March 30, 2020

Coronavirus Aid, Relief, and Economic Security (CARES) Act—Business Tax Provisions

CARES Act Provides Tax Relief to Businesses

SUMMARY

On March 27, 2020, Congress voted to pass the "Coronavirus Aid, Relief, and Economic Security Act" (the "CARES Act"), and the president signed it into law shortly thereafter. Also known as "phase three" in a series of legislation passed by Congress in response to the ongoing Coronavirus ("COVID-19") pandemic, the CARES Act provides approximately $2 trillion in financial relief and provides wide ranging support to various industries and businesses, workers, students, families and the unemployed in a variety of ways. This memorandum focuses on the business tax relief aspects of the CARES Act, while other S&C publications address other topics and can be found here.

The provisions related to business tax relief include, among others:

- providing an employee retention payroll tax credit of up to $5,000 per employee for wages paid by eligible employers whose business has been fully or partially suspended due to government-mandated restrictions on commerce, travel and group meetings or has experienced a significant decline in quarterly gross receipts;
- allowing a deferral of payroll taxes for 2020, payable in two equal installments, at the end of 2021 and at the end of 2022;
- permitting a five-year carryback of net operating losses ("NOLs") arising in 2018, 2019 and 2020 and permitting such losses to offset 100% of taxable income, temporarily reversing changes made in the 2017 federal tax reform that generally eliminated the carryback of NOLs arising after 2017 and allowed such NOLs carried forward to offset no more than 80% of taxable income;
- providing an acceleration of refunds for unused corporate AMT credit;

- providing an increase in the cap for business interest deductions from 30% to 50% of adjusted taxable income, and permitting the use of 2019 adjusted taxable income for computing the cap in 2020; and
- making technical amendments to the 2017 federal tax reform legislation to permit immediate deductions for 100% of costs incurred in certain "qualified improvements" to nonresidential real property.

DISCUSSION

This memorandum summarizes the provisions of Title II, Subtitle C of the CARES Act (Sections 2301-2307) related to tax provisions relating to businesses. Other sections of the CARES Act that also contain tax-related provisions, such as charitable contribution deductions and tax relief for employees, are not discussed herein.

A. OVERVIEW OF THE BUSINESS PROVISIONS

1. Employee Retention Credit for Employers Subject to Closure Due to COVID-19

Section 2301 of the CARES Act provides certain employers with refundable payroll tax credits equal to 50% of qualified wages paid to each employee after March 12, 2020 and before January 1, 2021 (but such wages cannot exceed $10,000 per employee for all calendar quarters, *i.e.*, the maximum credit an employer can receive is $5,000 per employee). There is no limit as to the number of employees in respect of which an employer can claim the credit. The Treasury Secretary is given authority to issue regulations or guidance to allow advance payment of such credits to employers and is authorized to waive penalties for an employer's failure to make deposits of employment taxes in reasonable anticipation of receiving such credits.

An employer is eligible for such tax credits (an "Eligible Employer") with respect to any calendar quarter (i) during which the employer's trade or business is fully or partially suspended due to government-mandated measures limiting commerce, travel or group meetings due to COVID-19 ("Suspension of Business") or (ii) during the period beginning with the first calendar quarter beginning after December 31, 2019, for which the employer's gross receipts are less than 50% of the gross receipts for the same calendar quarter in the prior year ("Significant Decline"), until gross receipts for a calendar quarter are greater than 80% of the gross receipts for the same calendar quarter in the prior year.[1] Note that the CARES Act does not specify what it means for a business to be "partially suspended", although we imagine that, in most cases, the IRS will not take an overly restrictive position.

[1] The Treasury Secretary is to issue regulations or guidance for new businesses that did not have a trade or business in the same quarter of the prior year.

In addition, the number of employees affects the amount of "qualified wages" included in computing the payroll tax credit.[2] An Eligible Employer that had more than 100 full-time employees on average during 2019 can only take into account wages paid to retained employees who are not working due to a Suspension of Business or Significant Decline. In practice, there may be circumstances in which it is unclear whether an employee is considered not to be working, or whether the reason for not working is due to a Suspension of Business or Significant Decline. An Eligible Employer that had 100 or fewer full-time employees on average during 2019 can take into account wages paid to any retained employees during any Suspension of Business or period of Significant Decline.

