March 31, 2020

Summary of Certain Tax Relief Available in COVID-19 CARES Act

On March 27, in response to the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was passed by Congress and signed by President Donald Trump. This alert summarizes certain key tax provisions of the CARES Act.

Section 1106(i): Forgiveness of Certain Small Business Loans Not Considered Taxable Income

- Under the CARES Act, certain loans guaranteed by the Small Business Administration under Section 7(a) of the Small Business Act and made between February 15 and June 30, 2020 (covered period) are eligible for forgiveness of an amount equal to the costs of payroll, interest on mortgages, rent obligations, and utility payments during the covered period, subject to limitations.
- Under general income tax rules, forgiveness or cancellation of indebtedness is taxable as ordinary income.
- Section 1106(i) provides that forgivable portions of CARES Act loans are excluded from the gross income of the borrower for federal income tax purposes.

Section 2303: NOL Limitation

- Prior to the 2017 Tax Cuts and Jobs Act (TCJA), the amount of net operating losses (NOLs) that could be used to offset income was not limited, and unused NOLs could be carried back up to five years. This was changed under the TCJA, which both limited the amount of NOLs that could be used to offset income, to a maximum of 80 percent of the taxpayer's taxable income for the tax year (computed without regard to NOL deduction), and eliminated carrybacks of NOLs.
- Under the CARES Act, the 80 percent limitation is removed for taxable years beginning prior to January 1, 2021, such that taxable income may be offset by all NOLs generated in the tax year. The CARES Act also allows unused NOLs arising in 2018 through 2020 to be carried back to the preceding five taxable years.
- Finally, while the 80 percent limitation returns for tax years beginning on or after January 1, 2021, under the CARES Act, when determining taxable income for purposes of calculating the limitation, (i) NOLs carried forward from pre-2018 tax years and used in the current tax year are applied first, and (ii) the deductions under Section 199A (for qualified business income) and Section 250 (for foreign-derived intangibles and GILTI income) will not be taken into account. Note that to the extent that these additional NOLs reduce taxable income below the sum of foreign-derived intangible income and GILTI, the Section 250 deduction will be reduced. Companies with significant amounts of foreign-derived intangible income or GILTI will want to carefully model the net impact of carrying back (or forward) these NOLs.

Section 2304: Excess Business Losses

- Under prior law, noncorporate taxpayers were subject to limitations on deductions for excess business losses for tax years 2018 through 2025. An excess business loss is the amount by which the total deductions attributable to a taxpayer's trades or businesses exceed total gross income and gains attributable to those trades or businesses, plus $250,000 (or $500,000 in the case of a joint return).

- Section 2304 of the CARES Act now permits deductions for excess business losses for tax years beginning in 2018 through 2020. In determining excess business losses for all taxable years, the deductions under Section 199A (for qualified business income) and Section 250 (for foreign-derived intangibles and GILTI income) are not taken into account.

Section 2305: AMT Refundable Tax Credit

- The minimum tax credit is a refundable credit available to certain corporate taxpayers that had been subject to the corporate alternative minimum tax (AMT) prior to its repeal under the TCJA. Under prior law, in determining the minimum tax credit, the AMT refundable credit amount was limited to 50 percent for tax years beginning prior to 2021 and 100 percent thereafter.
- The CARES Act makes the AMT refundable credit amount 100 percent as of the 2020 tax year and further allows taxpayers to elect to take the refundable credit effective as of the tax year beginning in 2018.

Section 2306: Interest Expense Deduction

- Under prior law (as modified by the TCJA), Section 163(j) provided for a limitation on the deduction for business interest expense based on the sum of business interest income plus 30 percent of adjusted taxable income plus floor plan financing interest.
- Section 2306 of the CARES Act increases the 30 percent limitation to 50 percent of adjusted taxable income for tax years beginning in 2019 and 2020.
- In addition, for tax years beginning in 2020, taxpayers may elect to use their 2019 adjusted taxable income figure in determining the 50 percent limitation. This will be helpful for taxpayers who had higher income in 2019 than they ultimately will have in 2020.
    - This rule does not apply to partnerships, which generally determine excess business interest limitations under Section 163(j) on a stand-alone basis. However, unless a partner elects out, the CARES Act provides that 50 percent of the excess business interest that is disallowed at the partnership level will be allowable in the partner's first taxable year beginning in 2020 and the other 50 percent will be subject to the general limitations on business interest applicable to the partner.

Section 2307: Technical Correction: Depreciation of Qualified Improvement Property

- As a result of an oversight in the TCJA, qualified improvement property (QIP) was not assigned a recovery period, resulting in ambiguous treatment for depreciation purposes and excluding it from bonus deprecation. QIP is any improvement to the interior portion of a building that is nonresidential real property made after the date the building was first placed into service.
- The CARES Act provides a technical correction, assigning QIP a 15-year recovery period and resulting in QIP being eligible for bonus depreciation.
- This will be welcome relief to the restaurant, retail, and hospitality industries, which were the industries primarily affected by the oversight in the TCJA.

- For a taxpayer using the alternative depreciation method, including a real property trade or business that elected not to have the interest deduction limitation of Section 163(j) apply, QIP has a 20-year recovery period and remains ineligible for bonus depreciation.

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COVID-19 DISCLAIMER: As you are aware, as a result of the COVID-19 pandemic, things are changing quickly and the effect, enforceability and interpretation of laws may be affected by future events. The material set forth in this document is not an unequivocal statement of law, but instead represents our best interpretation of where things stand as of the date of first publication. We have not attempted to address the potential impacts of all local, state and federal orders that may have been issued in response to the COVID-19 pandemic.

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