BUSINESS STRATEGIES: COPING WITH COVID-19

The CARES Act

What businesses need to know

Panelist

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The tax implications of the CARES Act

Overview of today's discussion

- SBA loan program
- Payroll credits & deferral of payroll tax credits
- Qualified improvement property & changes to depreciation
- Business interest expense limitation changes
- Losses & how to use losses
- Potpourri of other tax changes
- What should taxpayers be doing right now?

Paycheck Protection Program

SBA backstops forgivable loans

Paycheck Protection Program

- Less than 500 employees
- Affiliation rules impact employee count as commonly-controlled businesses would be considered in the aggregate
- Exception for certain businesses in hospitality and restaurant industries
- Franchise Identifier Codes – Businesses with franchise codes can waive affiliation rules
- Maximum loan value is 2.5 times average monthly payroll costs which includes wages, commissions, vacation, health insurance, and retirement benefits
- Compensation included in payroll costs can’t exceed $100k per employee

Paycheck Protection Program

How much of the loan is forgiven?

- Cash expended (not accrued) during 8-week covered period for the following:
  - Payroll costs (same as in determining max loan value)
  - Interest portion of mortgage
  - Rent
  - Utilities (electricity, gas, water, transportation, telephone, internet)
  - Mortgage, rent, and utilities must be in writing and in force by February 15, 2020.

Paycheck Protection Program

How much of the loan is forgiven?

- Not more than 25% of the loan forgiveness amount may be attributable to non-payroll costs
- Forgiveness may not exceed principal. Forgiveness is not taxable
- Reductions in loan forgiveness may apply for reduction in monthly average full time equivalent employees for the covered period or compensation reductions in excess of 25%
- Reductions in employment or wages that occur between February 15, 2020 and April 26, 2020 shall not reduce the amount of loan forgiveness if by June 30, 2020 the borrower eliminates the reduction in employees and/or reduction in wages

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Comparison: SBA Economic Injury Disaster Loans and Paycheck Protection Programs, CARES Act

Information in this chart includes definitions and guidance on the relief programs as of March 27, 2020 and is not inclusive of all terms and conditions. The SBA has up to 30 days to issue regulatory guidance for certain provisions of the CARES Act. Additionally, the Treasury Department is required to issue regulations and providing guidance under certain provisions of the CARES Act. Issuance of regulations may delay loan approval, disbursement, or may modify/waive certain requirements.

	Economic Injury Disaster Loan	Paycheck Protection Program
Period	January 31, 2020–December 31, 2020	February 15, 2020 - June 30, 2020
Eligibility	Small businesses, small agricultural cooperatives, private nonprofit organizations, and entities considered small for the industry in which they operate	Small business, nonprofit organization, veterans' organization, or Tribal business, which employs not more than 500 employees or the allowed number as set by the SBA industry size standard of the assigned NAICS code
Affiliation	Size is subject to aggregation with affiliates, which should be considered carefully. SBA generally includes aggregation of affiliates owned by investors who have certain controls features over the subject company. Affiliations include foreign parents and subs. Affiliations include all related PE/VC portfolio companies under common control Exceptions: 1. SBIC owned business are not considered affiliates of the SBIC; 2. Tribunal business are not considered affiliates of the Native American tribe; 3. Businesses that lease employees are not affiliated with the leasing entity.	Size is subject to aggregation with affiliates, which should be considered carefully. SBA's affiliation rule generally includes aggregation of affiliates owned by investors who have control features over the subject company. Affiliations include foreign parents and subs. Affiliations include all related PE/VC portfolio companies under common control Exceptions: 1. Businesses assigned a NAICS code beginning with 72 (hotels and restaurants); 2. Franchises assigned an SBA franchise identifier code and 3. Businesses that receive financial assistance from a licensed SBIC.
Loan Amount	Up to $2 million; used to help meet financial obligations and operating expenses that could have been met had the disaster not occurred Loan amount will be based on actual economic injury and company's financial needs	Amount equal to the lesser of: 1. The sum of - i. 2.5x the trailing twelve-month average for payroll costs (salaries*, wages, commissions, cash tips, severance, group health insurance premiums, sick/medical/family leave, state and local payroll taxes) ii. Balance owed on any SBA EIDL originated between January 31, 2020 and the PPP the loan origination date; 2. $10,000,000 * Exceptions exist for compensation in excess of $100,000; employees with principal residences outside the US; and payroll taxes under IRC Chapter 21, 22, and 24

