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THE CARES ACT'S IMPACT ON BUSINESSES

On March 27, 2020, Congress passed and the president signed into law the "Coronavirus Aid, Relief and Economic Security Act" (CARES Act). It provides a $2 trillion economic stimulus for businesses and individuals faced with the challenges of the COVID-19 pandemic. This is a brief overview of notable provisions of the CARES Act, many of which will be substantial for individuals and business owners.

SBA LOANS

The CARES Act amends the Small Business Act (SBA), creates a new program category for SBA loans (Paycheck Protection Loans) and expands the Disaster Loan Program that was, itself, recently enhanced.

Paycheck Protection Loans

The Paycheck Protection Loan program provides eligible businesses with loans to help with salaries, commissions, paid leave, severance, group health benefits, retirement benefits, state and local taxes payroll and the like up to a maximum of $100,000 annualized salary (Payroll Costs), and interest on mortgage loans, rent and utilities.

An eligible business must have 500 or fewer employees, with certain exceptions for restaurants and hotels, and otherwise be eligible for SBA loans under pre-CARES Act standards. To be eligible the loan must be needed to continue operations during the COVID-19 emergency.

The maximum amount of the loan is $10 million and is generally limited to 2.5 times the business's average monthly Payroll Costs for the 12-month period prior to the loan.

The Paycheck Protection Loans do NOT require collateral or personal guarantees. Interest on Paycheck Protection Loans cannot exceed 4%.

The loan will be forgiven (and will not be deemed debt cancellation income) if used exclusively for Payroll Costs, rent, interest payments on mortgages and utility payments incurred and paid during an eight week period following the origination of the loan. However, the forgiveness amount will be reduced for a reduction in wages or full-time employees pursuant to a mathematical formula.

SBA Disaster Relief Expansion

SBA Disaster Relief loans of not more than $200,000 will not require personal guarantees (increased from $25,000).

TAXES

Net Operating Losses

Prior to the enactment of the Tax Cuts and Jobs Act of 2017 (TCJA), net operating losses of a business could be carried back 2 years and carried forward 20 years, with the ability to offset 100% of taxable income if carried forward. The TCJA drastically changed these rules. Under the TCJA, Congress disallowed carrybacks to all losses, while providing an indefinite carryforward period with one limitation—instead of allowing 100% of taxable income to be offset by carryforward losses, Congress limited it to 80%.

The CARES Act provides much needed relief regarding net operating losses. Losses from 2018, 2019 and 2020 are now allowed to be carried back for up to 5 years. Losses carried forward to 2019 and 2020 will be permitted to again offset 100% of taxable income, instead of the 80% limitation imposed by TCJA.

Deferral of Payroll Tax

Employers will be able to defer paying their share of payroll taxes in 2020. The deferred amounts will be payable over the next two years—50% of the amount owed on December 31, 2021, with the remainder due on December 31, 2022. This rule also applies to self-employed individuals.

Payroll Tax Credit

The CARES Act also provides an incentive for employers to retain employees during this time. The CARES Act provides a 50% tax credit against payroll tax liability against up to $10,000 in payroll and health benefits costs for each employee. To be eligible for this credit, employers must have carried on a trade or business during 2020 and either have operations fully or partially suspended from COVID-19 governmental orders or experienced a significant decline in gross receipts compared to the same quarter in the previous year. A significant decline in gross receipts occurs when gross receipts for one quarter are less than 50% for the same quarter in the prior year and continue until gross receipts exceed 80% of gross receipts for the same calendar quarter in the prior year. It is worth noting that an employer who takes a Paycheck Protection Loan (discussed above) will not be allowed to claim the employee retention credit.

Qualified Improvement Property

The CARES Act also corrects an omission in the TCJA, which will affect the tax consequences of improvements made to qualified improvement property (QIP). QIP is defined as interior improvements made to a nonresidential building. Prior to the CARES Act, the depreciable life of a QIP has been 39 years. Congress intended to reduce the depreciable life of a QIP to 15 years in 2017, however, the TCJA failed to include this in the final bill. To make matters worse for some property owners, Congress' failure to give

QIP a 15-year life resulted in the inability for a property owner to qualify for the 100% depreciation allowed for assets with a life under 20 years. The CARES Act includes a provision correcting this error. QIP property is now given a 15-year life and the change is effective as of January 1, 2018. This means that taxpayers who suffered from making interior improvements to QIP are allowed to go back and amend their 2018 and 2019 tax returns and reap the benefits of accelerated depreciation.

Business Interest Deduction

The CARES Act temporarily increases the limitation of business interest deductions for businesses taxed as a C-Corporation or S-Corporation under the TCJA. Normally, a deduction is only allowed against 30% of adjusted taxable income. Under the CARES Act, this limitation is increased to 50% of adjusted taxable income for 2019 and 2020. The CARES Act will also allow a taxpayer to elect to use 2019 adjusted taxable income to calculate the 2020 limitation. This will be beneficial to most businesses, as most businesses will not have taxable income in 2020.

Entities taxed as a partnership are still subject to the 30% limitation. However, beginning in 2020, partners in partnerships will be able to deduct 50% of any excess business interest expense that was allocated to them in 2019. The remaining 50% is deductible when the partnership allocates excess taxable income to the partners.

UNEMPLOYMENT BENEFITS AND BUSINESSES

The CARES Act provides funding for currently existing “short-time compensation” programs or work programs. Under “short-term compensation” programs, employees whose hours are reduced are entitled to receive pro-rated unemployment benefits with the state covering the expenses to provide this benefit. The “short-time compensation” program incentivizes employers to retain their employees in lieu of lay-offs.

States that have a “short-time compensation” program in place will receive funding from the federal government to cover 100% of the costs incurred to retain these employees whose hours have been reduced. States that do not currently have a “short-time compensation” program can enter into an agreement with the federal government and receive 50% of the funding to cover the costs incurred by the state for implementing this program. The remaining 50% will be paid by participating employers.

The CARES Act makes substantial changes to unemployment assistance, expanding the benefits available and extending coverage to more individuals. The CARES Act extends coverage to certain individuals who are affected by COVID-19, including individuals who are self-employed. For information regarding expanded unemployment benefits for self-employed individuals, see our article on our website titled “The CARES Act’s Impact on Individuals.”

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MOMKUS LLC IS HERE TO HELP

Please feel free to contact your Momkus LLC attorney with questions or concerns. Our office is operating at 100% and we've been designated as an "essential service" during the crisis; your calls and emails will receive prompt attention, even if we can't personally shake your hand.