SQUIRE PATTON BOGGS

The CARES Act of 2020:

Taxation Provisions May Provide Some Relief for Your Business

The Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act), enacted and expected to be signed into force on March 27, 2020, is bipartisan legislation intended to provide more than US$2 trillion in relief for companies and families affected by the coronavirus disease 2019 (COVID-19) pandemic. It includes a number of taxation-related provisions that are targeted at minimizing the impact on companies of a suddenly and significantly scaled-back economy.

In this update, we provide a summary of each of these provisions. Tax provisions relating to employment, benefits and retirement provisions are covered in a separate client alert.

Section 2204. Allowance of Partial Above-the-Line Deduction for Charitable Contributions

Under current tax law, individuals must itemize their deductions to receive a benefit for charitable contributions. With the introduction of the significantly increased standard deduction in the Tax Cuts and Jobs Act (TCJA), however, many taxpayers no longer find it beneficial to itemize their deductions. Section 2204 of the CARES Act amends the Code to allow non-itemizing individual taxpayers to claim an "above-the-line" deduction of up to US$300 for cash contributions to "qualified charitable organizations," such as hospitals, churches and education institutions. Qualified charitable organizations do not include private foundations, supporting organizations or donor advised funds. This permanent modification, which is effective for taxable years beginning after December 31, 2019, provides non-itemizing taxpayers an opportunity to claim charitable contribution deductions.

Section 2205. Modification of Limitations on Charitable Contributions During 2020

Under current law, charitable contribution deductions are limited to 10% of a corporation's taxable income, while individuals' charitable contribution deductions are limited to 60% of their taxable income. Section 2205 of the CARES Act relaxes these limitations by providing a temporary deduction for "qualified contributions" of cash.

Section 2205 defines a "qualified contribution" as a gift or charitable contribution that is (1) made in 2020; (2) paid in cash; and (3) made to certain organizations described in Section 170(b)(1)(A) of the Code, including charities, churches, hospitals and education organizations. "Qualified contribution" specifically excludes contributions to private foundations, supporting organizations or donor advised funds.

In the case of a corporation, the qualified contribution deduction is limited to 25% of taxable income (determined without certain deductions). In the case of an individual, the qualified contribution deduction is limited to 100% of adjusted gross income before net operating loss deductions.

These limits are reduced by the amount of any non-qualified charitable contributions otherwise allowable, and any qualified contributions exceeding these limits can be carried forward for up to five years.

Section 2205 also temporarily increases the limit on deductions for charitable contributions of food from 15% of adjusted gross income to 25% of taxable income.

Together, these relaxed limits are intended to encourage additional charitable contributions of cash and food.

Hospitals, colleges and universities, and other charities that solicit contributions through use of Section 509(a)(3) supporting organizations should note that the benefits of the two charitable contribution provisions do not apply to contributions to supporting organizations. As a result, some organizations may need to establish procedures to allow the supported charitable or educational organization to accept contributions directly.

Section 2303. Modifications for Net Operating Losses

Under current, post-TCJA, law, net operating losses (NOLs) generated in tax years beginning after December 31, 2017, can only be used to offset up to 80% of taxable income. In addition, such NOLs cannot be carried back to prior tax years. Section 2303 of the CARES Act provides important temporary relief from these limitations on the use of NOLs, as well as corrects a technical issue that affected certain non-calendar year taxpayers after TCJA.

The relief from carryback limitations and current year NOL utilization applies to NOLs arising in taxable years beginning after December 31, 2017, and before January 1, 2021 (the "affected NOLs"). The CARES Act temporarily removes the taxable income limitation to allow affected NOLs to fully offset income. In addition, the CARES Act allows affected NOLs to be carried back five years prior to the year in which the affected NOL was generated. This provision is effective for taxable years beginning after December 31, 2017, and taxable years beginning on or before December 31, 2017, to which NOLs arising in taxable years beginning after December 31, 2017, are carried back.

These NOL relaxation provisions should provide an immediate reduction in cash taxes to be paid by corporations, thereby allowing them to access much-needed cash, which can then be deployed for operations. Additional limitations may apply to REITS and taxpayers that had an income inclusion under Code Section 965.

The technical amendment adjusts the effective date of the TCJA NOL limitation to taxable years beginning (instead of ending) after December 31, 2017, and allows a taxpayer to apply for a quick refund (which the IRS must apply within 90 days after the application is filed) under Section 6411. This is effective as if the provision was originally included in the TCJA.

Section 2304. Modification of Limitation on Losses for Taxpayers Other Than Corporations

Prior to TCJA, individual taxpayers could deduct business losses against other types of income without limit. Beginning in 2018, TCJA limited the use of individuals' businesses losses to gross income attributable to such business, plus US$250,000 (or US$500,000 in the case of a joint return), and any "excess business loss" is carried forward as an NOL. Section 2304 of the CARES Act retroactively postpones, effective for taxable years beginning after December 31, 2017, application of the "excess business loss" rules until 2021.

In addition to retroactively postponing application of the excess business loss rules, Section 2304 makes conforming changes and slightly modifies how the rules apply to capital gains and losses. Specifically, capital losses are no longer limited by the rule, and, for purposes of determining the excess business loss limit, only net capital gains of the trade or business are included in the gross income. Section 2304 also clarifies that the rule does not apply to pass-through deductions for qualified business income available under 199A.

Retroactively postponing application of the excess business loss rules should allow individuals to submit amended returns and claim refunds for excess business losses that were previously disallowed.

