THE CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY (CARES) ACT RESOURCE GUIDE

THE FOLLOWING COLLECTION OF ARTICLES provides an in-depth look at some of the most important provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020. Please keep in mind that there are still many questions about each of these provisions that remain unanswered, as we await guidance from the Department of the Treasury and the Internal Revenue Service (IRS). As this guidance comes out, we will continue to update this resource. We encourage you to reach out to your HBK tax advisor to discuss how the CARES Act may apply to your particular situation.

These articles were last updated on: March 31, 2020.

TABLE OF CONTENTS

PAYROLL PROTECTION PROGRAM

Section authored by: Amy M. Reynallt, MBA | areynallt@hbkcpa.com

Special Note: Since there is a large demand for the SBA 7(a) Payroll Protection Program, and funds are limited, it is critical that all businesses that will qualify for and have need of an SBA 7(a) loan contact an approved SBA 7(a) lender as soon as possible to start the application process now.

BACKGROUND INFORMATION

Section 7(a) of the Small Business Act (SBA) authorizes the United States Small Business Administration to offer loans to eligible small businesses within the United States and its territories. The loans are deployed by lending partners and can typically be used for a number of things, including starting a business, working capital, and business expansion. However, the SBA 7(a) loans under the CARES Act are special loans for the specific purpose of helping businesses get through the COVID-19 pandemic, and these CARES Act loans may only be used for very specific purposes, as described below.

EXPANSION OF SBA 7(A) LOAN PROGRAM

Section 1102 of the CARES Act expands the SBA 7(a) program to allow qualified businesses to apply for loans with an approved SBA 7(a) lender equal to the lesser of 250 percent of the average monthly payroll cost in the prior year plus the amount of any disaster loan to be refinanced under the loan, or $10 million. Loans are typically provided with a maximum of four percent interest rate and maximum term of 10 years. A portion of this loan may also qualify for debt forgiveness, discussed below.

QUALIFIED BUSINESSES

In order to qualify for the expanded SBA 7(a) loan, the business(es) or entity(ies) must have been in operation on February 15, 2020. The business must be a small business concern, or any business concern, nonprofit organization, veterans organization, or Tribal business concern described in § 31(b)(2)(C) of the SBA. These businesses must have fewer than 500 employees, using the required affiliation rules, or the applicable size standard in number of employees for the North American Industry Classification System (NAICS) industry as provided by the Small Business Association, if it is higher. Note that sole proprietors, independent contractors, and eligible self-employed individuals may qualify for an SBA 7(a) loan.

The CARES Act provides an exception to the 500 employee rule for business concerns that do not employ more than 500 employees at each physical location of the business concern, and that are assigned an NAICS code beginning with 72.

AFFILIATION RULES

When determining whether a business concern meets or exceeds the employee limit to qualify for an SBA 7(a) loan, the business must count employees of all affiliates. In general, an affiliation may exist when one business controls or has the power to control another business, or when a third party (or parties) controls or has the power to control both businesses. Control is typically determined by looking at ownership, management, or other relationships or interactions that may indicate control exists.

Under the CARES Act, the affiliation rules are waived for the following business concerns:

1. Business concerns that do not employ more than 500 employees at each physical location and that have an NAICS code beginning with 72;
2. Business concerns operating as a franchise that is assigned a franchise identifier code by the Small Business Administration; and
3. Business concerns that receive funding through a Small Business Investment Company.

PAYROLL COSTS INCLUDED IN CALCULATION

As stated above, loans are calculated based on the lesser of 250 percent of average monthly payroll cost in the prior year plus the amount of any disaster loan to be refinanced under the covered loan and $10 million. Special calculation periods for seasonal employers, as defined by the Small Business Administration, and new employers may apply.

For the purposes of the payroll cost calculation, the following types of compensation are included:

- Salary, wages, commission and similar compensation including cash tips;
- Payments for vacation leave;
- Payments for parental, family, medical or sick leave;
- Allowances for dismissal or separation;
- Payment of any retirement benefits;
- Group health care benefits, including insurance premiums;
- State and local payroll taxes assessed on the compensation of employees; and
- The sum of payments to or income of a sole-proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment or similar compensation and that is not more than $100k in 1 year, prorated for the covered period.

Payroll costs do not include:

- The compensation of an individual employee in excess of an annual salary of $100,000, as prorated for the covered period;
- Taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code, which are specifically taxes under the Federal Insurance Contributions Act (FICA), the Railroad Retirement Tax Act (RRTA), and withholding taxes;
- Compensation of employees whose principal residence is outside the United States; and
- Any qualified sick or family leave wages for which a credit is allowed under sections 7001 or 7003 of the Families First Coronavirus Response Act (FFCRA).

