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CARES Act Offers Income Tax Relief for Business

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On March 27, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act was passed to stabilize the flagging U.S. economy. Among other measures designed to provide an economic boost, the Act makes several amendments to the income tax law (the "Code"), some of which roll back or limit changes made by the Tax Cuts and Jobs Act of 2017 (the "TCJA"). This Alert discusses five changes to the Code relevant for businesses. Each of these changes has potential benefits for taxpayers, but some require adjustments to prior-year profitability. Post-tax reform models will need to be re-run to determine the net benefit before action is taken.

Net Operating Losses

Under current law, net operating losses ("NOLs") attributable to taxable years beginning in 2018 and later may be carried forward and used to offset 80% of taxable income but generally may not be carried back to earlier years.[1] Reverting in part to pre-TCJA law, the CARES Act would allow NOLs for taxable years beginning before January 1, 2021 to fully offset taxable income, without regard to the 80% limitation. In addition, losses arising in a taxable year beginning after December 31, 2017 and before January 1, 2021 can be carried back (up to five years) as well as forward; however, income includible under Section 965 (the repatriation tax) cannot be reduced by such carrybacks.[2] Taxpayers that carryback NOLs arising from the most recent year can file for a quickie refund (Form 1139 for corporations, Form 1045 for individuals, estates, and trusts), which generally permits a processing of the refund in 90 days. In addition, corporations may apply for a quickie refund for overpaying estimated taxes for the current year by filing Form 4466.

According to a Senate Finance Committee summary released on the day the Act passed the Senate, the Act's changes to the Code's NOL provisions "will allow companies to utilize losses and amend prior years' returns, which will provide critical cash flow and liquidity during the COVID-19 emergency."[3]

Excess Business Loss

Current law applicable to taxable years through 2025 limits the amount of loss related to a trade or business that a non-corporate taxpayer may deduct in any year 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. Any excess business loss will carry over as a net operating loss to the following taxable year under Code section 172.[4] Rolling back another TCJA change, the CARES Act removes the limitation on the deduction of business losses for taxable years beginning before

[1] I.R.C. § 172(a), (b).
[2] Section 2303 of the CARES Act.
[3] CARES Act summary. The summary was originally authored by the Congressional Research Service and released by Senator Charles Grassley's office.
[4] I.R.C. § 461(l).

December 31, 2020.[5]

The Senate Finance Committee explains these modifications to the loss deduction limitation for pass-through businesses and sole proprietors as intended to enable them to "utilize excess business losses and access critical cash flow to maintain operations and payroll for their employees."[6]

Credit for Alternative Minimum Tax

The TCJA abolished the corporate alternative minimum tax ("AMT") starting in 2018 but permitted corporations to use AMT credits from earlier years in offsetting their regular tax liability and treating a portion of the credits as refundable in 2018 to 2021.[7] Under the CARES Act, corporate AMT credits would be fully refundable starting in 2019, and corporations can elect to claim the entire refundable credit amount in 2018. The Act instructs the IRS to process any refund claims within 90 days of filing.[8]

According to the Senate Finance Committee's summary, this provision will both "accelerate[] the ability of companies to recover . . . AMT credits" and permit them "to claim a refund now and obtain additional cash flow during the COVID-19 emergency."[9]

Business Interest Deductions

Current law generally limits a taxpayer's deduction of business interest expense for any taxable year to the sum of business interest income, 30 percent of adjusted taxable income, and floor plan financing interest (relevant for auto dealerships). The limitation does not apply to taxpayers with average annual gross receipts for the past three tax periods below an inflation-adjusted threshold ($26 million in 2020).[10] For most taxpayers, the CARES Act increases the "30 percent" limitation to "50 percent" for taxable years beginning in 2019 and 2020, although a taxpayer may elect to continue applying the 30% limitation. For partners in a partnership, the increase to "50%" applies only to taxable years beginning in 2020, but a partner can carry over to 2020 any business interest that was disallowed in 2019 and deduct 50% of that amount, with the remaining 50% subject to the otherwise applicable rules. The CARES Act also allows any taxpayer to elect to use its 2019 adjusted taxable income instead of its 2020 adjusted taxable income when computing the business interest limitation for 2020.[11]

The Senate Finance Committee summary again ties these changes to liquidity: "As businesses look to weather the storm of the current crisis, this provision will allow them to increase liquidity with a reduced cost of

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[5] Section 2304 of the CARES Act. The Act also clarifies that an excess business loss will be determined (i) without regard to capital losses or any deductions, gross income, or gains attributable to any trade or business of performing services as an employee; and (ii) by taking into account the lesser of capital gain attributable to a trade or business or net capital gain income.
[6] CARES Act summary.
[7] I.R.C. § 53. The amount of the AMT credits that would be refundable is equal to 50% of the excess of the minimum tax credit for the taxable year over the amount of credit allowable for the year against regular tax liability (the 50% limitation increases to 100% in 2021).
[8] Section 2305 of the CARES Act.
[9] CARES Act summary.
[10] I.R.C. §163(j)(1).
[11] Section 2306 of the CARES Act.

capital, so that they are able to continue operations and keep employees on payroll."[12] In our view, these changes—which will reduce many businesses' 2020 tax liability and accordingly their current-year estimated tax payments—will likely enhance liquidity and help some businesses, particularly highly leveraged ones, to stay afloat in the current crisis.

Qualified Improvement Property

Before the TCJA, capitalized expenditures for qualified improvement property—i.e., certain improvements to the interior of a non-residential building that occurred after the building was placed in service—generally had a 39-year recovery period, except that three categories of property (qualified leasehold improvements, retail improvements, and restaurant property) had a more beneficial, 15-year recovery period.[13] In an apparently inadvertent glitch, the TCJA included a provision removing the alternative 15-year recovery period for the three favored categories while omitting a companion provision that would have afforded a 15-year recovery period for all qualified improvement property (thereby making all such property eligible for bonus depreciation). This so-called "retail glitch" left the recovery period of all qualified improvement property at 39 years, preventing taxpayers from claiming bonus depreciation for any such property and more than doubling the recovery period for the three, previously favored categories.

The CARES Act would fix the retail glitch by affording a 15-year recovery period for all qualified improvement property, thereby making all such property eligible for bonus depreciation. This change would be treated as if had been included in the TCJA, and would thus be retroactive to January 1, 2018.[14]

According to the Senate Finance Committee, the change would not only increase "companies' cash flow by allowing them to amend a prior year return, but also incentivize[] them to continue to invest in improvements as the country recovers from the COVID-19 emergency."[15] In our view, this long-awaited fix to the retail glitch is welcome—and well-targeted given that restaurants and other retail businesses may suffer disproportionately from the current pandemic.

Final Thoughts

The CARES Act is intended to inject liquidity into the economy, and the above changes to the Code reflect that Congressional desire. However, the ability for taxpayers to access cash based on these changes will ultimately depend on actions by the taxpayers and ability of the IRS to process and respond. For more information regarding the above-described CARES Act provisions and how they may affect your business, please contact:

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[12] CARES Act summary.
[13] I.R.C. § 168(e)(6).
[14] Section 2307 of the CARES Act.
[15] CARES Act summary.

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