Section 2305. Modification of Credit for Prior Year Minimum Tax Liability of Corporations

Before TCJA, corporations were subject to an alternative minimum tax (AMT) that was computed by disallowing certain deductions and modifying other deductions (e.g., stretching out depreciation) for purposes of the AMT. Under AMT, corporations paid the higher of their regular income tax or the AMT computation. AMT amounts (i.e., generally, the extra tax payable by reason of the AMT) paid by a corporation carried forward as a credit in future years available to offset tax in certain situations. TCJA repealed the corporate AMT effective for tax years beginning after December 31, 2017. Companies that had an AMT credit for AMT amounts paid prior to repeal have been allowed to use that AMT credit and receive percentage refunds over a four-year period from 2018 to 2021.

The CARES Act accelerates those refunds of AMT credits by making them fully refundable sooner. A taxpayer can elect a full refund in its tax year beginning in 2018 and can claim the full refund in 2019 in any event. In addition, the CARES Act allows for "quickie" refunds in connection with claiming these accelerated AMT credit refunds for tax years beginning in 2018 and provides the secretary with authority to address such refunds in the context of consolidated returns.

These provisions should significantly accelerate the cash recovery of prior AMT payments made by corporations. All corporate taxpayers who brought an AMT credit amount into 2018 should consider claiming these AMT credit refunds.

Section 2306. Temporary Modification of Limitation on Business Interest

Starting in 2018 after the TCJA tax reform, corporate business interest deductions generally have been limited to 30% of "adjusted taxable income" (basically EBIDTA through 2021 and EBIT thereafter). Under special rules, this limitation was also applicable with respect to entities classified as "partnerships" for tax purposes. The CARES Act will relax that limitation to allow business interest deductions of up to 50% of adjusted taxable income for tax years beginning in 2019 and 2020, and the special rules applicable to "tax partnerships" will be adjusted to reflect the relaxed limitation. The partnership adjustments are particularly complex and will require special study by affected taxpayers. In addition, taxpayers can elect to use 2019 adjusted taxable income for their 2020 calculations, and presumably will do so when their 2019 income is higher (which will often be the case). Taxpayers can also elect out of this new temporary regime when it is advantageous to do so, as may be the case with certain real estate businesses.

The provision is temporary and there can be no certainty whether it will be extended. In some cases, therefore, it may be better suited to short-term debt incurred to manage current cash flow issues, as opposed to long-term debt incurred to finance general business expansion. In addition, businesses that have been profitable until the current crisis may find it advantageous to utilize the net operating loss carryback provisions of the CARES Act to provide a source of funds for repayment of all or a portion of any debt incurred during the period when the limitation on business interest deductions is in effect. Finally, and in addition to enabling businesses to borrow money more tax-efficiently, the provision could, through the creation of tax losses for 2020 that can be carried back to prior years under the net operating loss carryback provisions of the CARES Act, generate tax refunds for businesses that have been profitable in recent years.

Section 2307. Technical Amendment Regarding Qualified Improvement Property (the Retail Glitch)

Under the TCJA, changes to the bonus depreciation generally provided for the immediate, 100% expensing of depreciable business assets with a recovery period of 20 years or less and certain other property (e.g., machinery, equipment, computers, appliances and furniture), including used property. This tax benefit applies to such property acquired and placed in service between September 27, 2017, and December 31, 2022. Although Congress intended such immediate expensing to apply to interior upgrades, such as remodeling, installing energy efficient equipment, or improving handicap accessibility (i.e., qualified improvement property [QIP]), missing language in the TCJA not only kept QIP out of immediate expensing, but also increased the QIP depreciation period from 15 to 39.5 years.

The CARES Act fixes this so-called "retail glitch" and enables businesses to immediately deduct costs associated with QIP, retroactive to January 1, 2018.

Section 2308. Temporary Exception From Excise Tax for Alcohol Used to Produce Hand Sanitizer

Code Section 5214(a) provides that when a distillery sells distilled spirits to a distributor or a state liquor agency, the distillery is subject to an excise tax of US$13.50 per proof gallon, unless it meets certain exceptions. In order to incentivize increased production and availability of hand sanitizer, the CARES Act will, for calendar year 2020, waive the federal excise tax on any distilled spirits used for, or contained in, hand sanitizer that is produced and distributed in a manner consistent with guidance issued by the US Food and Drug Administration.

Section 4007. Suspension of Certain Aviation Excise Taxes

As part of congressional efforts to support US commercial airlines and air cargo carriers, the CARES Act suspends the collection of the Section 4216 7.5% excise tax on amounts paid for transporting persons (i.e., ticket tax) and the Section 4271 6.25% tax on amounts paid for transporting property (i.e., cargo tax). The suspension applies to taxes for transportation by air occurring after the date of enactment and before January 1, 2021, other than amounts paid on or before the date of enactment for transportation by air. Additionally, the legislation suspends the excise tax on kerosene used as aviation fuel, with the exception of the Leaking Underground Storage Tank Trust Fund tax – a tax that exists to raise money to enforce and fund cleanup operations of contamination resulting from underground storage tanks. The suspension of the kerosene excise tax applies to kerosene used after the date of enactment and before January 1, 2021.

How We Can Help

Our dedicated team of leading tax and public policy experts located in key jurisdictions around the world will help your company address the many issues that will arise in the wake of the global novel coronavirus pandemic. We look forward to engaging with you as your trusted adviser, to help you navigate this unprecedented period, as developments rapidly unfold.

We have also curated a resource hub to provide guidance on the key legal issues arising as a result of COVID-19 for your business to consider, and outline some practical steps you can take.

If you have questions about how any of the CARES Act provisions might impact your business, please contact any of the individuals listed here.

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