US CARES Act : What Businesses Need to Know...

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The coronavirus COVID-19 is affecting 204 countries and territories around the world and 1.2 million people as we speak. Without doubt, it's a generational challenge for countries, communities, businesses, its leaders and for humanity to slow the spread. The world as we know it has never been shut down, until now. Measures of societal and business closures while effective at fighting a pandemic, also have a dramatic impact on the economy. The COVID-19 pandemic is a human tragedy and global health crisis, and its rapidly escalating into an economic crisis with a long, lingering impact.

The challenge for world leaders is two-fold: Health - put societal measures to slow the spread, scramble medical care for people impacted, accelerate research and roll-out of treatments; Economy - Provide income support to large swaths of population, financial support & liquidity to businesses, and enact measures to minimize the likely recession to follow. Governments across are enacting emergency relief measures to underpin the building blocks of economy.

Simplistically, with Covid-19 shutting down large swathes of the economy, consumer and business activity has come to a standstill, the Government stimulus aims to fill that vacuum. In 2019, US GDP was ~$21 trillion, the $2 trillion Coronavirus Aid, Relief, and Economic Security (CARES) Act aims to make-up for 15-25% anticipated reduction in Q-2 GDP. It's the largest stimulus bill in modern history, more than double the 2009 bill during the Global Financial Crisis. There are five components in CARES:

Category	**Total Amount**	**% of total**
Individuals / Families (cash in hand, higher unemployment support)	$604 bn	30%
Big Business (targeted relief for hard hit industries)	$500 bn	25%
Small Business (wide raging lending support)	$377 bn	19%
State and Local Government	$340 bn	17%
Public Services	$180 bn	9%

Congress had already enacted two coronavirus (COVID-19) relief bills:

Phase 1: An $8.3 bn emergency funding bill to treat and prevent the spread of COVID-19 and give Public Health Support for federal agencies to respond to the coronavirus outbreak. 81% of this bill is designated for US domestic response and 19% for coordinating international response.

Phase 2: Families First Coronavirus Response Act, $192bn targeted relief for individuals by providing paid sick leave, family and medical leave, employer tax credits, and free COVID-19 testing; expanding food assistance and unemployment benefits; and increasing Medicaid funding.

The CARES Act (CARES) builds on these two legislations by providing more robust support to both individuals and businesses, including changes to tax code. This might not be the end of the line and there is already talk of a Phase 4 stimulus. The COVID-19 stimulus bill runs into 880 pages and its scope is wide-ranging, in this article I am providing a high-level summary of 'What is in it for Businesses' in two buckets - Tax Reliefs and Financial Assistance.

A. Tax Reliefs:

1. Net Operating losses

2. Business interest expense - section 163(j)

3. Alternate Minimum Tax

4. Qualified Immovable Property

5. Charitable contributions

6. Payroll Tax deferral

7. Employee Retention Credit - Payroll tax relief

B. Financial Assistance Program

1. Payroll Protection Program for small businesses

2. Loans for mid-sized businesses

3. Loan assistance to big businesses in worst hit sectors

A. Tax Reliefs

1. Net Operating losses (NOLs) - Carry backs

After the Tax Cuts and Jobs Act of 2017 (TCJA), NOLs generally could not be carried back but could be carried forward indefinitely. It also limited NOL absorption to 80% of taxable income. CARES provides for carry back for five years and also temporarily removes the 80% limitation for tax years beginning after 2020.

- NOLs arising in tax years beginning after December 31, 2017, and before January 1, 2020 may be carried back to each of the five tax years preceding the tax year of such loss. For instance, a 2018 NOL can be carried back to 2013.
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NOL generated in tax years	Eligibility for Carryback	Eligibility for Carryforward	Eligibility for offset against Taxable Income
December 31, 2017 or prior	2 tax years	20 tax years	100% of TI
After December 31, 2017 and before January1, 2017	5 tax years	Indefinite	100% of TI before 2020 80% of TI after 2020
After January1, 2017	No carryback	Indefinite	80% of TI

• Also, there is Rate Benefit for this period ending March 31, 2020 for carrying back to tax years 2013-2017. For NOL carrybacks the current 21% rate to be used as against a 35% corporate tax rate - this is a significant opportunity for corporates.

• Besides the cash flow benefits from an immediate refund, NOL carrybacks present an opportunity for permanent tax savings. It is important to consider the interaction of an NOL carryback with international provisions of the TCJA like impact of Foreign tax credits, deduction u/s 250 for Foreign Derived Intangible income (FDII)/ global intangible low-taxed income (GILTI), and IRC provisions like AMT, 163 (j) limitations. So, calculation needs to redone considering such limitations to determine value of NOL and then determine whether the carryback is right for each case.

2. Interest deductibility- relaxation of limits

Section 163(j) of the IRC limits the amount of business interest expense that may be deducted in a tax year to the sum of (1) the taxpayer's business interest income for the year; (2) 30% of the taxpayer's adjusted taxable income (ATI) for the year; and (3) the taxpayer's financing interest expense for the year.

