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ALERT

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CARES Act – Key Tax Provisions

By: Robert M. Finkel

The CARES Act contains several provisions intended to provide individuals and businesses income tax relief. Business provisions include several that roll back restrictions on the use of operating losses enacted as part of the 2017 Tax Act; and others that provide credits against payroll taxes, and defer payment of payroll taxes. Individual provisions include a $1,200 recovery rebates available for some taxpayers; a relaxation of limitations on deductions for charitable contributions and a relaxation on mandatory distributions from defined contribution retirement plans.

BUSINESS TAX PROVISIONS

Employee Retention Credit. A tax credit is available for eligible employers (including tax-exempt organizations) whose businesses contract or shutter due to the economic downturn related to COVID-19. Eligible employers may claim a refundable payroll tax credit of up to 50% of qualified wages paid. For Eligible employers with more than 100 full-time employees, qualified wages are wages paid to employees who are not providing services because the business has fully or partially suspended operations due to a governmental entity limiting travel or meetings; or gross receipts have declined, generally, by more than 50% relative to the same quarter in the prior year. For Eligible employers with 100 or fewer full-time employees, all employee wages qualify for the credit

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The credit is provided for the first $10,000 of compensation paid, including health benefits, to an eligible employee in the quarter, for wages paid from March 13th through December 31st. It is limited to employment taxes on wages paid, reduced by certain other payroll credits including those enacted by the Families First Coronavirus Response Act, which passed earlier this month. Employers that receive a CARES Act loan are not eligible for the employee retention credit.

Deferral of Employer Payroll Taxes. The CARES Act permits an employer to defer the employer share of Social Security taxes due in 2020. The deferred tax can be paid over the following two years, half by December 31, 2021 and the balance by December 31, 2022. The payroll taxes subject to deferral are those incurred during the period beginning on the CARES Act's date of enactment and ending before January 1, 2021. A similar rule applies to the 50% self-employment taxes owed by a self-employed individual.

Qualified Plan Funding. The CARES Act delays minimum funding contributions for qualified plans, including quarterly contributions until 1-1-21

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Rollback of Tax Cuts and Jobs Act of 2017 Rules on NOLS. The Tax Cuts and Jobs Act of 2017 contained provisions that limited taxpayers' use of current year losses or prior year credits. The TCJA limited taxpayers' ability to carry back NOLs and limited the use of carry forwards to 80%. The CARES Act permits a 5-year carryback of NOLs arising in tax years 2018, 2019, and 2020; and temporarily removes the 80% of taxable income limitation.

Rollback of Tax Cuts and Jobs Act of 2017 Rules Limiting the Use of Business Losses. The TCJA limited the use by individuals of excess business losses to offset unrelated income beginning in 2018. The CARES Act reinstates taxpayers' ability to deduct excess business losses attributable to pass-through businesses and sole proprietorships for tax years 2018-2020. New rules apply for 2021

Increase in Taxable Income Threshold for Deducting Interest Expense. The TCJA restricted the deductibility of business interest expense - generally limiting it to 30% of taxable income. The CARES Act raises the threshold from 30% to 50% for 2019 and 2020 for taxpayers. Special rules apply to partnerships. The CARES Act allows taxpayers to elect out of the increased limitation, which can adversely impact taxpayers subject to other loss limitation provisions, such as BEAT. While the CARES Act does not increase the interest deduction limitation for partnerships, it does increase the limitation at the partner level. Under the CARES Act, partners can use 50% of the suspended excess interest expense allocated to them for 2019. The remaining 50% is subject to the TCJA rules otherwise applicable to partner excess interest expense. Partners can elect out of the new rule.

Qualified Improvement Property Fix. The CARES Act fixes a much discussed drafting error in the TCJA that classified qualified improvement property as 39-year property. It was widely agreed that it was intended to be treated as 15-year property. The CARES Act changes the classification of qualified improvement property to 15-year property. At last, qualified improvement property will be eligible for bonus depreciation and a shorter recovery period. This provision is effective for property acquired and placed in service after September 27, 2017.

Exception from Excise Tax on Alcohol Used to Produce Hand Sanitizer. The CARES Act waives the federal excise tax on alcohol used for, or contained in, hand sanitizer that is produced and distributed in a manner consistent with guidance issued by the Food and Drug Administration. This applies to 2020 only.

INDIVIDUAL TAX PROVISIONS

$1,200 Recovery Rebates for Individuals. . U.S. individuals who are not claimed as a dependent on another person's tax return and have adjusted gross income of up to $75,000 will receive a payments of $1,200, plus $500 for every dependent child (For married couples filing a joint return, the rebate amount is $2,400 for couples with adjusted gross

income of up to $150,000). There is a phase out of the payment for taxpayers with higher adjusted incomes. The payment is generally in the form of a credit allowable for tax year 2020. Certain individuals are eligible for an advance refund amount based on their 2019 adjusted gross income (or their 2018 adjusted gross income if a 2019 income tax return has not been filed).

Retirement Plan Relief. The CARES Act temporarily removes the 10% penalty associated with early withdrawals of up to $100,000 from retirement accounts. This relief is available for individuals diagnosed with COVID-19 or who have a spouse or dependent diagnosed with COVID-19, or who have suffered economic hardship from COVID-19 (*e.g.* laid off). The relief applies for withdrawals made in 2020. In addition, distributions made to an eligible distributee are taxable ratably over a 3-year period. Individuals would be allowed to recontribute any COVID-19 distribution back into the retirement plan within the 3-year period beginning on the day after such distribution was received. The payments must be made in a trustee to trustee transfer.
The amount available for plan loans is increased from $50,000 to $100,000 and the percentage test limit for loans was increased from 50% of the PV of the participant's benefit to 100% of the value of the entire benefit under the plan.
In addition, required minimum distributions from defined contribution plans and individual retirement accounts (not DB plans) are waived for 2020.

Deductions for Charitable Contributions. The CARES Act provides taxpayers with the ability to claim an "above-the-line" deduction of up to $300 for cash charitable contributions made in 2020, irrespective of whether the taxpayer itemizes. Also, deductions for cash contributions made during 2020 to certain charitable organizations are not subject to the 50% AGI limitation. This relief does not apply to contributions made to private foundations or donor-advised funds.

Employer Payments of Student Loans. Employers can provide up to $5,250 on a tax-free basis to employees who use the funds to pay student loans. This provision applies only to payments made before January 1, 2021.

Any issues raised in this Alert may be addressed to Mr. Finkel. He can be reached at (212) 239-5526 or at rfinkel@morritthock.com.

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