The CARES Act provides other special rules that prevent the duplicative receipt of tax credits and other tax benefits by the employer for the same wages paid to an employee, such as excluding wages already taken into account for payroll tax credits for required paid sick leave or required family leave under the Families First Coronavirus Response Act.[3] An Eligible Employer can elect to opt out of the payroll tax credits with respect to any calendar quarter and the credit is not available to employers receiving loans under the "paycheck protection plan" pursuant to the CARES Act.[4]

2. Delay of Payment of Employer Payroll Taxes

Section 2302 of the CARES Act allows employers to defer the payment (including the deposit) of payroll taxes for the 2020 calendar year (but beginning after the date of enactment of the CARES Act) until (i) December 31, 2021 for 50% of such taxes and (ii) December 31, 2022 for the remaining 50% of such taxes. Unlike the payroll tax credits discussed above, all employers regardless of size are generally eligible for this deferral of employer payroll taxes, except for employers whose loans under the paycheck protection program are forgiven under certain other provisions of the CARES Act.[5] In addition to payroll taxes, payment for 50% of self-employment income is also deferred and payable in two equal installments in the same manner as payroll taxes.

3. Modifications for Net Operating Losses

Section 2303 of the CARES Act substantially modifies Section 172 of the Code governing net operating losses ("NOLs") arising in taxable years beginning in 2018, 2019 and 2020. Section 172 had undergone

---

[2] For purposes of the employee retention credit, entities treated as a single employer under Section 52(a) or (b) (an affiliated group of corporations or partnerships under common control) or Section 414(m) or (o) (an affiliated service group) are treated as one employer.

[3] *See, e.g.*, Section 2301(c)(3) and (h) of the CARES Act.

[4] *See* Section 1102 of the CARES Act, which authorizes nearly $350 billion in lending to small businesses through a temporary payroll protection program administered by the Small Business Administration. For more information on the payroll protection program, see the Sullivan & Cromwell publication, dated March 29, 2020, titled "Coronavirus Aid, Relief, and Economic Security Act," *available at* https://www.sullcrom.com/files/upload/SC-Publication-Coronavirus-Aid,-Relief,-and-Economic-Security-Act.pdf.

[5] *See* Sections 1106 and 1109 of the CARES Act.

significant changes under the federal tax reform of December 2017 (the "2017 Tax Reform") in a manner that generally reduced the tax benefit of NOLs for most taxpayers, and the CARES Act's modifications reverse such changes temporarily to provide relief to taxpayers.

a. Five-Year Carryback for 2018, 2019 and 2020 NOLs

Most significantly, the CARES Act provides that an NOL arising in a taxable year beginning after December 31, 2017 and before January 1, 2021 will be carried back to each of the five years preceding the year of such loss (the "5-Year Carryback Period").[6] Such NOLs carried back to taxable periods prior to the 2017 Tax Reform will offset taxable income taxed at highest marginal rates of 35% rather than the 21% rate. Taxpayers that had NOLs arising in 2018 or 2019 (to the extent the returns for each of those years have been filed) can now amend prior year tax returns and obtain refunds to the extent they had paid income taxes during the 5-Year Carryback Period, providing immediate liquidity to such taxpayers.[7]

Despite Congressional intent to provide much-needed relief to business taxpayers, the potential interaction between the five-year carryback and other provisions of the Code, in particular with some of the international provisions created by the 2017 Tax Reform, brings into question whether taxpayers would receive the full expected benefit of the NOL carryback under the CARES Act.

For instance, taxpayers that have GILTI income inclusions may find themselves utilizing NOLs at significantly lower rates than 21% because NOLs effectively offset income that would have been taxed at 10.5% or at even lower rates if foreign tax credits are available. More specifically, GILTI income is subject to a 50% deduction (so-called "Section 250 Deductions"), but the amount of Section 250 Deductions is limited to taxable income. As a result, to the extent NOLs (whether current, carryback or carryforward) reduce taxable income and thereby also reduce Section 250 Deductions, then only half the NOLs are effectively generating an incremental deduction.

In addition, a taxpayer subject to BEAT in any taxable year during the 5-Year Carryback Period may have increased BEAT liability if NOLs were carried back to such year. For example, assume that a calendar year taxpayer had BEAT liability in 2018. If such taxpayer has NOLs arising in 2020 carried back to 2015, and the taxpayer did not have sufficient taxable income to absorb all such losses during the pre-2017 Tax Reform years such that some NOLs were carried-back to 2018, then a portion (equal to the "base erosion

[6] Consistent with pre-2017 Tax Reform law, a REIT is not permitted to carry back NOLs and is not permitted to use any NOLs carried back from a year in which the entity is not a REIT. In addition, a life insurance company's NOLs carried back to a taxable year beginning before 2018 will be treated in the same manner as an "operations loss carryback" under pre-2017 Tax Reform law.

