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The Coronavirus Aid, Relief and Economic Security (CARES) Act Summary

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief and Economic Security (CARES) Act, which provides relief to taxpayers affected by the novel coronavirus (COVID-19). The CARES Act is the third round of federal government aid related to COVID-19. We have summarized the top provisions in the new legislation below, with more detailed alerts on individual provisions to follow. Click here for a link to the full text of the bill.

2020 Recovery Refund Checks for Individuals

The CARES Act provides eligible individuals with a refund check equal to $1,200 ($2,400 for joint filers) plus $500 per qualifying child. The refund begins to phase out if the individual's adjusted gross income (AGI) exceeds $75,000 ($150,000 for joint filers and $112,500 for head of household filers). The credit is completely phased out for individuals with no qualifying children if their AGI exceeds $99,000 ($198,000 for joint filers and $136,500 for head of household filers).

Eligible individuals do not include nonresident aliens, individuals who may be claimed as a dependent on another person's return, estates, or trusts. Eligible individuals and qualifying children must all have a valid social security number. For married taxpayers who filed jointly with their most recent tax filings (2018 or 2019) but will file separately in 2020, each spouse will be deemed to have received one half of the credit.

A qualifying child (i) is a child, stepchild, eligible foster child, brother, sister, stepbrother, or stepsister, or a descendent of any of them, (ii) under age 17, (iii) who has not provided more than half of their own support, (iv) who has lived with the taxpayer for more than half of the year, and (v) who has not filed a joint return (other than only for a claim for refund) with the individual's spouse for the taxable year beginning in the calendar year in which the taxable year of the taxpayer begins.

The refund is determined based on the taxpayer's 2020 income tax return but is advanced to taxpayers based on their 2018 or 2019 tax return, as appropriate. If an eligible individual's 2020 income is higher than the 2018 or 2019 income used to determine the rebate payment, the eligible individual will not be required to pay back any excess rebate. However, if the eligible individual's 2020 income is lower than the 2018 or 2019 income used to determine the rebate payment such that the individual should have received a larger rebate, the eligible individual will be able to claim an additional credit generally equal to the difference of what was refunded and any additional eligible amount when they file their 2020 income tax return.

Individuals who have not filed a tax return in 2018 or 2019 may still receive an automatic advance based on their social security benefit statements (Form SSA-1099) or social security equivalent benefit statement (Form RRB-1099). Other individuals may be required to file a return to receive any benefits.

The CARES Act provides that the IRS will make automatic payments to individuals who have previously filed their income tax returns electronically, using direct deposit banking information provided on a return any time after January 1, 2018.

Charitable Contributions

Above-the-line deductions: Under the CARES Act, an eligible individual may take a qualified charitable contribution deduction of up to $300 against their AGI in 2020. An eligible individual is any individual taxpayer who does not elect to itemize his or her deductions. A qualified charitable contribution is a charitable contribution (i) made in cash, (ii) for which a charitable contribution deduction is otherwise allowed, and (iii) that is made to certain publicly supported charities.

This above-the-line charitable deduction may not be used to make contributions to a non-operating private foundation or to a donor advised fund.

Modification of limitations on cash contributions: Currently, individuals who make cash contributions to publicly supported charities are permitted a charitable contribution deduction of up to 60% of their AGI. Any such contributions in excess of the 60% AGI limitation may be carried forward as a charitable contribution in each of the five succeeding years.

The CARES Act temporarily suspends the AGI limitation for qualifying cash contributions, instead permitting individual taxpayers to take a charitable contribution deduction for qualifying cash contributions made in 2020 to the extent such contributions do not exceed the excess of the individual's contribution base over the amount of all other charitable contributions allowed as a deduction for the contribution year. Any excess is carried forward as a charitable contribution in each of the succeeding five years. Taxpayers wishing to take advantage of this provision must make an affirmative election on their 2020 income tax return.

This provision is useful to taxpayers who elect to itemize their deductions in 2020 and make cash contributions to certain public charities. As with the aforementioned above-the-line deduction, contributions to non-operating private foundations or donor advised funds are not eligible.

For corporations, the CARES Act temporarily increases the limitation on the deductibility of cash charitable contributions during 2020 from 10% to 25% of the taxpayer's taxable income. The CARES Act also increases the limitation on deductions for contributions of food inventory from 15% to 25%.

