

CRAIG M. COHEN, STEVEN L KOPP, and DAVID Z. NIRENBERG are tax partners in the New York office of Chapman and Cutler LLP.

# Federal Tax Legislative Developments

## *Brief Summary of Selected Tax Provisions in the CARES Act*

By Craig M. Cohen, Steven L Kopp, and David Z. Nirenberg\*



The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”),<sup>1</sup> which was designed to support individuals and businesses affected by the COVID-19 pandemic, was signed into law on March 27, 2020. This column summarizes various tax provisions in the CARES Act. Except as otherwise noted, the changes made by the CARES Act apply regardless of whether a taxpayer has personally suffered any adverse effect of the COVID-19 pandemic.

The CARES Act applies solely for federal tax purposes, and there is no requirement for states to conform to the new federal rules. For example, New York—which generally conforms to the Internal Revenue Code on a rolling basis—passed a budget on April 3, 2020, which states that the New York tax laws generally do not adopt any changes made to the Internal Revenue Code after March 1, 2020, for taxable years that begin before 2022.<sup>2</sup>

### Interest Disallowance

Taxpayers are permitted to deduct interest expense allocable to a trade or business, but generally only to the extent of the sum of the taxpayer’s business interest income and 30% of the taxpayer’s adjusted taxable income (“ATI”) for the year.<sup>3</sup> ATI, which is comparable to EBITDA, means the taxable income of the taxpayer computed without regard to (i) business interest income or expense; (ii) income, gains, deductions, or losses not allocable to a trade or business; (iii) NOLs; (iv) qualified business income deductions for non-corporate entities; and (v) for taxable years beginning before 2022, deductions allowed for depreciation, amortization, or depletion.<sup>4</sup>

In the case of a partnership, the interest expense limitation is applied first at the partnership level.<sup>5</sup> Any net interest expense of the partnership that is disallowed will be allocated to its partners.<sup>6</sup> This disallowed interest expense can only be used by a partner in a subsequent taxable year for which 30% of

the partnership's ATI exceeds its net interest expense; for such years, the previously disallowed interest expense can be used to offset the partner's allocable share of the partnership's excess ATI.<sup>7</sup>

Pursuant to the CARES Act, the general ATI limitation on the deductibility of net interest expense described above is increased from 30% to 50% of the taxpayer's ATI for taxable years beginning in 2019 or 2020.<sup>8</sup> Where the relevant taxpayer is a partnership, this increase only applies to taxable years beginning in 2020.<sup>9</sup> With respect to any interest expense disallowed at the partnership level for the taxable year beginning in 2019, however, a partner in such partnership can deduct 50% of such disallowed interest expense in 2020 without regard to the limitations on deduction of business interest (with respect to a partner in a partnership or otherwise), and 50% of such disallowed interest expense will be subject to the general limitations on excess business interest expense.<sup>10</sup>

Taxpayers can elect out of each of the above rules.<sup>11</sup> In addition, taxpayers can affirmatively elect to calculate their interest expense limitation for taxable years beginning in 2020 using their ATI from the 2019 taxable year.<sup>12</sup> This election, which would permit taxpayers to claim additional interest expense deductions in 2020, would benefit taxpayers whose ATI was lower in 2020 due to the economic downturn caused by the COVID-19 pandemic (although the election is available regardless of the reason for any decline in ATI).

## Disallowed Losses

The CARES Act temporarily reinstates certain rules regarding taxpayer losses that were repealed by the Tax Cuts and Jobs Act (the "TCJA")<sup>13</sup> in 2017. In particular:

- The CARES Act allows corporations (other than REITs) to carry back any unused NOLs generated in 2018, 2019, or 2020, to offset income from the five taxable years preceding the relevant loss year.<sup>14</sup>
- The CARES Act removes the 80% cap (initially instituted for taxable years beginning in 2018) on the amount of taxable income that can be offset by NOL deductions, for taxable years beginning in 2018, 2019 and 2020.<sup>15</sup>
- The CARES Act allows noncorporate taxpayers, such as individual owners of passthrough businesses, to fully deduct excess business losses for 2018, 2019 and 2020 (removing the limitation initially imposed for taxable years beginning in 2018).<sup>16</sup>

In each case, a taxpayer may be required to amend an already-filed tax return in order to claim a refund.

## Other Notable Tax Provisions

In addition to the above changes, the CARES Act:

