

## CARES Act – Bracewell Employment and Tax Lawyers Weigh In

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The ***Coronavirus Aid, Relief, and Economic Security (CARES) Act*** was signed into law on March 27, 2020. The ***CARES Act***, an emergency relief bill providing roughly \$2 trillion to businesses and individuals, aims to provide relief to the American economy in the midst of the economic downturn created by the current COVID-19 health crisis. This is the third aid package passed by Congress, with the two previous stimulus bills being the ***Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020*** and the ***Families First Coronavirus Response Act***.

### CARES Act Summary for Employers

The ***CARES Act*** contains a variety of provisions aimed at assisting employees and businesses—from tax credits and paycheck protection to unemployment benefits for their employees.

#### ***Paycheck Protection Program***

Through a new \$349 billion Paycheck Protection Program, the ***Keeping American Workers Paid and Employed Act*** expands the ability of certain employers to obtain loans under Section 7(a) of the Small Business Act. Generally, the covered employers include (1) small businesses and nonprofits with fewer than 500 employees; (2) hospitality businesses with fewer than 500 employees at each location; and (3) sole-proprietors, independent contractors, and self-employed individuals. The program covers loans obtained (retroactively) from February 15, 2020 through June 30, 2020. Significantly, the loans are 100% guaranteed by the federal government; collateral and personal guarantees are not required. The maximum loan amount is \$10 million for expenses through December 31, 2020, and is tied to payroll costs incurred by the business. Loans can be used for payroll support, meaning employee salaries, paid sick or medical leave, insurance premiums, and mortgage, rent, and utility payments. The provision also allows additional lenders to be approved to help keep workers paid and employed.

The Program establishes that employer borrowers are eligible for loan forgiveness equal to certain amounts used on payroll costs, mortgages, utilities, etc. Notably, the amount forgiven will be reduced proportionally by any reduction in employees compared to the prior year. The amount forgiven will also be reduced by the reduction in pay for any employees beyond 25% of their compensation from the prior year. To encourage employers to rehire any employees laid off due to the COVID-19 health crisis, employer borrowers that re-hire their laid off workers will

not be penalized for having a reduced payroll when the CARES Act takes effect.

### ***Unemployment Assistance***

Through the ***Assistance for American Workers, Families, and Businesses (Relief for Workers Affected by Coronavirus Act)***, the CARES Act expands certain unemployment benefits for workers. Specifically, a temporary Pandemic Unemployment Assistance Program will provide payment to workers traditionally not eligible for unemployment benefits who are unable to work because of the current health crisis. Moreover, emergency provisions set forth an additional \$600 per week federally funded payment for up to four months to individuals collecting state unemployment insurance benefits, and employees will be eligible for an additional 13 weeks of unemployment benefits through December 31, 2020. Furthermore, when waiving the typical one-week waiting period, states can rely on federal funding to cover the cost of the first week of unemployment benefits.

In furtherance of its effort to help both employers and employees, the CARES Act delivers funding to support so-called “short-time compensation” programs implemented by employers, such as reducing employee hours instead of conducting layoffs. It will also provide pro-rated unemployment benefits to employees with reduced hours. 100% of costs incurred by employers in providing short time compensation through December 31, 2020 will be covered by the Act.

### ***Payroll Tax Credit***

The CARES Act provides an expected refundable payroll tax credit of 50% of qualified wages paid by employers (including tax-exempt organizations) to employees during the COVID-19 crisis. The credit is available to employers if (1) its operations were fully or partially suspended due to a COVID-19 crisis related governmental shut-down order, or (2) its gross receipts declined by more than 50% when compared to the same quarter in the taxable year 2019. The credit is provided for wages paid or incurred from March 13, 2020 through the end of the calendar year, and the amount of wages taken into account with respect to any employee is limited to the first \$10,000 of compensation, including health benefits, paid by the employer. In determining the amount of the credit, employers with 100 or fewer full-time employees compute the credit based on all employee wages (whether or not the employer is open for business or closed due to a shut-down order). For employers with more than 100 full-time employees, the credit is computed based only on wages paid to employees *not* providing services due to decreased business as a result of the COVID-19 crisis.

### ***Delay of Payment of Employer & Self-Employment Payroll Taxes***

Pursuant to the CARES Act, employers and self-employed individuals will be given a grace period for depositing certain payroll taxes, such as social security taxes, otherwise due from the date of enactment through the end of the calendar year. Specifically, employers will be treated as timely making any required deposits if 50% of all such deposits are made by or prior to the calendar year 2022 and the remaining amounts are made prior to the calendar year 2023.

### ***Paid Leave Clarifications***

The CARES Act confirms certain caps set forth in the Families First Coronavirus Response Act (“FFCRA”), stating the caps with respect to each employee who takes the leave. It also adds an additional provision regarding rehired employees—an employee who was laid off by an employer after March 1, 2020, who had worked for the employer for at least 30 of the prior 60

calendar days before the employee's layoff, and who is rehired by the employer, is eligible for the paid family and medical leave set forth in the FFCRA.

## **CARES Act Key Tax Implications for Businesses**

The CARES Act includes several amendments to the Internal Revenue Code of 1986, as amended (the "Code"), that will impact taxpayers engaged in active businesses. Certain amendments modify provisions included in the Tax Cuts and Jobs Act ("TCJA"), which was enacted on December 22, 2017. Below are highlights from the key tax provisions impacting businesses.

### **Loss Limitation Relief**

The CARES Act relaxes certain limitations on taxpayers' use of net losses from business operations.