	Economic Injury Disaster Loan	Paycheck Protection Program
Loan Terms	Interest rate not to exceed 4% Repayment terms up to 30 years and determined by ability to repay the loan Forgivable grant up to $10,000 funded within three days after the SBA receives the application. Repayment of grant not required, even if application is denied.	Interest rate not to exceed 4% Repayment terms up to 10 years of any amount not forgiven after submission to SBA Complete payment deferment relief for a period of not less than 6 months, but not to exceed 1 year
Loan Forgiveness	Immediate grants up to $10,000 will be forgiven	Loan forgiveness amount equivalent to an amount used to fund payroll costs*, interest on mortgage, covered rent expense, and covered utility payments during the eight-week period after loan origination. Amount of forgiveness will be reduced in accordance with any reduction in the average number of FTE or salary reductions in excess of 25% during the covered period (excludes reductions to salaries in excess of $100,000). Any remaining loan balance will have a maximum maturity of 10 years from application date to the SBA for forgiveness. * Salary capped at $100,000 (annualized)
Taxability	Amount forgiven will not be considered income for taxes	Amount forgiven will not be considered income for taxes
Collateral	Collateral required for loans over $25,000 Loan will not be declined for lack of collateral	No collateral pledge required
Guarantee	No personal guarantee for loans less than $200,000	No personal guarantee required
Credit Elsewhere	Test waived as part of CARES Act	Test waived
Application	Apply directly online with the SBA at sba.gov Approval based on applicant's FICO credit score and do not require assessing applicant's ability to repay.	Apply directly with participating SBA 7(a) lenders Requires business make a good faith certification that funds are requested due to current economic uncertainty and funds will be used to retain employees Limits eligibility of SBA EIDL for the same purpose. However, it allows a borrower who has an EIDL loan to apply for a PPP loan and refinance that loan into the PPP loan. Note: The amount forgiven under the PPP will reduce by the EIDL grant of up to $10,000
Loan Fees	Not Applicable	Paid to Lender by SBA

Payroll credits & deferral of payroll tax payments

Employer payroll tax credits & deferral provisions

One new credit and a deferral provision supplement two credits introduced in FFCRA

- The employee retention credit is new in the CARES Act.
- An employer payroll tax deferral provision is included in the CARES Act.
- The required paid sick leave credit was included as part of FFCRA.
- The required paid family medical leave credit was included as part of FFCRA.

Employee retention credit

This is a refundable, quarterly credit in the amount of 50% of "qualified wages" up to $10,000 per employee.

- The credit applies against the employer's portion of the 6.2% FICA tax, but any excess is refundable.
- Any refundable amounts will offset other employment tax obligations for the quarter, including other employer tax obligations (1.45% Medicare) and remittances of employer withholdings.
- Employers may claim an advance credit refund on Form 7200.

Employee retention credit

Nonduplication provisions

- The credit isn't available to an employer that receives a covered loan under the Paycheck Protection Program with the SBA.
- If an employer claims the employee retention credit and later receives a covered loan under the Paycheck Protection Program, a recapture of the credit most likely applies.

Employee retention credit

Employers eligible for credit

- Businesses that have operated in 2020, including tax-exempt organizations (not limited to nonprofit charities, but including all 501(c) organizations)

Governments, including governmental agencies and instrumentalities, aren’t eligible for the credit.

Employee retention credit

Eligibility criteria

- Two criteria, either of which may entitle an employer to the credit during a quarter
  - Suspension of operations due to governmental restriction
  - Significant decline in gross receipts

Employee retention credit

Full or partial suspension of operations

- A business (or tax-exempt entity) that either fully or partially suspends operations may be entitled to the credit for the affected calendar quarter.
- The suspension must result from an appropriate governmental authority imposing restrictions upon the business operations by limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 such that the operation can not continue (full suspension) or still continue to operate, but not at its normal capacity (partial suspension).

Employee retention credit

Significant reduction in gross receipts

- A business that suffers a reduction in gross receipts for any calendar quarter of more than 50% relative to the same quarter of 2019 may be entitled to claim a credit.
- The business remains eligible through the calendar quarter in which gross receipts are restored to greater than 80% of the gross receipts of the same calendar quarter of 2019.