LOAN FORGIVENESS

Section authored by: Amy M. Reynallt, MBA | areynallt@hbkcpa.com

Section 1106 of the CARES Act allows for loan forgiveness for all or a portion of the SBA 7(a) loans allowed under the Paycheck Protection Program (described above) when the loan funds are used for certain purposes. Forgiveness, which can not exceed the total principal amount of the loan, is calculated based on payroll costs, payments of interest on covered mortgage obligations, rent obligations, and utilities for which the obligation was in effect prior to February 15, 2020.

The amount of the loan that qualifies for forgiveness may be reduced if the employer reduces employee headcount or employee wages within the eight weeks following the origination date of the loan, or by the amount of any emergency advances that were provided through the SBA's economic injury disaster loan program. If an employer has reduced employee headcount or employee wages, these reductions will not prevent the loan forgiveness so long as the employer eliminates the reduction(s) no later than June 30, 2020.

Borrowers must work with SBA 7(a) lenders to obtain forgiveness, and must provide documentation of the payroll costs and covered expenses in order to qualify for forgiveness. Forgiveness of the loan will not be considered taxable income under the Internal Revenue Code.

2020 RECOVERY REBATES FOR INDIVIDUALS

Section authored by: Amy L. Dalen, JD | adalen@hbkcpa.com

Special Note: Be aware that there are currently scams circulating related to the individual recovery rebates. The IRS will never call you or e-mail you requesting your Social Security number. If you receive a phone call, e-mail, or letter that is purportedly from the IRS, we encourage you to reach out to the IRS directly in order to verify the legitimacy, or to contact your HBK advisor for guidance.

PAYMENT AMOUNTS AND THRESHOLDS

Under Section 2201 of the CARES Act, individuals who meet certain income thresholds are entitled to an advance payment (rebate) of a new credit, which will ultimately be calculated on their 2020 income tax returns. Individuals will qualify for the full rebate amount of $1,200 if their income as a single filer is $75,000 ($112,500 for an individual filing as head of household) or less, or $2,400 for a couple if their income is $150,000 or less and they file jointly. An additional $500 per dependent child under the age of 17 is also allowed. The rebate phases out if adjusted gross income exceeds these thresholds, and will be fully phased out once adjusted gross income reaches $99,000 for a single filer, $136,500 for head of house, and $198,000 for a married couple filing jointly. This full phaseout level increases if the individual or couple has dependent children under the age of 17, so a married couple with two children will have the rebate fully phased out when income reaches $218,000. Married individuals that file separate returns should look at their income levels closely to determine whether it makes more sense for them to file separately or jointly for 2019, if they have not yet filed their 2019 return, or for 2020.

HOW THE IRS DETERMINES ELIGIBILITY

Since the IRS does not know what an individual's 2020 income level will be, the rebate will be based on an individual's 2019 income tax return. If a 2019 income tax return has not yet been filed, then the IRS will look at the individual's 2018 income tax return. If an individual has not filed a return for either 2018 or 2019, then the IRS will look at Social Security information that may be available. The IRS encourages all individuals who would qualify for the rebate based on their 2019 income tax return to file as soon as possible. While the IRS has released some guidance, it is not yet known what date the 2019 income tax return must be filed by in order to be used for the calculate of the rebate.

WHEN PAYMENTS WILL BE MADE

The IRS has indicated that direct deposits of the rebate amount will begin within the next three weeks (presumably by April 20, 2020) and that these payments will be made automatically. If an individual has not previously provided their direct deposit information to the IRS, the IRS will be sending out information on how the direct deposit information can be submitted in order to allow for a direct deposit of the rebate. If the rebate is not direct deposited, then checks will be mailed later on. All advance payments must be made by December 31, 2020. If an individual qualifies for the credit but does not receive an advance payment, the credit will be calculated and paid with the individual's 2020 income tax return.

DEPENDENTS NOT ELIGIBLE FOR REBATE

Individuals who are claimed as dependents on another individual's return are not eligible to receive the rebate, though if they are under the age of 17 then the parent claiming them as a dependent will receive the additional $500 rebate. If the dependent is over the age of 17, then neither the dependent, nor the person claiming them as a dependent, will receive a rebate for the dependent. This means that many college students who are still claimed as dependents on their parents' returns will not be eligible for a rebate payment.

