

Congress Reaches Agreement On A Coronavirus Relief Package: Tax Aspects Of The CARES Act

[Tony Nitti](#) Senior Contributor
[Taxes](#)

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• • A nation desperate for any reason for optimism got just that on Wednesday evening, with word that Congress had finally agreed upon a stimulus package designed to reverse the devastating impact of the COVID-19 pandemic. The Senate overwhelmingly passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and the House is set to do the same on Friday, paving the way for the President to sign the bill into law.

In addition to providing a large cash infusion to hospitals and broader access to COVID-19 testing to individuals, the CARES Act aims to boost the economy with over \$2 trillion in relief, ranging from individual rebates and small business loans to increased unemployment benefits and a wide variety of tax breaks.

Small Business Loans

In a move designed to keep small businesses afloat, the CARES Act provides that businesses with fewer than 500 employees — including sole proprietors and nonprofits— will have access to nearly \$350 billion in loans under Section 7 of the Small Business Act during the “covered period,” which runs from February 15, 2020 through June 30, 2020. The loans, which are referred to as “paycheck protection loans” and are fully guaranteed by the federal government through December 31, 2020 (returning to an 85% guarantee for loans greater than \$150,000 after that date), are generally limited to the LESSER OF:

- the sum of 1) average monthly “payroll costs” for the 1 year period ending on the date the loan was made (an alternative calculation is available for seasonal employers) multiplied by 2.5, and 2) any disaster loan (discussed below) taken out after January 31, 2020 that has been refinanced into a paycheck protection loan, and
- \$10 million.

Payroll costs, in turn, are the sum of the following:

- wages, commissions, salary, or similar compensation to an employee or independent contractor,
- payment of a cash tip or equivalent,
- payment for vacation, parental, family, medical or sick leave,
- allowance for dismissal or separation,
- payment for group health care benefits, including premiums,

- payment of any retirement benefits, and
- payment of state or local tax assessed on the compensation of employees,

Payroll costs do not include, however:

- the compensation of any individual employee in excess of an annual salary of \$100,000,
- payroll taxes,
- any compensation of an employee whose principal place of residence is outside the U.S., or
- any qualified sick leave or family medical leave for which a credit is allowed under the new Coronavirus Relief Act passed last week.

Example. Rob's Car Wash applies for a paycheck protection loan on May 1, 2020. The business had \$1.2 million in payroll costs for the period May 1, 2019 through May 1, 2020, for a monthly average of \$100,000. Rob's Car Wash is entitled to a fully guaranteed federal loan —assuming it's made before December 31, 2020 — equal to the LESSER OF:

- \$250,000 ($\$100,000$ in average payroll costs * 2.5), or
- \$10 million.

The loans will have a maximum maturity of 10 years and an interest rate not to exceed 4%. Proceeds may be used to cover payroll, mortgage payments, rent, utilities, and any other debt service requirements. The standard fees imposed under Section 7 of the Small Business Act are waived, and no personal guarantee is required by the business owner.

An additional provision in the CARES Act provides for possible deferment of repayment of the loans for a period of at least six months, but not to exceed a year.

Loan Forgiveness of Paycheck Protection Loans

A separate section of the CARES Act calls for a portion of the aforementioned paycheck protection loans to be forgiven on a tax-free basis. The amount to be forgiven is the sum of the following payments made by the borrower during the 8-week period beginning on the date of the loan:

- payroll costs (as defined above)
- mortgage interest,
- rent,
- certain utility payments.

To seek forgiveness, a borrower must submit to the lender an application that includes documentation verifying the number of employees and pay rates, and cancelled checks showing mortgage, rent, or utility payments.

Example. Continuing the previous example with Rob's Car Wash, in the first 8 weeks after the business borrows the \$250,000, the business pays \$200,000 in payroll costs, mortgage interest, and utility payments. Rob's Car Wash is eligible to have \$200,000 of the \$250,000 loan forgiven.

The forgiveness will not create taxable income. In addition, because of the deferment rules in the CARES Act, any payments due on the remaining \$50,000 will not be due for six months.

There is a provision, however, that reduces the amount that may be forgiven if the employer either:

- Reduces its workforce during the 8-week covered period when compared to other periods in either 2019 or 2020, or
- Reduces the salary or wages paid to an employee who had earned less than \$100,000 in annualized salary by more than 25% during the covered period.

This reduction can be avoided, however, if the employer rehires or increases the employee's pay within an allotted time period.

Emergency Government Disaster Loan and Grant

The CARES Act also expands access to Economic Injury Disaster Loans under Section 7(b)(2) of the Small Business Act to include not only businesses with fewer than 500 employees, but also sole proprietors and ESOPs. For any loan made under this program before December 31, 2020, no personal guarantee will be required on loans below \$200,000. The bill allows a disaster loan to be taken out between January 31, 2020 and the date on which a paycheck protection loan is available for reasons "other than paying payroll costs." Presumably, any loan taken out for payroll purposes will be confined to the paycheck protection loans described above.

In addition, the Act creates a new Emergency Grant to allow a business that has applied for a disaster loan to get an immediate advance of up to \$10,000. The advance can be used to maintain payroll, and is not required to be repaid, even if the borrower's request for a 7(b) loan is denied.