Employee retention credit

Eligibility — employer size

- All qualified types of employers may be eligible for the credit.
- The rules apply differently for small employers (less than an average of 100 employees, determined using the same rules as the Affordable Care Act for 2019) and large employers.
- The statute provides that aggregation rules may apply to pull two employers together for purposes of determining whether an employer is a small employer.

Employee retention credit

"Qualified wages" — small employers:

- Includes all wages of the affected quarter (for first quarter, only wages going back to March 12 apply) for all employees.
- Includes a pro rata share of employer health plan expenses.
- Maximum of $10,000 per employee for all quarters combined.
- Doesn't require that employees no longer be performing services to qualify.

Employee retention credit

“Qualified wages” — large employers:

- Includes only wages paid by employers to employees who aren’t performing services due to circumstances described in the previously discussed eligibility.
- Also includes a pro rata share of employer healthcare plan expenses into gross wages.
- Maximum of $10,000 per employee for all quarters combined.

Employee retention credit

“Qualified wages” — nonduplication rule

“Qualified wages” cannot be qualified wages for both the employee retention credit and the credits for paid sick leave and family leave under the FFCRA.

Employer deferral of FICA taxes

Employer deferral provisions

- Employers may defer the payment of its 6.2% share of FICA taxes.
- Half of the tax is due on Dec. 31, 2021, and the remaining half is due on Dec. 31, 2022.
- Effective March 27, 2020 through December 31, 2020
- All types of employers are qualified (including governments – different from employee retention credit qualifications)
- Employers aren't eligible if they receive loan forgiveness under the SBA Paycheck Protection Program (not just receive a loan that would make an employer ineligible for the employee retention credit).
- Any failure-to-deposit or failure to pay penalties wouldn't apply to an eligible deferral.
- It's unclear whether there would be any interest charges for the deferral period.

Summary of COVID-19 Employer Tax Incentives

	Employee retention credit	Deferral of employer payroll taxes	Paid sick leave credit	Paid family leave credit
Employee threshold	None (but modified calculation above 100)	None	<500	<500
Employee counting and employer aggregation rules*	Affordable Care Act rules and Internal Revenue Code sections 52 and 414	None	Fair Labor Standards Act and Family Medical Leave Act (see Dept. of Labor FAQ)	Fair Labor Standards Act and Family Medical Leave Act (see Dept. of Labor FAQ)
Required impact from COVID-19	Operations must be fully or partially suspended or result in a substantial reduction in gross receipts	None	Employee must not be working for one of 6 COVID-19 related reasons	Employee must be on leave to take care of child whose school or care provider is closed
Method of obtaining cash benefits	Retain all payroll taxes and withholdings up to credit amount; optional periodic advance payment of excess; quarterly cash refund for remainder	Retain eligible employer social security taxes	Retain all payroll taxes and withholdings up to credit amount; optional periodic advance payment of excess; quarterly cash refund for remainder	Retain all payroll taxes and withholdings up to credit amount; optional periodic advance payment of excess; quarterly cash refund for remainder
Credit calculation	50% of up to $10,000 of qualified wages per employee	6.2% of all wages subject to social security tax	Up to $200 or $511 per day per employee, depending on the reason for the absence; maximum of 10 days; increased by health care expenses and employer Medicare tax	Up to $200 per day per employee; maximum of $10,000; increased by health care expenses and employer Medicare tax
Qualified wages	All wages if <100 employees; wages only of employees not working for others	All wages subject to social security tax	Only sick leave wages required to be paid under FFCRA	Only family leave wages required to be paid under FFCRA
Treatment of allocable health plan expenses	Included in qualified wages and subject to same overall limitation	Not eligible for benefits	Direct increase to credit amount	Direct increase to credit amount

Effective date	March 13, 2020	March 27, 2020	April 1, 2020	April 1, 2020
Expiration date	December 31, 2020	December 31, 2020	December 31, 2020	December 31, 2020
Restrictions on small business loans	Cannot claim credits if Payroll Protection Program loan obtained	Cannot defer payroll tax if Payroll Protection Program or §1109 loan forgiven	None	None
Common law employers and third-party payers	Credit available to common law employer, not third-party payer	Deferral available to common law employer, not third-party payer	Credit available to common law employer, not third-party payer	Credit available to common law employer, not third-party payer
Self-employment (SE) tax benefits	None	SE tax equivalent eligible for deferral	SE tax credit available for sick leave equivalent of self-employed individual	SE tax credit available for family leave equivalent of self-employed individual
Section 501(c) entities	Eligible	Eligible	Eligible	Eligible
Federal, state, and local governments / agencies	Not eligible	Eligible	Not eligible	Not eligible

*The Payroll Protection Program loans generally require an employer to have less than 500 employees. This 500-employee threshold is determined under a different set of employee counting and aggregation rules as determined by the Small Business Administration. See the Affiliation guide in the Size Standards section of the Small Business Administration website for details.