- CARES allows taxpayers the option to limit the deduction for net business interest to 50% of ATI for any taxable years beginning in 2019 or 2020. For partnerships, 50% of ATI shall be included in the 163(j)

limitation for tax years beginning in 2020
- The taxpayers are also given an option to use their ATI for 2019 to calculate their limit for 2020.

Since these changes are elective, corporates need to assess:

- If they have otherwise disallowed business interest expense (the amount in excess of 30% of ATI, up to 50%), may be able to deduct more business interest expense in 2019 and 2020.
- If they have more ATI in 2019 than 2020; they may use election of ATI of 2019 instead of that of 2020 and may have more deductible interest expense

3. AMT credits - acceleration

Taxpayers were allowed to recover 50% of their AMT credits against the regular tax liability. The TCJA had repealed the corporate AMT. It allowed corporations to:

- Immediately claim unused AMT credits and offset against regular tax liability;
- Any unused AMT credit amount became refundable credits over the 4 tax years beginning from 2018, 2019, 2020 and 2021.
- CARES accelerates the refund schedule. It allows corporates to claim the refund fully in the tax years 2018 or 2019.

4. Qualified improvement property (QIP) - technical correction

▪ QIP, relevant for any business that makes improvements to interiors of a nonresidential building that is placed in service after the building's initial placed in service date.

▪ CARES corrects a technical error to the 2017 TCJA retroactively. QIP is now classified as 15-year depreciable property and is eligible for 100% bonus depreciation.

▪ Under TCJA, it had to be depreciated over 39 years.

▪ This change is retrospective to 2018 and taxpayers should generally be able to change QIP depreciation methods by:

  - filing an automatic accounting method change in their next return, or
  - possibly amend prior returns to claim this benefit.
  - file superseding returns based on when QIP was placed in service and when the applicable return(s) were originally filed

Taxpayers need to determine which of these options are best suited to their specific situations.

5. Charitable contribution - increase in deduction

- CARES increases the limitations on deductions for charitable contributions for corporations who make cash contributions in 2020 from 10% of taxable income to 25% of taxable income.
- Contributions must be made to a public charity or foundation described in section 170(b) (1)(A), but contributions to a supporting organization or a donor-advised fund would not qualify for the increased limits.
- The relevant percentage limitation applicable to certain donations of food inventory (namely, those that are eligible for an enhanced charitable deduction) is also increased for donations made in 2020, from 15% to 25%.

Usually for presidentially declared disasters, it is required from taxpayer to obtain a written acknowledgment of the use of the contribution for this purpose. There is no such requirement that a contribution be used in COVID19 relief efforts in order to take advantage of the higher percentage limitations

6. Payroll Tax Deferral - Employer Portion of Social Security Taxes .

CARES allows employers and self-employed individuals to defer over two years the payment of the employer's portion of the 6.20% Social Security payroll tax on employee wages paid between the March 27, 2020, and December 31, 2020. Taxpayers must pay:

- 50% of the deferred amount by December 31, 2021, and
- 50% by December 31, 2022.

This credit is not available to employers receiving assistance through the PPP loan forgiveness provisions.

7. Employee Retention Credit: tax credit

All businesses, regardless of size, are eligible for a 50% refundable payroll tax credit of 'qualified wages' paid by certain eligible employers to employees.

· Eligible employers are those carrying on a trade or business in calendar year 2020 whose:

- Operations were fully or partially suspended, due to the COVID-19 crisis, or

- Gross receipts declined by more than 50% when compared to the same quarter in the prior year. For the gross receipts test, eligibility ceases at the end of the calendar quarter in which gross receipts are greater than 80% of gross receipts for the same calendar quarter for the prior year.

· “Qualified wages”-

- wages paid March 13, 2020 to December 31, 2020

- for eligible employers with More than 100 full time employees - wages paid to an employee who is not providing services

- for employers with 100 or less full-time employees - all employees' wages

· Credit is capped at first $10,000 of compensation per employee.

- Creditable against Social Security tax up to $5,000 per employee (50% of wages up to $10,000);

- excess credit refundable

· Taxpayers receiving an Small Business Administration (SBA) loan are not eligible for this credit.

The credit is available to corporations as well as Pass-through entities, such as LLCs, S-Corps, partnerships, sole proprietors and to most tax-exempt organizations. Although the credit is available to all entity types, the business must meet the eligibility requirements.

B. Financial Assistance Program/ other reliefs

1. Paycheck Protection Program (PPP) - for Small businesses

The $350 billion PPP is the most promising part of the legislation and aims to help Small businesses payroll and other expenses from February 15 to June 30. Small businesses may take loans up to $10 million, limited to a payroll cost formula. Loans may be forgiven if usage and other conditions are met.

· Eligible recipients: Any business entity, sole proprietorship, independent contractors, self-employed individuals or Non-profit entities, employing no more than the greater of:

- 500 employees; or
- SBA industry-based size standard requirements

Loan duration and other details

- Maximum maturity of 2 years
- Maximum interest rate of 0.5%
- Maximum amount of loan is 250% of the average monthly payroll costs for the past year, upto $10 million

Payroll costs included:

- Salary, wage, commission, cash tips etc.;
- Payment for vacation, parental, family, medical, or sick leave;
- Allowance for dismissal or separation;
- Retirement benefit costs;

- Group health care benefits, including insurance premiums;
- State or local taxes imposed on employee compensation.