CLAIMING THE CREDIT ON THE 2020 RETURN

When an individual finally files their 2020 return, the credit will then be calculated based on the individual's 2020 adjusted gross income and the thresholds listed above. If the individual did not receive the full rebate during 2020, and the individual is entitled to the full credit based on their 2020 adjusted gross income, then the amount that the individual did not receive during 2020 will be applied as a credit on the 2020 return. If an individual received a greater rebate in 2020 than they were entitled to, based on their 2020 adjusted gross income, then there is currently no requirement that the excess amount received be paid back or included in the individual's gross income. The lack of repayment or inclusion in income provides a unique opportunity for individuals who would qualify based on their 2018 or 2019 returns, but not on their 2020 returns.

RETIREMENT PLAN CHANGES

Section authored by: Sarah Gaymon, CPA | sgaymon@hbkcpa.com

DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS

In general, a penalty of 10 percent is assessed on early distributions from qualified retirement plans unless the distribution meets one of a few exceptions. Section 2202 of the CARES Act removes the 10 percent penalty for any distribution, up to $100,000, made between January 1, 2020 and December 31, 2020 that relates to the coronavirus. In order to meet the requirements of a coronavirus distribution, it must be made to a qualified individual. A qualified individual is defined as an individual who:

- Is diagnosed with SARS-CoV-2 or with coronavirus disease of 2019 (COVID-19);
- Has a spouse or dependent who is diagnosed with the virus; or
- Self certifies to the plan's administrator that the individual is experiencing adverse financial consequences as a result of being quarantined, furloughed, or laid off, having to close a business owned, receiving reduced work hours, unable to work due to lack of child care, or other factors determined by the Secretary of the Treasury.

In addition to the removal of the 10 percent penalty, the CARES Act allows an individual who receives a coronavirus distribution to pay tax on the distribution ratably over a three-year period, or to recontribute the funds income tax free over the three-year period, without regard to contribution limitations.

MODIFICATION OF LOANS FROM QUALIFIED RETIREMENT ACCOUNTS

Prior to the enactment of the CARES Act, the maximum loan allowable from a retirement account was $50,000 or 50 percent of the account balance. The CARES Act expands the allowable loan limits to $100,000 or 100 percent of the account balance for qualified individuals, defined above. Qualified individuals that already have a loan outstanding from a retirement account may delay loan repayments that are due for the period after enactment of the CARES Act through December 31, 2020, for up to one year.

SUSPENSION OF THE REQUIRED MINIMUM DISTRIBUTIONS (RMD) FOR 2020

Under Section 2203 of the CARES Act, individuals over the age of 72 (or 70½ if this age was reached prior to January 1, 2020), or individuals with inherited IRAs who are otherwise required to take an RMD for the year, can forgo the requirement for calendar year 2020. For individuals with inherited IRAs that are required to withdraw the account assets over a five-year period, the five-year period would be determined without regard to calendar year 2020.

This provision applies to individual retirement plans, as well as defined contribution plans organized under IRC § 403(a), § 403(b), and § 457(b), provided the employer of the § 457(b) plan is a state or an agency, instrumentality, or subdivision of a state.

CHARITABLE GIVING PROVISIONS

Section authored by: Amy L. Dalen, JD | adalen@hbkcpa.com

NEW ABOVE-THE-LINE CHARITABLE CONTRIBUTION

Section 2204 of the CARES Act creates a new above-the-line charitable deduction of up to $300 for individuals who do not itemize their deductions. While many provisions of the CARES Act are only temporary, in contrast, this provision is permanent and applies to all tax years ending after December 31, 2019.

In order to qualify for the above-the-line deduction, the contribution must be of cash and must fit the definition of a "charitable contribution" under Internal Revenue Code § 170(c). Generally, this section provides that only charitable contributions made to qualifying organizations will be deductible. Qualifying organizations are generally those organizations that are organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, to prevent cruelty to children or animals, or to foster national or international amateur sports competition. IRC § 170(c) also generally limits a deduction to organizations that are organized under the laws of the United States, the District of Columbia, or a state, and provides other definitions and limitations.

While this new above-the-line charitable deduction relies on the current limitations placed on charitable contributions, Section 2204 of the CARES Act also places two additional limitations on the types of contributions that are eligible for the above-the-line deduction. The first limitation is that the contribution cannot be made to an IRC § 509(a)(3) organization. An IRC § 509(a)(3) organization is a charitable organization that is organized to support another charitable organization. The second limitation is that the contribution cannot be made to a donor advised fund.

MODIFICATION OF LIMITATIONS ON QUALIFIED CHARITABLE CONTRIBUTIONS

Section 2205 of the CARES Act disregards the adjusted gross income (AGI) limitations for qualified charitable contributions made by individuals, thus allowing a deduction for charitable contributions up to 100 percent of an individual's AGI. Qualified charitable contributions are contributions that are paid in cash and must be paid during calendar year 2020. Any qualified charitable contribution made in excess of 100 percent of an individual's AGI is carried forward for up to five years. This modification does not apply to contributions made to supporting organizations or contributions made to donor advised funds. In addition, the individual must make an election for this modification to apply.

