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The CARES Act: Basic Federal Income Tax Provisions Affected by COVID-19

On March 27, 2020, the Federal government enacted the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") in the wake of the coronavirus ("COVID-19") pandemic. The CARES Act, in part, provides relief to individuals and business alike in the form of tax assistance. The tax provisions of the CARES Act are highlighted as follows:

2020 Recovery Rebate for Individuals

Recovery rebates in the form of checks will be paid to eligible individuals. Generally, an eligible individual is any individual who has a social security number, other than a nonresident alien. The Federal government will pay each individual an amount equal to the sum of $1,200 ($2,400 for those filing a joint return), plus $500 per qualified child. However, not all individuals are eligible to receive these rebates. Individuals are phased-out of receiving such payments based on their income. Individuals earning at least $75,000 ($150,000 for joint filers) will be phased-out of this rebate by reducing the rebate amount by five dollars for every $100 that an individuals' income exceeds the threshold. Those individuals with income in excess of $112,500 and filing as a head of household will be subject to the same phase-out calculation. Single-filers with income in excess of $99,000, joint-filers with income exceeding $198,000, and head of household filers with one child with income exceeding $146,500 will not receive these rebates. The taxpayer's income threshold will be determined by examining their 2019 Federal income tax return, and if that has not yet been filed, their 2018 Federal income tax return.

Taxpayers who have direct deposit setup with the Internal Revenue Service will receive their payments via direct deposit, whereas taxpayers who do not will receive their checks in the mail. No later than 15 days after a payment has been distributed to an individual, such individual shall receive a notice of confirmation that such payment has been made from the Federal government.

Retirement Plans and Distributions

As with the Federal income tax return and payment due date, the due date for IRA contributions and plan contributions for the 2019 tax year has been extended to July 15, 2020. The CARES Act also allows those taxpayers who have retirement plans to take early distributions up to $100,000 penalty-free if such distributions are coronavirus-related. A coronavirus-related distribution is defined as a distribution made to an individual during the 2020 tax year: (1) who is diagnosed with the virus SARS-CoV-2 or with coronavirus disease 2019 by a test approved by the Center for Disease Control and Prevention; (2) whose spouse or dependent (as defined in Section 152 of the Internal Revenue Code) is diagnosed with such virus or disease by such a test; or

(3) who experiences adverse financial consequences as a result of being quarantined, being furloughed, or laid off or having work hours reduced due to such virus or disease, being unable to work due to lack of child care due to such virus or disease, or closing or reducing hours of a business owned or operated by the individual due to such virus or disease.

Although a coronavirus-related distribution is penalty-free, such a distribution is not tax-free. Income attributable to coronavirus-related distributions is still subject to tax, but such income may be spread over three years. Furthermore, an individual who takes a coronavirus-related distribution may recontribute such distribution to their retirement plan regardless of that year's limitation on contributions.

The CARES Act has also waived the required minimum distribution requirement for tax year 2020.

Charitable Contributions

For tax years beginning in 2020, individual taxpayers who claim the standard deduction on their Federal income tax return, as opposed to itemizing deductions, are permitted to make qualified contributions of up to $300 and use such contribution as an "above-the-line" deduction in computing their adjusted gross income. Individual taxpayers who itemize their deductions can make qualified contributions and deduct such contributions up to 100 percent of adjusted gross income. Corporate taxpayers that make qualified contributions can deduct such contributions up to 25 percent of adjusted taxable income, rather than the 10 percent limitation from the Tax Cuts and Jobs Act. Excess contributions can be carried forward over the next five taxable years. Qualified contributions do not include contributions for the establishment of a new, or maintenance of an existing, donor advised fund.

Student Loans and Qualified Educational Expenses

The CARES Act expands the income tax exclusion to those employees who receive payment of employer-provided qualified educational expenses from the date of enactment to December 31, 2020. Employers can pay up to $5,250 of an employee's (1) student loans and (2) qualified educational expenses, in the aggregate, on a tax-free basis to the employee. The Tax Cuts and Jobs act did not allow an income tax exclusion to those employees whose employers contribute to the payment of an employees' student loans.

Employee Retention Credit

Eligible employers are allowed as a credit against payroll taxes for each calendar quarter in an amount equal to 50 percent of the first $10,000 qualified wages per employee. Qualified wages include qualified health plan expenses. The credit is applied against the eligible employer's Social Security payroll tax for each calendar quarter, and any excess credit is refunded to the employer. Eligible employers are defined as those continuing to do business in 2020 that (1) had their business suspended in whole or in part to because of the pandemic or (2) in comparing calendar years between 2020 and 2019 have a reduction in gross receipts of 50 percent or more. The credit is only available to eligible employers until the first calendar quarter in which the employer earns gross receipts equal to more than 80 percent of its gross receipts from the corresponding calendar quarter of the prior year. This credit is attributable to wages paid from March 13, 2020 to the earlier of (i) December 31, 2020 or (ii) until an eligible employer reaches the 80 percent threshold described in the preceding sentence.

Additionally, there are variations to the calculation of qualified wages based on the size of the employer. If the employer employs more than 100 full-time employees, only those employees who are not providing services due to a suspension of the business are considered in calculating qualified wages. The calculation of qualified wages for eligible **employers** with 100 or fewer full-time employees considers the wages to paid to all such employees, regardless of whether the employee is providing services.

Deferral of Employer Payroll Taxes and Self-Employment Taxes

The employer's portion of Social Security payroll taxes that would otherwise be due through December 31, 2020 can be deferred in two installments: (1) 50 percent due on December 31, 2021 and (2) 50 percent due on December 31, 2022. Similarly, self-employed taxpayers who would otherwise have self-employment tax due through December 31, 2020 can defer 50 percent of such tax in two installments: (1) 25 percent due on December 31, 2021 and (2) 25 percent due on December 31, 2022. Note that these payroll tax deferrals may not apply if the employer uses the loan forgiveness provisions of the CARES Act.

Net Operating Losses

Net operating losses for corporations for tax years 2018, 2019, and 2020 can be carried back to each of the five taxable years preceding the net operating loss tax year. Thus, those corporations that incurred net operating losses can proceed with filing amended returns to obtain a refund for taxes that were paid. Also, the 80 percent limitation on net operating losses offsetting taxable income has been suspended, and net operating losses can offset 100 percent of taxable income for tax years 2018, 2019, and 2020. However, the limitation is re-enacted beginning with the 2021 tax year.

Excess Business Losses

The limitations on excess business losses have been suspended for tax years 2018, 2019, and 2020. For such tax years, individual can use 100 percent of business losses to offset income, whereas the Tax Cuts and Jobs Act limited the amount of business loss to $250,000 ($500,000 if filing jointly). Thus, those individuals with excess losses that were previously disallowed can be carried back to 2018 or 2019. A taxpayer would receive a refund for these years by filing amended returns.

Corporate Alternative Minimum Tax ("AMT") Credits

The payment of corporate AMT credits to corporations are accelerated and not subject to the limitation under Internal Revenue Code Section 383. The full credit will be available for a corporation's first taxable year beginning in tax years 2018 or 2019. Generally, corporations are provided with a tax refund opportunity with this provision.

Interest Expense

A business may deduct interest expense of up to 50 percent of adjusted taxable income for 2019 and 2020 and can carry any excess interest expense forward to the 2020 tax year. This carry forward will work as follows: a business uses its 2019 adjusted taxable income in place of its 2020 taxable income for purposes of this interest expense calculation and deducts any carried forward interest expense against such amount.

Excise Tax

There shall be no excise tax on distilled spirits used to produce hand sanitizer for the 2020 tax year.

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