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## *PH COVID-19 Client Alert Series: Business Tax Provisions of the CARES Act*

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Following intense debate and negotiations throughout the week, on Friday, March 27, 2020, the U.S. House of Representatives passed the [Coronavirus Aid, Relief and Economic Security Act](#) (the “Act”), providing more than \$2 trillion of federal economic relief to many businesses, States, municipalities, and individuals affected by COVID-19. The scope of the ACT is comprehensive and includes almost \$600 billion in tax cuts. This includes changes to payroll taxes, the rules for net operating losses, as well as several other important modifications. Below is a summary of the Act’s key business tax provisions.

### **Section 2301. Employee retention credit for employers subject to closure due to COVID-19.**

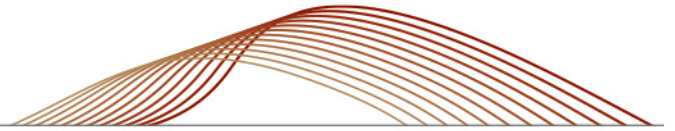
**Background:** Under current law, Internal Revenue Code (“IRC”) sections 3111(a) and 3221(a) impose certain employment taxes levied at a rate of approximately 6.2 percent (“Applicable Employment Taxes”).

**Summary:** Act Section 2301 provides for a refundable payroll tax credit against Applicable Employment Taxes equal to 50 percent of qualified wages paid by Eligible Employers. An employer is an “Eligible Employer” in one of two circumstances (note that both sets of circumstances could well apply to a given employer):

1. An employer will be an “Eligible Employer” for the period that starts with the first quarter of 2020 if its operations are fully or partially suspended due to COVID-19; or
2. An employer will be an “Eligible Employer” for the period that starts with the first quarter of 2020, where its gross receipts are less than 50 percent of its gross receipts for the same quarter in its prior tax year. An Eligible Employer no longer qualifies in the quarter *after* the quarter in which its gross receipts exceed 80 percent of gross receipts for the same quarter in its prior tax year.

Note that tax-exempt organizations whose operations were suspended due to COVID-19 are considered “Eligible Employers.”

The credit is limited to the amount of Applicable Employment Taxes paid, reduced by any credits, including the credits provided for in sections 7001 and 7003 of the [Families First Coronavirus Response Act](#) (see [PH COVID-19 Client Alert](#)); however, if the amount of the credit exceeds this



amount, the excess will be treated as an overpayment and refunded by the IRS. The credit covers the first \$10,000 of an employee's "qualified wages," which includes wages and employer-provided health benefits that are properly allocable to those wages. This credit is available for qualified wages paid or incurred from March 13, 2020 through December 31, 2020.

Eligible employers who, on average, have more than 100 full-time employees are entitled to claim the credit for (i) wages paid to employees when they were not working due to a COVID-19-related shutdown or (ii) due to the specified decline in gross receipts.

Eligible employers who, on average, have 100 or fewer full-time employees are entitled to claim the credit for all wages paid to employees during a COVID-19-related shutdown or during the quarter or quarters encompassed in the period wherein there is a "significant decline in gross receipts." The period where there is a "significant decline in gross receipts" begins with the first period in 2020 for which gross receipts are less than 50 percent of gross receipts for the same quarter in 2019 and ends with the calendar quarter *after* the quarter in which the employer's gross receipts are greater than 80 percent of gross receipts for the same quarter in 2019.

In addition, qualified wages paid or incurred by an eligible employer may not exceed the amount such employee would have been paid for working an equivalent duration during the 30 days immediately preceding such period.

Exclusions: Wages paid to employees eligible for the Work Opportunity Tax Credit, employees taking leave under the Family and Medical Leave Act, and employers taking the Small Business Interruption Loan provided for under Act section 1102 may not take this credit.

## **Section 2302. Delay of payment of employer payroll taxes.**

Background: IRC section 3111(a) imposes a 6.2 percent excise payroll tax on employers for wages paid, which includes all cash and non-cash remuneration for employment, as detailed in IRC section 3121(a). In general, this means all compensation paid to an employee, with exclusions for certain items such as fringe benefits, travel reimbursement, insurance premiums, and employee contributions to qualified retirement plans.

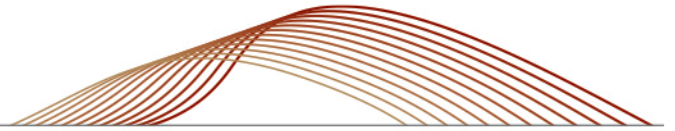
Similarly, under IRC section 1401(a), self-employed individuals are subject to an excise payroll tax of 12.4 percent of the amount of the taxpayer's self-employment income. Self-employment income includes the gross income from any trade or business less any allowed deductions.

Summary: Act Section 2302 allows employers to defer payment of 100 percent of the taxes imposed by IRC section 3111(a) and allows self-employed individuals to defer payment of 50 percent of the taxes imposed by IRC section 1401(a). The amount deferred is payable over the 2021 and 2022 tax years: 50 percent of the amount deferred must be paid by December 31, 2021, and 50 percent of the amount deferred must be paid by December 31, 2022.

Exclusions: Employers that have had a Small Business Administration loan forgiven under Act sections 1102 and 1106 or have had debt forgiven under Act section 1109 may not take advantage of this deferral.