Compensation, Benefits, and Payroll Relief

The law temporarily increases the amount of and expands eligibility for unemployment benefits, and it provides relief for workers who are self-employed. Additionally, several provisions assist certain employers who keep employees on payroll even though the employees are not able or needed to work. The cornerstone of the payroll protection aid is a streamlined application process for SBA loans that can be forgiven if an eligible employer maintains its workforce at certain levels. Additionally, certain employers affected by the pandemic who retain their employees will receive a credit against payroll taxes for 50% of eligible employee wages paid or incurred from March 13 to December 31, 2020. This employee retention credit would be provided for as much as $10,000 of qualifying wages, including health benefits. Eligible employers may defer remitting employer payroll tax payments that remain due for 2020 (after the credits are deducted), with half being due by December 31, 2021, and the balance due by December 31, 2022. Employers with fewer than 500 employees are also allowed to give terminated employees access to the mandated paid federal sick and child care leave benefits for which the employer is 100% reimbursed by the government through payroll tax credits if the employer rehires the qualifying employees.

Any benefit that is driven off the definition of "employee" raises the issue of partner versus employee. The profits interest member that is receiving a W-2 may not be eligible for inclusion in the various benefit computations.

Eligible individuals can withdraw vested amounts up to $100,000 during 2020 without a 10% early distribution penalty, and income inclusion can be spread over three years. Repayment of distributions during the next three years will be treated as tax-free rollovers of the distribution. The bill also makes it easier to borrow money from 401(k) accounts, raising the limit to $100,000 from $50,000 for the first 180 days after enactment, and the payment dates for any loans due the rest of 2020 would be extended for a year.

Individuals do not have to take their 2020 required minimum distributions from their retirement funds. This avoids lost earnings power on the taxes due on distributions and maximizes the potential gain as the market recovers.

Two long-awaited provisions allow employers to assist employees with college loan debt through tax free payments up to $5,250 and restores over-the-counter medical supplies as permissible expenses that can be reimbursed through health care flexible spending accounts and health care savings accounts.

Deferral of Net Business Losses for Three Years

Section 461(l) limits non-corporate taxpayers in their use of net business losses to offset other sources of income. As enacted in 2017, this limitation was effective for taxable years beginning after 2017 and before 2026, and applied after the basis, at-risk, and passive activity loss limitations. The amount of deductible net business losses is limited to $500,000 for married taxpayers filing a joint return and $250,000 for all other taxpayers. These amounts are indexed for inflation after 2018 (to $518,000 and $259,000, respectively, in 2020). Excess business losses are carried forward to the next succeeding taxable year and treated as a net operating loss in that year.

The CARES Act defers the effective date of Section 461(l) for three years, but also makes important technical corrections that will become effective when the limitation on excess business losses once again becomes applicable. Accordingly, net business losses from 2018, 2019, or 2020 may offset other sources of income, provided they are not otherwise limited by other provisions that remain in the Code. Beginning in 2021, the application of this limitation is clarified with respect to the treatment of wages and related deductions from employment, coordination with deductions under Section 172 (for net operating losses) or Section 199A (relating to qualified business income), and the treatment of business capital gains and losses.

Section 163(j) Amended for Taxable Years Beginning in 2019 and 2020

The CARES Act amends Section 163(j) solely for taxable years beginning in 2019 and 2020. With the exception of partnerships, and solely for taxable years beginning in 2019 and 2020, taxpayers may deduct business interest expense up to 50% of their adjusted taxable income (ATI), an increase from 30% of ATI under the TCJA, unless an election is made to use the lower limitation for any taxable year. Additionally, for any taxable year beginning in 2020, the taxpayer may elect to use its 2019 ATI for purposes of computing its 2020 Section 163(j) limitation. This will benefit taxpayers who may be facing reduced 2020 earnings as a result of the business implications of COVID-19. As such, taxpayers should be mindful of elections on their 2019 return that could impact their 2019 and 2020 business interest expense deduction. With respect to partnerships, the increased Section 163(j) limit from 30% to 50% of ATI only applies to taxable years beginning in 2020. However, in the case of any excess business interest expense allocated from a partnership for any taxable year beginning in 2019, 50% of such excess business interest expense is treated as not subject to the Section 163(j) limitation and is fully deductible by the partner in 2020. The remaining 50% of such excess business interest expense shall be subject to the limitations in the same manner as any other excess business interest expense so allocated. Each partner has the ability, under regulations to be prescribed by Treasury, to elect to have this special rule not applied. No rules are provided for application of this rule in the context of tiered partnership structures.