[7] In addition to NOLs arising in a taxable year after December 31, 2017, the CARES Act includes a technical correction to the 2017 Tax Reform, now allowing non-calendar year taxpayers to carry back NOLs arising in a taxable year beginning before 2018 and ending after December 31, 2017. The original effective date provisions in the 2017 Tax Reform bill had disallowed the carryback of such NOLs. Special rules are provided in the CARES Act to ensure that the taxpayer is treated as having timely filed for any refunds or elections with respect to such NOLs carried back.

percentage") of the NOLs that reduced taxable income for 2018 would be added to the modified taxable income under the "add back" rules,[8] resulting in higher BEAT liability.[9]

A taxpayer may elect to waive such carryback in two circumstances: the taxpayer may waive the entire 5-Year Carryback Period and choose to only carry forward applicable NOLs, or, if a taxpayer's 5-Year Carryback Period includes any taxable year in which the taxpayer had an income inclusion under Section 965(a) ("Section 965(a) Inclusion"), then such taxpayer may elect to exclude all such taxable years in which it had such Section 965(a) Inclusions.[10] On the other hand, if a taxpayer does not elect to waive NOL carrybacks to taxable years in which it had a Section 965(a) Inclusion, then such taxpayer is treated as having made the election under Section 965(n) of the Code with respect to such taxable year, which allows the taxpayer to forego the use of NOLs to offset any Section 965(a) Inclusions when there are foreign tax credits available. It appears that, if an election under Section 965(n) had not been previously made, the carryback of an NOL to a Section 965(a) Inclusion year may cause such an election to also apply for prior year losses carried forward to that year or that year's own losses, possibly creating a tax liability that reduces any tax benefit the taxpayer may have obtained from the NOL carryback.

b. Temporary Repeal of Taxable Income Limitation

NOL carryovers and carrybacks to a taxable year beginning before 2021 can be deducted from 100% of taxable income for such year. For taxable years beginning after 2020, NOLs arising from taxable years beginning before January 1, 2018 are still deductible against 100% of the taxpayer's income, but NOLs arising in later years are only deductible against 80% of the taxpayer's income. For these purposes, taxable income is calculated without taking into account any NOL deductions, GILTI or FDII deductions[11] or qualified business income deductions.

4. Modification of Limitation on Losses for Taxpayers Other Than Corporations

Under the 2017 Tax Reform, starting with the taxable year beginning after December 31, 2017, a noncorporate taxpayer cannot deduct "excess business losses," which generally are net losses from trades or businesses that exceed $250,000 ($500,000 for taxpayers filing joint returns, in each case adjusted for inflation). Section 2304 of the CARES Act allows a noncorporate taxpayer to deduct excess business

---

8 Treas. Regs. § 1.59A-4(b)(2).

9 BEAT liability is the *excess* of the applicable BEAT rate (5% for 2018) multiplied by modified taxable income *over* the regular tax liability of the taxpayer.

10 Section 965, enacted as part of the 2017 Tax Reform, provides a one-time "transition tax" to ensure that the previously untaxed offshore earnings of U.S. corporations are not lost to the U.S. tax system because of the implementation of the so-called "participation exemption," whereby U.S. corporate parents are entitled to a 100% dividends-received deduction for dividends paid by 10%-owned foreign subsidiaries.

11 This is consistent with the proposed regulations under Section 250 of the Code. *See* Prop. Treas. Regs. § 1.250(b)-1(d)(2)(ii).

losses arising in taxable years beginning before December 31, 2020. Similar to NOLs carried back for corporate taxpayers, to the extent that a noncorporate taxpayer has filed tax returns for any taxable years beginning after December 31, 2017 without claiming a deduction for excess business losses, the taxpayer can now amend such tax returns and obtain a refund.

5. Acceleration of Corporate AMT Credit Refunds

The 2017 Tax Reform eliminated the alternative minimum tax ("AMT") for corporations and allowed corporate taxpayers to claim up to 50% of any unused AMT credits (which offset regular tax liability and are refundable) for taxable years beginning in 2018, 2019 and 2020, and claim 100% of any remaining unused AMT credits in the taxable year beginning in 2021. Section 2305 of the CARES Act accelerates the recovery of such AMT credits by allowing corporate taxpayers to either (i) claim 50% of unused AMT credits in the taxable year beginning in 2018 and 100% of any remaining unused AMT credits in the taxable year beginning in 2019, or (ii) at the taxpayer's election, claim 100% of any unused AMT credits in the taxable year beginning 2018. In the latter case, the CARES Act provides that the taxpayer may file for (in the manner and form as the Secretary may prescribe) and receive a tentative refund within 90 days of such filing.

