 461(l); not only for 2020, but retroactive to January 1, 2018. As a result, taxpayer who found a loss limited by the provision in 2018 or 2019 can file an amended return to claim a refund.

The CARES Act clarifies that when the provision is reinstituted for 2020 and beyond, wages will NOT be considered business income. This will, in many cases, result in significantly more loss being limited.

Changes to the Interest Limitation Rules

The CARE Act reverses 3 items of the TCJA

1. the NOL changes,
2. Section 461(l), and
3. Section 163(j) — and the CARES Act largely reverses all three.

With respect to the final change, as part of the TCJA, new Section 163(j) limited a business's ability to deduct its interest expense to 30% of "adjusted taxable income," with any excess interest expense carried forward. The CARES Act would increase that limit to 50% of adjusted taxable income for 2019 and 2020, and perhaps more importantly given that most businesses will not HAVE taxable income in 2020, the business can elect to use its 2019 adjusted taxable income in computing its 2020 limitation. Thus, if a business had ATI of $10 million in 2019 but a negative ATI in 2020, it could elect to deduct $5 million of interest expense in 2020 (50% of $10 million), generate a bigger loss, and then use the favorable new net operating loss provisions to carry back the loss to 2019 and recover taxes paid in that year.

A partnership does not get to use the 50% limit of ATI for 2019. Instead, any interest disallowed at the partnership level is passed out to the partners, and is suspended at the partner level under the normal rules. In 2020, however, 50% of the suspended interest "frees up," and will be fully deductible, while the other 50% will remain suspended until the partnership allocates excess taxable income or excess interest income to the partner (or the partnership is no longer subject to Section 163(j).