Qualified improvement property & changes to depreciation

Qualified improvement property (QIP)

- Tax Cuts and Jobs Act (TCJA) rules
- The CARES Act technical correction for QIP
- 100% bonus depreciation or 15-year recovery
- Timing: Retroactive to TCJA
- Further guidance expected; timing unknown
- Possibly file superseded or amended returns; Form 3115

Business interest expense limitation changes

Business interest expense limitation: TCJA

The TCJA of 2017 imposed a new limitation on annual interest expense deductions for certain taxpayers.

Business interest expense deductions were limited to:

- Business interest income.
- Plus, 30% of adjusted taxable income (ATI).
- Plus floor plan financing interest.

Special rules were applied to small businesses, real estate, farming businesses, and utilities.

What changed?

The annual limitation is generally increased to include 50% of ATI for 2019 and 2020.

A special rule is applicable to partnerships:

- 2019: Partnerships still use the limitation based on 30% of ATI
- 2020: Partnerships use the increased limitation based on 50% of ATI
- 2020: Partners are able to deduct half of any suspended deductions (EBIE) allocated by the partnership in 2019; the remaining half of EBIE is subject to normal carryforward rules

For 2020, taxpayers can even elect to use their 2019 ATI

Losses & how to use losses

Net operating loss rule changes

Restored carryback rules apply

- The TCJA removed all carryback provisions and provided for unlimited carryforwards.
- The CARES Act restores the five-year carryback provisions for tax years 2018, 2019, 2020.
- This creates an opportunity to file amended returns to claim losses.
- Consideration must be made whether to file an election to waive the net operating loss carryback (trap provision).

Net operating loss rule changes

Limitations on utilization of net operating losses rules change

- Prior to the TCJA, net operating losses were available to reduce taxable income “dollar-for-dollar.”
- The TCJA limited utilization of net operating losses to 80% of taxable income.
- The CARES Act suspends the utilization limitation until 2021.
- There may be amended return opportunities to claim additional net operating losses.

Excess business loss rule changes

Limitations on excess business losses rules change

- Prior to the TCJA, there were no specific limitations on excess business losses.
- TCJA imposed a $250,000 net business loss rules ($500,000 for married couples filing jointly) for all "excess business losses," beginning with 2018.
- The CARES Act suspends the TCJA changes for tax years 2018, 2019, and 2020; the provision doesn't take effect until 2021.
- This may create additional original and amended return opportunities to claim additional business losses for 2018 and 2019.

Potpourri of other tax changes

Other changes

Changes impacting businesses

- Corporate charitable contributions
- AMT credits
- Employer-paid student loans

Changes impacting individuals

- Individual charitable contributions
- Retirement fund distributions
- Recovery rebates

Deferral of filing requirements

- 2019 Income tax filings and payments due on 4/15/20 are postposed to 7/15/20 (includes Q2 quarterly tax payments as well)
- Postponement is automatic
- No limitation on the amount due/postponed
- Penalties and interest disregarded during postponement
- Extensions beyond 7/15/20 require taxpayer action

What should taxpayers be doing right now?

What to do now?

Evaluate loan and payroll credit options

- Need to determine program eligibility and potential benefits
- Conclude on the most beneficial options

Integrate changes into 2019 tax returns

- Will require decisions, such as whether to claim bonus depreciation on QIP
- Previously filed 2019 returns should be evaluated for amendment or superseding return opportunities.

Identify opportunities for prior years

- Consider opportunities to amend prior year returns or to file accounting method changes to take advantage of new rules.
- Evaluate impact of loss carryback rules and opportunities to maximize benefits.

Continue to watch for additional guidance

COVID-19 resources

- plantemoran.com/covid-19
  - Articles & insights
  - Webinars
  - Preparedness assessments
  - Access to complimentary guidance from our COVID-19 taskforce hotline
- CARES Act resource center
- plantemoran.com/subscribe
  - All Plante Moran subscribers will receive relevant COVID-19 thought leadership and information.
- We share all relevant updates and thought leadership on our social media channels
  - Facebook
  - LinkedIn
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