Net Operating Losses Carryback Allowed for Taxable Years Beginning in 2018 and Before 2021

The CARES Act provides for an elective five-year carryback of net operating losses (NOLs) generated in taxable years beginning after December 31, 2017, and before January 1, 2021. Taxpayers may elect to relinquish the entire five-year carryback period with respect to a particular year's NOL, with the election being irrevocable once made. In addition, the 80% limitation on NOL deductions arising in taxable years beginning after December 31, 2017, has temporarily been pushed to taxable years beginning after December 31, 2020. Several ambiguities in the application of Section 172 arising as a result of drafting errors in the Tax Cuts and Jobs Act have also been corrected. As certain benefits (i.e., charitable contributions, Section 250 "GILTI" deductions, etc.) may be impacted by an adjustment to taxable income, and therefore reduce the effective value of any NOL deduction, taxpayers will have to determine whether to elect to forego the carryback. Moreover, the bill provides for two special rules for NOL carrybacks to years in which the taxpayer included income from its foreign subsidiaries under Section 965. Please consider the impact of this interaction with your international tax advisors. However, given the potential offset to income taxed under a 35% federal rate, and the uncertainty regarding the long-term impact of the COVID-19 crisis on future earnings, it seems likely that most companies will take advantage of the revisions. This is a technical point, but while the highest average federal rate was 35% before 2018, the highest marginal tax rate was 38.333% for taxable amounts between $15 million and $18.33 million. This was put in place as part of our progressive tax system to eliminate earlier benefits of the 34% tax rate. Companies may wish to revisit their tax accounting methodologies to defer income and accelerate deductions in order to maximize their current year losses to increase their NOL carrybacks to earlier years.

Alternative Minimum Tax Credit Refunds

The CARES Act allows the refundable alternative minimum tax credit to be completely refunded for taxable years beginning after December 31, 2018, or by election, taxable years beginning after December 31, 2017. Under the Tax Cuts and Jobs Act, the credit was refundable over a series of years with the remainder recoverable in 2021.

Technical Correction to Qualified Improvement Property

The CARES Act contains a technical correction to a drafting error in the Tax Cuts and Jobs Act that required qualified improvement property (QIP) to be depreciated over 39 years, rendering such property ineligible for bonus depreciation. With the technical correction applying retroactively to 2018, QIP is now 15-year property and eligible for 100% bonus depreciation. This will provide immediate current cash flow benefits and relief to taxpayers, especially those in the retail, restaurant, and hospitality industries. Taxpayers that placed QIP into service in 2019 can claim 100% bonus depreciation prospectively on their 2019 return and should consider whether they can file Form 4464 to quickly recover overpayments of 2019 estimated taxes. Taxpayers that placed QIP in service in 2018 and that filed their 2018 federal income tax return treating the assets as bonus-ineligible 39-year property should consider amending that return to treat such assets as bonus-eligible. For C corporations, in particular, claiming the bonus depreciation on an amended return can potentially generate NOLs that can be carried back five years under the new NOL provisions of the CARES Act to taxable years before 2018 when the tax rates were 35%, even though the carryback losses were generated in years when the tax rate was 21%. With the taxable income limit under Section 172(a) being removed, an NOL can fully offset income to generate the maximum cash refund for taxpayers that need immediate cash. Alternatively, in lieu of amending the 2018 return, taxpayers may file an automatic Form 3115, Application for Change in Accounting Method, with the 2019 return to take advantage of the new favorable treatment and claim the missed depreciation as a favorable Section 481(a) adjustment.

Effects of the CARES Act at the State and Local Levels

As with the Tax Cuts and Jobs Act, the tax implications of the CARES Act at the state level first depends on whether a state is a “rolling” Internal Revenue Code (IRC) conformity state or follows “fixed-date” conformity. For example, with respect to the modifications to Section 163(j), rolling states will automatically conform, unless they specifically decouple (but separate state ATI calculations will still be necessary). However, fixed-date conformity states will have to update their conformity dates to conform to the Section 163(j) modifications. A number of states have already updated during their current legislative sessions (e.g., Idaho, Indiana, Maine, Virginia, and West Virginia). Nonetheless, even if a state has updated, the effective date of the update may not apply to changes to the IRC enacted after January 1, 2020 (e.g., Arizona). A number of other states have either expressly decoupled from Section 163(j) or conform to an earlier version and will not follow the CARES Act changes (e.g., California, Connecticut, Georgia, Missouri, South Carolina, Tennessee (starting in 2020), Wisconsin). Similar considerations will apply to the NOL modifications for states that adopted the 80% limitation, and most states do not allow carrybacks. Likewise, in fixed-dated conformity states that do not update, the Section 461(l) limitation will still apply resulting in a separate state NOL for those states. These conformity questions add another layer of complexity to applying the tax provisions of the CARES Act at the state level. Further, once the COVID-19 crisis is past, rolling IRC conformity states must be monitored, as these states could decouple from these CARES Act provisions for purposes of state revenue.