### ***NOL Carrybacks***

Under current law, as a result of TCJA, a corporate taxpayer can utilize net operating losses ("NOLs") to offset only 80% of its taxable income for any taxable year. The CARES Act removes the 80% taxable income limitation imposed under TCJA and thus allows a corporation's NOLs to offset 100% of its taxable income for any taxable year beginning after 2017 and before 2021.

TCJA also eliminated the ability of corporate taxpayers to carry back NOLs to reduce their taxable income in a prior taxable year. The CARES Act allows corporations to carry back NOLs arising in taxable years beginning after 2017 and before 2021 to the five previous taxable years. Only those corporations with taxable income during the five-year carryback period will receive a benefit from this provision. All corporations, however, will continue to enjoy an unlimited carryforward period as provided by TCJA, which repealed the previous 20-year limitation.

Special rules apply to corporations that are subject to the one-time transition tax under Code Section 965, which is applied to the deemed repatriation of earnings from certain foreign subsidiaries. Specifically, corporations may not use an NOL carryback to offset taxable income included by reason of the transition tax. This limitation ultimately may benefit taxpayers, because the taxable income resulting from the deemed repatriation is taxed at reduced rates, and thus available NOL carrybacks may be utilized to offset taxable income that is subject to tax at a higher (21%) rate.

### ***Excess Business Losses***

The CARES Act temporarily suspends the limitation (the "EBL Limitation") applicable to pass-through businesses and sole proprietors on excess business losses ("EBLs") as a result of TCJA.

Under the EBL Limitation, the amount of loss related to a trade or business that a non-corporate taxpayer may deduct in any taxable year ending before 2026 is limited to the sum of (i) the income or gain attributable to that trade or business and (ii) \$250,000 (\$500,000 for joint return filers), adjusted for inflation; the excess loss is the disallowed EBL. The CARES Act suspends the EBL Limitation for pass-through businesses and sole proprietors (to whom the EBL Limitation otherwise applies) for taxable years beginning after 2017 and before 2021.

The CARES Act also includes technical corrections to the EBL Limitation that clarify which types of income, gain and loss are taken into account in the computation of the limitation going forward. Notably, losses that relate to NOLs, the deduction for qualified business income under Code Section 199A and capital losses are not taken into account for purposes of calculating EBLs, which may permit taxpayers to reduce EBLs once the EBL Limitation is in effect. These technical corrections will apply after the temporary suspension of the EBL Limitation.

#### **AMT Refundable Credit**

The CARES Act modifies the schedule for refundable corporate alternative minimum tax ("AMT") credits. TCJA repealed the corporate AMT, but any unused AMT credit was refundable over four years ending in 2021. The CARES Act provides that the AMT credit is refundable over a corporation's 2018 and 2019 taxable years without further action by the corporation.

#### **Modification to Limitation on Interest Expense Deduction**

As a result of TCJA, most taxpayers are subject to a yearly limit (the "Interest Limitation") on interest deductions equal to the sum of (a) the taxpayer's interest income for the taxable year and (b) 30% of the taxpayer's adjusted taxable income ("ATI") for the taxable year. The CARES Act temporarily increases the ATI ceiling from 30% to 50% for taxable years beginning in 2019 and 2020. However, the 50% ceiling does not apply to partnerships. Instead, partners with excess interest expense are permitted to deduct 50% of interest arising in taxable years beginning in 2019 without the application of the Interest Limitation, and treat the remaining 50% as paid or accrued in the taxable year 2020 and subject to the unmodified (30%) Interest Limitation. Partners may elect out of this treatment.

The CARES Act also provides that a taxpayer can elect to apply the ATI amount from its 2019 taxable year to calculate its Interest Limitation for 2020. Taxpayers for whom 2020 is a short taxable year may prorate their 2019 ATI for this purpose. This special rule may permit certain taxpayers to increase their amount of deductible interest expense for 2020, provided that their 2019 ATI is greater than their 2020 ATI (presumably based on certain assumptions regarding economic performance during the COVID-19 crisis).

#### **Treatment of Certain Acquisitions by the Federal Government**

The CARES Act provides support in an aggregate amount of up to \$500 billion to be provided in accordance with the Federal Credit Reform Act of 1990 (which provides oversight over, and the means of allocating resources among, federal credit programs and other spending programs). Specifically, the CARES Act permits the federal government to invest in distressed companies through the provision of loans and loan guarantees and, as part of this initiative, authorizes the acquisition of ownership interests in private companies. To protect distressed corporations, the CARES Act authorizes the U.S. Treasury Department to provide guidance that the acquisition of stock in these corporations will not trigger (or count towards) an ownership change under Code Section 382. In general, when a corporation undergoes an "ownership change," Code Section 382 imposes a limit on the amount of the corporation's pre-change NOLs that can be used to offset income from post-ownership change taxable years. An ownership change occurs when the percentage of stock held by "5% shareholders" (as specifically defined) increases by more than 50% over a specified testing period (including as a result of a single transaction). While the CARES Act does not by its own terms prevent an ownership change by reason of the federal government's acquisition of stock, this authorization indicates that the federal government should not count as a 5% shareholder under these specific circumstances.

The CARES Act also provides that loans or loan guarantees provided by the federal government shall be treated as debt for federal income tax purposes. Among other helpful consequences, this provision makes clear that the IRS will not recharacterize these loans as equity, and therefore these loans should not trigger (or count towards) an ownership change for a corporate borrower.

**Qualified Improvement Property**

The CARES Act provides a welcome technical correction to the 100% bonus depreciation provisions under TCJA. TCJA inadvertently excluded “qualified improvement property,” which includes certain restaurant and retail property, from the category of tangible personal property that is eligible for bonus depreciation. The CARES Act resolves this issue by specifically designating qualified improvement property as 15-year property for depreciation purposes that is eligible for 100% bonus depreciation.