6. Modifications of Limitation on Business Interest

Section 2306 of the CARES Act generally increases the limitation on business interest deductions ("Section 163(j) Limitation") for any taxable year beginning in 2019 or 2020 to 50% of adjusted taxable income, from the current limitation of 30%. However, special rules apply with respect to a partnership: (i) the increase in the Section 163(j) Limitation to 50% only applies to the partnership's taxable year beginning in 2020 and not 2019; although (ii) for the partnership's taxable year beginning in 2019, 50% of the "excess business interest" allocated to a partner will be treated as business interest paid or accrued in the following tax year without limitation, whereas the remaining 50% of the excess business interest will be subject to the rules normally applicable to such excess business interest.[12] The taxpayer may elect out of the increase in the Section 163(j) Limitation for any taxable year. In the case of a partnership, the partnership may elect out of such increase only for taxable years beginning in 2020.

In addition, for any taxable year beginning in 2020, the CARES Act allows the taxpayer to elect to use the adjusted taxable income for the last taxable year beginning in 2019. Given that businesses generally expect income in 2020 to be worse than in 2019 at least partly due to the impact of COVID-19, such an election to reference the 2019 adjusted taxable income should generally increase the amount of interest deductions allowed for 2020.

[12] Excess business interest is the partnership's interest expense in excess of the Section 163(j) Limitation determined at the partnership level. Under the normally applicable rules, excess business interest allocated to a partner can only be used when such partner is allocated "excess taxable income" from the partnership.

7. Technical Amendments Regarding Qualified Improvement Property

Section 2307 of the CARES Act provides technical amendments to the 2017 Tax Reform bill with respect to costs incurred for "qualified improvement property" ("QIP").[13] Notwithstanding clear legislative intent to the contrary,[14] the 2017 Tax Reform bill did not assign a recovery period for QIP, generally resulting in a 39-year recovery period that makes QIP ineligible for immediate expensing (so-called "100% bonus depreciation"). The technical amendments assign a 15-year recovery period (or a 20-year recovery period under the alternative depreciation system) to qualified improvements of most property, making expenses for such improvements immediately deductible. The technical amendment takes effect as if included originally in the 2017 Tax Reform.

B. ADDITIONAL CONSIDERATIONS

As discussed above, the CARES Act provides temporary relief from some of the less taxpayer-friendly changes made by the 2017 Tax Reform. We note, however, that the CARES Act did not make other amendments that might have been natural to assume could have been appropriate in this context. For example, the CARES Act did not extend Section 108(i) of the Code, which had granted taxpayers an election to defer cancellation of indebtedness income arising in connection with the reacquisition (including restructuring) of certain debt instruments in 2009 and 2010, during the aftermath of the 2008 financial crisis. Note that the CARES Act does provide relief (exclusion from income rather than deferral) for certain loans for small businesses: Under Section 1106 of the CARES Act, which creates a "Paycheck Protection Program" administered by the Small Business Administration to provide short-term loans for small businesses to fund payroll expenses, taxpayers can obtain forgiveness of such loans under certain circumstances and the CARES Act expressly provides that such forgiveness of loans would not result in any gross income to the taxpayer. Presumably, there will be additional avenues for the government to consider such relief in the future.

Questions regarding the CARES Act may be directed to any member of the Tax Group.

* * *

---

13 QIP generally refers to improvements to an interior portion of a nonresidential building.

14 The Joint Explanatory Statement of the Committee of Conference states that ". . . the conference agreement provides a general 15-year MACRS recovery period for qualified improvement property."

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York			
	Ronald E. Creamer Jr.	+1-212-558-4665	creamerr@sullcrom.com
	David P. Hariton	+1-212-558-4248	haritond@sullcrom.com
	Jeffrey D. Hochberg	+1-212-558-3266	hochbergj@sullcrom.com
	Donald L. Korb	+1-212-558-4822	korbd@sullcrom.com
	Andrew S. Mason	+1-212-558-3759	masona@sullcrom.com
	Andrew P. Solomon	+1-212-558-3783	solomona@sullcrom.com
	David C. Spitzer	+1-212-558-4376	spitzerd@sullcrom.com
	Davis J. Wang	+1-212-558-3113	wangd@sullcrom.com
	S. Eric Wang	+1-212-558-3328	wangs@sullcrom.com
	Isaac J. Wheeler	+1-212-558-7863	wheeleri@sullcrom.com
	M. John Jo	+1-212-558-3202	jojohn@sullcrom.com
Washington, D.C.			
	Donald L. Korb	+1-202-956-7675	korbd@sullcrom.com
London			
	Ronald E. Creamer Jr.	+44-20-7959-8525	creamerr@sullcrom.com
	S. Eric Wang	+44-20-7959-8411	wangs@sullcrom.com