The Act gives the U.S. Department of Labor authority to issue regulations that would exclude certain health care providers and emergency responders from being able to take emergency family and medical leave. The Department of Labor also has the authority to issue regulations to exempt small businesses with fewer than 50 employees from the emergency family and medical leave requirements if the imposition of such requirements would jeopardize the viability of the business as a going concern. The Act would also exempt employers with fewer than 50 employees in a 75-mile radius from civil damages in an FMLA lawsuit.

Under the Act, covered employers (those with less than 500 employees) are required to hold an employee’s job open for them until the end of the leave period. However, an exception applies to employers with fewer than 25 employees if the employee’s position no longer exists due to economic conditions or other changes in the employer’s operations that affect employment and are caused by the COVID-19 crisis, and the employer made reasonable efforts to restore the employee’s job. And, if those efforts failed, the employer agrees to reinstate the employee if an equivalent position becomes available within a year.

The Act creates new, refundable payroll tax credits for employers to help cover the costs of this new paid sick and family leave.

Payroll Tax Credits

To assist employers who are required to provide emergency paid sick leave or FMLA leave under the programs described above, the Act provides for a refundable tax credit applicable against the employer’s portion of Social Security or Railroad Retirement Tax Act (RRTA) tax for amounts paid under those programs. The credit is equal to 100% of the compensation paid in each calendar quarter to employees who are not working for the reasons enumerated above, subject to the following limitations:

For payments to an employee who needs time off for self-isolation, diagnosis, or care of a COVID-19 diagnosis, or compliance with a health care provider’s recommendation or order, the credit is capped at $511 of eligible wages per employee per day. For payments to an employee who needs time off to care for a family member who has been exposed to or diagnosed with the COVID-19, or a child under age 18 whose school or place of care has been closed, the credit is capped at $200 of eligible wages per employee per day. The credit for emergency paid sick leave wages is only available for a maximum of 10 days per employee over the duration of the program. For expanded FMLA, the credit is capped at $200 of eligible wages per employee per day and $10,000 for all calendar quarters.

Both of the credits are increased by any amounts paid or incurred by the employer to maintain a group health plan, to the extent those expenses are (1) excluded from the employee's gross income under the tax code and (2) "properly allocable" to the respective qualified sick or FMLA wages required to be paid under the Act. The exact method of allocation will be provided by regulation at a later date, but the Act provides that the allocation will be treated as properly made if done "on the basis of being pro rata among covered employees and pro rata on the basis of periods of coverage."

If the credit exceeds the employer's total liability for Social Security or RRTA tax for all employees for any calendar quarter, the excess is refundable to the employer. The employer may choose not to apply the credit. Further, to prevent a double benefit, the employer cannot obtain a deduction for the amount of the credit. In addition, employers may not receive the credit in connection with wages for which a credit is allowed under Section 45S (credit for paid family and medical leave).

Similar rules apply to a self-employed individual that allow a refundable tax credit against the individual's self-employment tax. The credit is capped at the lesser of the amounts that apply to eligible wages per employee or the individual's lost self-employment income. The House-passed version of the Act provides guidance on how to determine the individual's lost income due to the corona virus.

Notably, required payments for emergency paid sick leave or FMLA under the Act will not be considered wages for purposes of calculating the employer's portion of the Social Security or RRTA tax. In addition, the tax credits available to an employer are increased by the amount of the employer's liability for Medicare tax on wages paid under the Act, effectively exempting the emergency sick leave and FMLA payments from that tax as well. In this way, the Act provides employers with two tax benefits: (1) refundable credits against the employer's portion of Social Security or RRTA tax; and (2) an exemption from, or credit against, the employer's portion of Social Security or RRTA and Medicare taxes on the wages required to be paid under the Act.

However, the law does not exempt these payments from the definition of wages for the purpose of other taxes (including the employee's portion of Social Security, RRTA and Medicare taxes).

The Act ensures there is no negative impact to the Social Security program caused by the tax credit or the exemption of sick pay and family leave pay from Social Security tax by authorizing a transfer of funds from the General Fund to the Social Security and disability insurance trust funds to replace the lost employer contributions. The tax provisions discussed herein will apply beginning on a date to be determined by the Secretary of the Treasury after the enactment of the Act and ending on December 31, 2020.