## **Section 2303. Modifications for net operating losses.**

Summary: Net Operating Losses ("NOLs") incurred in 2018, 2019, and 2020 may be carried back five years and may be used to fully offset income for tax years up to December 31, 2020.



Special rule for REITs: NOLs for a REIT tax year may not be carried back, and non-REIT NOLs may not be carried back to REIT years.

Special rule for life insurance companies: If an NOL is carried back to a tax year before January 1, 2018, that NOL will be treated as an operations loss carryback under IRC section 810 as it was in force before its repeal.

Special rule for carrybacks to years in which the IRC section 965 repatriation transition tax applies: If a taxpayer carries back an NOL to a year in which income was includible in gross income due to the IRC section 965 transition tax, the taxpayer will be deemed to have made the 965(n) election with respect to that year to not consider NOLs with regard to certain included income. A taxpayer may elect to exclude years in which it was required to include foreign income by IRC section 965 if such years are covered in a five-year carryback period. This election must be made by the due date for the taxpayer's tax return for the first tax year ending after the date of the enactment of the Act.

"Straddle Year" Taxpayers: If a taxpayer's tax year begins before the effective date of the Tax Cuts and Jobs Act (January 1, 2018) and ends after the effective date of the Tax Cuts and Jobs Act (December 31, 2017) (the "straddle year") that taxpayer may within 120 days of enactment of the CARES Act elect to:

- Forgo any carryback of a loss incurred in the straddle year;
- Reduce the period to which a loss attributable to that loss may be carried back; or
- Revoke any election made to forgo any NOL carryback.

## **2304. Modification of limitation on losses for taxpayers other than corporations.**

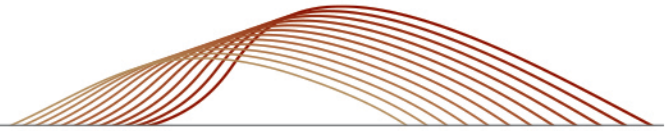
Background: IRC section 461(l) generally disallows excess business losses to noncorporate taxpayers. "Excess business losses" is defined to mean the excess of the taxpayer's aggregate business deductions over the sum of (i) the taxpayer's gross business income plus (ii) \$250,000 (or \$500,000 in the case of a joint return), adjusted for inflation. Excess business losses are treated as a net operating loss carryover to the following year.

Summary: Under Act section 2304, for tax years beginning prior to January 1, 2021 and after December 31, 2025 pass-through entities may deduct excess business losses. In defining "excess business loss," the Act does not take into account IRC sections 172 ("NOLs") and 199A (qualified business income) deductions, capital losses, and income attributable to services as an employee. Capital gains are considered to the lesser of net capital gain income attributable to business activity only or of total net capital gain income. This Act section applies for taxable years beginning after December 31, 2017 and before January 1, 2026.

## **2305. Modification of credit for prior year minimum tax liability of corporations.**

Background: Under prior law, IRC section 53(e) stated that corporations would be able to use their corporate alternative minimum tax credits in increasing amounts for tax years 2018 through 2021. In 2021, the credit would have been fully refundable.

Summary: As a result of Act section 2305, corporate taxpayers are now allowed to take fully refundable corporate alternative minimum tax credits beginning in tax year 2019 and may elect to take the entire refundable credit amount in tax year 2018.



## **2306. Modification of limitation on business interest.**

Background: IRC section 163(j) generally limits business interest deductions to 30 percent of the adjusted taxable income of such taxpayer.

Summary: Under the Act, during tax years 2019 and 2020, business taxpayers may deduct business interest up to the sum of business interest income, 50 percent of adjusted taxable income, and floor plan financing interest. For the 2020 tax year, taxpayers may also elect to use their 2019 adjusted taxable income.

Special Rules for Partnerships: This change does not apply to partnerships for tax years beginning in 2019. However, where there is excess business interest allocated to a partner, unless the partner elects otherwise, half of the amount allocated will be treated as paid or accrued in 2020 and fully deductible by the partner and half will be treated as subject to the IRC section 163(j) limitation on the deductibility of business interest expense (as revised by this Act section 2306). For the period covered under this Act, IRC section 163(j) limits a business' interest deduction for a tax year to the sum of (a) its business interest income for the year, (b) 50 percent of its adjusted taxable income for the year, and (c) its floor plan financing interest.

Election Out of Limitation: Taxpayers may elect out of this provision. In the case of partnerships, this election is made at the partnership level.

## **2307. Technical amendment regarding qualified improvement property. ("The Retail Glitch")**

Background: With the Tax Cuts and Jobs Act of 2017, lawmakers had sought to synchronize the various definitions of "improvement property" that existed under old law, combine them under one new definition, and assign the new definition a 15-year cost recovery period so that it would be eligible for a 100 percent bonus depreciation provision. However, a clerical error prevented investments in Qualified Improvement Property ("QIP") from qualifying for bonus depreciation. This error had a large impact on retail businesses.

Summary: Act section 2307 states that businesses may immediately deduct costs associated with improving QIP. QIP is defined as any improvement to an interior portion of a nonresidential building, as long as that improvement is placed in service after the building was first placed into service. QIP excludes expenditures for (1) the enlargement of a building, (2) elevators or escalators, or (3) the internal structural framework of a building.

*If you have any questions concerning these developing issues, please do not hesitate to contact the following Paul Hastings New York lawyer:*

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