Employee Retention Credit

New to the final version of the CARES Act is a one-year only credit against the employer's 6.2% share of Social Security payroll taxes for any business that is forced to suspend or close its operations due to COVID-19, but that continues to pay its employees during the shut-down. It works like so...

A business is eligible for the credit in one of two ways:

1. The operation of the business was fully or partially suspended during any calendar quarter during 2020 due to orders from an appropriate government authority resulting from COVID-19, or
2. The business remained open, but during any quarter in 2020, gross receipts for that quarter were less than 50% of what they were for the same quarter in 2019. The business will then be entitled to a credit for each quarter, until the business has a quarter where it's recovered sufficiently that its receipts exceed 80% of what they were for the same quarter in the previous year.

For each eligible quarter, the business will receive a credit against its 6.2% share of Social Security payroll taxes equal to 50% of the “qualified wages” paid to EACH employee for that quarter, ending on December 31, 2020.

The business’s qualified wages depend on its size; if there were more than 100 employees during 2019, the qualified wages are limited ONLY to those wages that were paid by the employer during the quarter for the period of time the business was shut down.

If there were less than 100 employees for 2019, however, qualified wages include not only those paid to employees during a shut-down, but also wages paid for each quarter that the business has suffered a sharp decline in year-over-year receipts, as described in #2 above.

In both cases, qualified wages include any “qualified health plan expenses” allocable to the wages, such as amounts paid to maintain a group health plan. In either case, however, the amount of qualified wages for EACH employee for ALL quarters may not exceed \$10,000.

As you might expect, any wages taken into account in determining the new payroll tax credit for family medical leave or sick leave as part of the Coronavirus Relief Act may not be taken into account in determining qualified wages for the employee retention credit.

The credit is refundable if it exceeds the business’s liability for payroll taxes, a likely outcome given the two new payroll tax credits mentioned immediately above that were created as part of the Coronavirus Relief Act late last week.

Finally, if an employer takes out a payroll protection loan under Section 7(a) of the Small Business Act as detailed above in this article, no employee retention credit will be available.

Delay of Payment of Employer Payroll Tax and Self-Employment Tax

In addition to the various new payroll tax credits created by the Coronavirus Relief Act and the CARES Act, the new law would again seek to alleviate the burden on employers struggling to make payroll by allowing the employer’s share of the 6.2% Social Security tax that would otherwise be due from the date of enactment through December 31, 2020, to be paid on December 31, 2021 (50%) and December 31, 2022 (50%).

Similarly, a self-employed taxpayer can defer paying 50% of his or her self-employment tax that would be due from the date of enactment through the end of 2020 until the end of 2021 (25%) and 2022 (25%).

If you’re scoring at home, this means an employer that incurs its 6.2% share of Social Security tax in 2020 may 1) defer payment of that tax until 2021 and 2020, but 2) receive an immediate credit against those yet-to-be paid payroll taxes via the sum of the emergency medical leave credit, sick leave credit, and new employee retention credit. While this will greatly increase the cash available to small businesses in the coming months, I am not nearly bright enough to understand how it will all come together in practice on 2020 income and payroll tax filings.

Also note, this deferral is not available to any business that takes out a payroll protection loan forgiven as discussed earlier in this article.

Changes to the Net Operating Loss Rules

Prior to 2018, net operating losses of a business or individual could be carried back two years and forward 20, and when carried forward, they could offset 100% of taxable income. The TCJA altered these rules, disallowing all carrybacks related to post-2017 losses, providing for an indefinite carryforward period, and limiting the use of post-2017 losses when carried forward to 80% of taxable income.

This, clearly, was unfortunate timing. Rare will be the business that doesn't run at a loss in 2020; as a result, Congress temporarily reversed the TCJA changes:

- Losses from 2018, 2019 and 2020, will be permitted to be carried back for up to five years. As was previously the case, a taxpayer will be permitted to forgo the carryback, and instead carry the loss forward.
- Losses carried TO 2019 and 2020 will be permitted to offset 100% of taxable income, as opposed to 80% under the TCJA.

Example. In 2015 and 2016, X Co. broke even. In 2017, X Co. reported taxable income of \$1 million and paid federal income tax of \$350,000. In 2018, X Co. reported taxable income of \$2 million and paid tax of \$420,000. In 2020, X Co. recognizes a net operating loss of \$3 million. X Co. may carry \$1 million of the loss back to 2017 and recover the taxes paid (subject to the alternative minimum tax), and then carry the remaining \$2 million loss to 2018 and recover that \$420,000 as well.

Conclusion

Coming on the heels of an extended tax filing deadline and last week's Coronavirus Relief Act, the CARES Act is the third step of what promises to be many taken by Congress to help the country recover. Rumbblings have already begun regarding a 4th and 5th relief package. In addition to the much needed changes being made to hospital resources and medical coverage, the small business and tax aspects of the CARES Act will put immediate cash in the hands of individuals and business owners, while continuing to provide relief into the future in the form of benefits that will be realized upon the filing of 2020 tax returns.