- Provides a refundable payroll tax credit equal to 50% of qualified wages and health benefits paid after March 12, 2020, and before January 1, 2021, up to a maximum credit of \$5,000 per employee, by employers that either (i) had business suspended in 2020 by government orders due to the COVID-19 pandemic or (ii) experienced at least a 50% decline in gross receipts for one or more calendar quarters of 2020 on a year-over-year basis.<sup>17</sup> For employers that have more than 100 full-time employees, this tax credit only applies to wages paid to employees when they were not providing services.<sup>18</sup> Neither governmental entities nor employers who received loans pursuant to the Paycheck Protection Program are eligible for this tax credit.<sup>19</sup>
- Allows employers to defer the deposit and payment of Social Security payroll taxes for the period beginning after March 26, 2020, and ending on December 31, 2020, until (i) December 31, 2021, with respect to 50% of such taxes, and (ii) December 31, 2022, for the remainder.<sup>20</sup> Employers who received loans pursuant to the Paycheck Protection Program are eligible for this deferral unless and until their loans are forgiven.<sup>21</sup> Payroll taxes that were due prior to the date an employer receives a decision from the relevant lender that its loan is forgiven will continue to be deferred, but thereafter amounts must be deposited and paid by the employer when due.<sup>22</sup>
- Allows corporations to accelerate the full recovery of any non-refunded AMT credits to taxable year 2019—previously, such credits did not become fully refundable until 2021—with tentative refunds to be paid within 90 days of the relevant filing.<sup>23</sup>
- Ensures that any loan guaranteed under the Paycheck Protection Program that is forgiven pursuant to the CARES Act will not give rise to cancellation of indebtedness income.<sup>24</sup>
- Upon election, increases the limitation on deductions for charitable contributions by a corporation from 10% to 25% of its taxable income for tax years beginning after 2019, with respect to charitable contributions (other than contributions to a supporting organization or a donor advised fund) made in cash during calendar year 2020.<sup>25</sup>
- Permits individuals who do not itemize deductions to deduct up to \$300 of charitable deductions (other

than contributions to a supporting organization or donor advised fund) made in cash during calendar year 2020.<sup>26</sup>

- Expands the definition of the term “educational assistance” excludible from income and from wages to include payments of principal or interest made by an employer on a qualified education loan incurred by an employee of the employer for the education of the employee, and thereby permits an employer to contribute up to \$5,250 to the repayment of principal and interest owed on qualified education loans from March 28, 2020, to December 31, 2020, without such payments being included in the employee’s gross income.<sup>27</sup> To the extent that these payments represent interest on qualified education loans, the interest expense will not be deductible by the employee.<sup>28</sup>
- Allows individuals to withdraw up to \$100,000 from a tax qualified retirement plan without being subject to immediate taxation or the 10% early-withdrawal penalty otherwise applicable to individuals under 59½.<sup>29</sup> The distribution must be made on or after January 1, 2020, and on or before December 30, 2020, to certain individuals who are diagnosed with COVID-19 or otherwise experience adverse financial consequences due to COVID-19.<sup>30</sup> Unless the individual elects to be taxed immediately upon receipt, the distribution is included in gross income

ratably over the three-year period beginning with the taxable year in which the distribution was made.<sup>31</sup> Alternatively, a distribution will not be subject to tax if it is recontributed to an eligible retirement plan during the three-year period beginning on the day after such distribution.<sup>32</sup>

- Waives the requirements for minimum distributions from certain retirement plans in calendar year 2020, including where the participant’s required beginning date has occurred during such period.<sup>33</sup> In addition, the five-year period beginning with an employee’s death during which required minimum distributions must be made is determined without regard to calendar year 2020.<sup>34</sup>
- Classifies improvements made by the taxpayer to the interior of a nonresidential building (“qualified improvement property”) as 15-year and 20-year property for purposes of MACRS and ADS depreciation, respectively, with respect to property placed into service after December 31, 2017.<sup>35</sup> As a result of its classification as 15-year property, qualified improvement property is eligible for 100% bonus depreciation.<sup>36</sup> This change is intended to be a technical correction to the TCJA, which created the category of qualified improvement property but failed to assign such property a specific recovery period despite express Congressional intent to do so.<sup>37</sup>

## ENDNOTES

\* Mr. Nirenberg is the co-author of Peaslee & Nirenberg, *FEDERAL INCOME TAXATION OF SECURITIZATION TRANSACTIONS AND RELATED TOPICS* (5th Edition 2018).

<sup>1</sup> The Coronavirus Aid, Relief, and Economic Security Act, P.L. 116-136, 134 Stat. 281 (March 27, 2020).

<sup>2</sup> S.B. 7508, 243rd Leg. Sess., Part WWW (N.Y. 2020).

<sup>3</sup> Code Sec. 163(j)(1). Unless otherwise noted, all Code Sec. references are to the Internal Revenue Code of 1986 (“Code”).

<sup>4</sup> Code Sec. 163(j)(8).

<sup>5</sup> Code Sec. 163(j)(4)(A).

<sup>6</sup> Code Sec. 163(j)(4)(B)(i).

<sup>7</sup> Code Sec. 163(j)(4)(B)(ii).

<sup>8</sup> Code Sec. 163(j)(10)(A)(i), as added by CARES Act §2306(a).

<sup>9</sup> Code Sec. 163(j)(10)(A)(ii)(I), as added by CARES Act §2306(a).

<sup>10</sup> Code Sec. 163(j)(10)(A)(ii)(II), as added by CARES Act §2306(a).

<sup>11</sup> Code Sec. 163(j)(10)(A)(ii) and (iii), as added by CARES Act §2306(a). Taxpayers may wish to make such an election if, for example, the additional interest deduction negatively impacts another tax provision (e.g., section 59A, Tax on

Base Erosion Payments with Substantial Gross Receipts). See also Rev. Proc. 2020-22, 2020-18 IRB 745 (providing guidance on timing and method of elections).