Payroll costs excluded:

- Annualized compensation > $100,000 of an individual employee;
- Payroll taxes, railroad retirement taxes, and income taxes withheld;
- Compensation of an employee whose principal place of residence is outside of the US;
- Qualified sick leave, family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.

Loan Usage:

- Payroll costs
- Insurance premiums and group health-care benefits during periods of paid sick, medical, or family leave
- Payments of interest on any mortgage obligations
- Rent
- Utilities
- Interest on any other debt incurred before the relevant covered period

Loan Forgiveness:

- Conditions
  - Loans are used exclusively for their intended purposes, as mentioned;
  - Loans are used to offset no more than eight weeks of eligible payroll expenses;
  - Businesses retain employees at salary levels comparable to before the crisis.

- Amounts forgiven are considered canceled indebtedness under Section 7(a) of the SBA and are not includible in gross taxable income of the borrower;
- The loan forgiveness amount is reduced by any reduction in employee wages in excess of 25% or a reduction in the number of employees in the covered period
- If a business claims a PPP loan, they are not eligible for the Employee Retention or the deferment of payment of employer payroll taxes until 2021.

Affiliation Rule and its relevance for Indian businesses with US interest

- SBA uses affiliate rules to determine eligibility for companies to qualify as “small businesses”
- For employee size criteria, the employees of the concern and its affiliates (domestic and foreign) are counted.
- Under current SBA regulations, concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties' controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists.

\- There are other circumstances when affiliation may be found, the considerations are very fact-dependent. Most common ways in which SBA finds affiliation:

- Based on Ownership
- A person/ concern owning 50% or more of another concern's voting equity
- Stock Options, Convertible Securities, Agreements to Merge
- Board of Directors/ President/ CEO/ other managing personnel in control of concern. The key is power to control
- Based on Management
- Common management

• Based on Identify of Interest

• Businesses have identical economic interests

• Economic dependence

• Angel Investors - potential use of control

• Negative control

• Supermajority consent

- The SBA may consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation

2. CARES - Lending program for Medium-sized business

CARES provides that the Treasury Department will create a lending program for U.S.-based, mid-size businesses, and nonprofits between 500 and 10,000 employees. The aspirational nature of this language makes predicting the timing and scope of this program difficult, key principles articulated thus far are:

· Interest rates on loans under this program would be capped at 2%.

· Borrowers would be required to certify in good faith:

o Retention of 90% of workforce at full compensation and benefits through September 30, 2020

o Restoration of workforce to 90% of February 1, 2020 workforce within four months of the end of the current COVID-19 emergency

o No outsourcing or offshoring of jobs for two years after repayment of loan

o No payment of dividends and no stock buy backs during term of loan

o The borrower is U.S. domiciled

3. CARES - Big Businesses

CARES contains $500 billion in business and local government lending. The largest amount of $454 billion supports Federal Reserve lending for the purpose of providing liquidity to the financial system, which in turn supports lending to eligible businesses, states and municipalities. The rest is allocated for loans and loan guarantees to:

- Passenger airlines - $25 billion;
- Cargo air carriers - $4 billion;
- Boeing and other companies deemed critical for national security - $17 billion.

Businesses that receive the loans may not issue dividends or buy back stocks; they must maintain at least 90% of their employment levels as of March 24, 2020, and the loans must be for less than five years.

Conclusion:

CARES is a significant legislation that will affect nearly every aspect of the economy; it's the need of the hour and appears to be the right move in the right direction. Taxpayers will need to carefully consider the interaction of the announced reliefs with various amended Internal Revenue Code (IRC) provisions. Time is of essence here - some of the provisions are time bound and may result in amendment of 2018 returns or using the 2019 return to claim refunds.

Many of the adjustments arising from CARES will result in income tax refunds associated with prior tax years with a corresponding reduction in deferred tax assets; however, given the potential for different tax rates to apply in the respective periods or changes in valuation allowance will happen. Impact on accounting for income taxes needs to be assessed and an entity's specific facts and circumstances examined.

This payroll tax deferral also has a limitation based on SBA program, although it is not identical to the limitation for the employee retention tax credit. CARES provides that taxpayers who receive a PPP loan and also seek loan forgiveness, are ineligible for the payroll tax payment deferral. Hence, the interaction of these payroll-related tax provisions with the loan program need to be considered by taxpayers in determining whether and how to claim benefits under CARES.

PPP is designed to keep small business afloat during the COVID-19 epidemic, but affiliation rules are yet unclear on whether startups backed by venture capital or private equity firms will be eligible.

The Federal Government is still releasing final details; more information is coming-in almost every day. Taxpayers should assess their options carefully before acting as different filing positions can affect the eventual size and timing of the benefit. In addition, where taxpayers have in-progress M&A, restructuring etc., they may have the opportunity to re-model financial case given the new CARES changes.

This is the time to be on top of a fluid situation and act fast but after careful consideration suited to a particular situation and with well sought advice.