<sup>12</sup> Code Sec. 163(j)(10)(B), as added by CARES Act §2306(a). See also Rev. Proc. 2020-22, 2020-18 IRB 745 (providing guidance on timing and method of elections).

<sup>13</sup> The Tax Cuts and Jobs Act, P.L. 115-97, 131 Stat. 2054 (2017).

<sup>14</sup> Code Sec. 172(b)(1)(D), as added by CARES Act §2303(b). See also Rev. Proc. 2020-24, 2020-17 IRB 750 (providing guidance on timing and method of electing out of NOL carryback). Special rules also apply to life insurance companies. Code Sec. 172(b)(1)(D)(iii), as added by CARES Act §2303(b)(1).

<sup>15</sup> Code Sec. 172(a), as amended by CARES Act §2303(a)(1).

<sup>16</sup> Code Sec. 461(l)(1)(B), as amended by CARES Act §2304(a).

<sup>17</sup> CARES Act §2301. See also IRS, FAQs: Employee Retention Credit under the CARES Act, available at [www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act](http://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act) (updated through April 10, 2020).

<sup>18</sup> CARES Act §2301(c)(3)(A).

<sup>19</sup> CARES Act §2301(f), (j).

<sup>20</sup> CARES Act §2302(a)(1).

<sup>21</sup> CARES Act §2302(a)(3).

<sup>22</sup> IRS, Deferral of employment tax deposits and payments through December 31, 2020, available at [www.irs.gov/newsroom/deferral-of-employment-tax-deposits-and-payments-through-december-31-2020](http://www.irs.gov/newsroom/deferral-of-employment-tax-deposits-and-payments-through-december-31-2020) (updated through April 10, 2020).

<sup>23</sup> Code Sec. 53(e), as amended by CARES Act §2305(a); CARES Act §2305(d)(2). Alternatively, the CARES Act allows corporations to elect to accelerate the full recovery of any non-refunded AMT credits to their first taxable year beginning in 2018. Code Sec. 53(e)(5), as added by CARES Act §2305(b).

<sup>24</sup> CARES Act §1106(i). After the enactment of the CARES Act, the Treasury clarified that no deduction will be allowed for expenses incurred in connection with such loan forgiveness (see Notice 2020-32, 2020-21 IRB 837). However, it is debatable whether such clarification actually reflected Congress’s intent, and Congress is considering passing legislation to reverse this notice (although it is unclear whether any such legislation will be enacted). See, e.g., Small Business Expense Protection Act of 2020, S. 3612, 116th Cong. (2020).

<sup>25</sup> CARES Act §2205(a)(2)(B)(i). For this purpose, taxable income is determined (as it was previously) under Code Sec. 170(b)(2)(D).

<sup>26</sup> Code Sec. 62(a)(22), as added by CARES Act §2204(a).

<sup>27</sup> Code Sec. 127(c)(1)(B), as amended by CARES Act §2206(a).

<sup>28</sup> Code Sec. 221(e)(1), as amended by CARES Act §2206(b).

<sup>29</sup> CARES Act §2202(a).

<sup>30</sup> CARES Act §2202(a)(4)(A).

<sup>31</sup> CARES Act §2202(a)(5).

<sup>32</sup> CARES Act §2202(a)(3).

<sup>33</sup> Code Sec. 401(a)(9)(l), as added by CARES Act §2203(a).

<sup>34</sup> Code Sec. 401(a)(9)(i)(iii)(II), as added by CARES Act §2203(a).

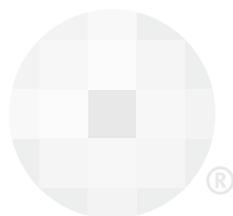
<sup>35</sup> Code Sec. 168(e)(3)(E)(vii), as added by CARES Act §2307(a)(1); Code Sec. 168(g)(3)(B), as amended by CARES Act §2307(a)(2); CARES Act §2307(b); Tax Cuts and Jobs Act, P.L. 115-97 §13204(b)(1), 131 Stat. 2054 (2017). *See also*

Rev. Proc. 2020-25, 2020-19 IRB 785 (providing guidance on timing and method of election to change depreciation of qualified improvement property).

<sup>36</sup> Code Sec. 168(k)(2)(A)(i)(I).

<sup>37</sup> *See, e.g.*, Joint Comm. on Taxation, General Explanation of Public Law 115-97, JCS-1-18, at 138 n. 632 and accompanying text (Dec. 20, 2018).

This article is reprinted with the publisher's permission from the Journal of Taxation of Financial Products, a quarterly journal published by Wolters Kluwer. Copying or distribution without the publisher's permission is prohibited. To subscribe to the JOURNAL OF TAXATION OF FINANCIAL PRODUCTS or other Wolters Kluwer Journals please call 1-800-344-3734 or visit [taxna.wolterskluwer.com](http://taxna.wolterskluwer.com). All views expressed in the articles and columns are those of the author and not necessarily those of Wolters Kluwer.



Wolters Kluwer