In addition to the individual AGI limitation modification, Section 2205 of the CARES Act also increases the limitation for qualified charitable contributions for C corporations from 10 percent of taxable income to 25 percent of taxable income. Any qualified charitable contributions made in excess of 25 percent of taxable income will be carried forward for up to five years. The definition of "qualified charitable contribution" is the same for both individuals and corporations.

Finally, Section 2205 increases the limitation for charitable contributions of food inventory made by businesses. For C corporations, the limitation is increased to 25 percent of taxable income. For all other businesses, the limitation is increased to 25 percent of the aggregate net income for the year from all trades and business that made contributions of food inventory. The charitable contribution of food inventory must occur during calendar year 2020 in order to qualify for the increased limitation.

EMPLOYER STUDENT LOAN PAYMENTS

Section authored by: Amy L. Dalen, JD | adalen@hbkcpa.com

IRC § 127 provides that an employer may provide educational assistance to an employee, and an amount up to $5,250 per year will not be included in the employee's income so long as the assistance is provided pursuant to an educational assistance program. An educational assistance program must be a nondiscriminatory written plan established by the employer for the exclusive benefit of employees, and notice must be provided that it exists. These types of plans typically provide for the payment of undergraduate and graduate educational expenses, which include tuition, fees, and books.

Section 2206 of the CARES Act amends IRC § 127 to allow employers to use educational assistance program funds to make payments on an employee's student loans. The student loan payments must be made prior to January 1, 2021 and can include both principal and interest payments.

EMPLOYEE RETENTION CREDIT

Section authored by: Dante Penza | dpenza@hbkcpa.com

Included in Section 2301 of the CARES Act is the employee retention credit for employers subject to closure due to COVID-19. Its purpose is to encourage businesses to keep employees on payroll during the COVID-19 pandemic and by providing a credit against an employer's FICA taxes for the rest of 2020.

This refundable credit is taken against applicable employment taxes (6.2 percent Social Security and 1.45 percent Medicare) and is equal to 50 percent of wages incurred or paid to each employee in each calendar quarter between March 13, 2020 and December 31, 2020. The total amount of wages used to calculate the credit is capped at $10,000 total for all quarters, which includes health plan expenses that are excluded from the gross income of employees. Furthermore, any wages used to calculate the credit cannot be used in the calculation of determining the Paid Family and Medical Leave credit (Internal Revenue Code § 45S).

In order to be eligible to take the credit, an employer must have either:

(1) Carried on a trade or business during year 2020 and had operations partially or fully suspended due to a COVID-19-related shut-down order; or,

(2) If still fully operational, had gross receipts decline by more than 50 percent when compared to the same calendar quarter of the prior year.

The number of full-time employees also plays an important role in calculating the credit. For an employer that averaged fewer than 100 full-time employees in 2019, the credit is based on all employee wages regardless of whether the business is open or closed due to a shut-down order. For an employer that averaged more than 100 full-time employees in 2019, the credit is based on wages paid to employees who are on payroll but are not currently providing services due to a related COVID-19-related shut-down order.

The credit can be taken until:

(1) The business recovers to 80 percent of gross receipts of the relative prior calendar quarter;

(2) The $10,000 limit per employee is reached; or

(3) The December 31, 2020 cutoff date arrives.

As a simple example to demonstrate the credit, consider the following: A business with 20 employees that each make more than $10,000 in each quarter within the qualifying period is eligible for a maximum credit of $100,000 for the entire year. The credit is not to exceed applicable employment taxes, but any excess credit is treated as an overpayment and is refunded.

The credit is available to nearly all businesses of any size, including some tax-exempt organizations, with some exceptions. It is not available to any federal, state, or local agency or to employers receiving a loan under section 7(a)(36) of the Small Business Act. Business owners will need to decide if it would be more beneficial for an employer to take a small business interruption loan or the employee retention credit.

PAYROLL TAX DEFERRAL

Section authored by: Darla Brocker | dbrocker@hbkcpa.com

Section 2302 of the CARES Act provides a delay in payment of employment taxes on wages paid from the date of enactment of March 27, 2020 through December 31, 2020 (payroll tax deferral period). Eligible employment taxes are the employer's share of the 6.2 percent OASDI (Old Age, Survivors, and Disability Insurance) more commonly known as Social Security taxes as well as self-employment taxes for self-employed individuals.

Employers can defer payment of their share of Social Security taxes (6.2 percent) on wages paid during the payroll tax deferral period with 50 percent of taxes due to be paid on December 31, 2021 and the remainder due on December 31, 2022.

For example, an employer paying $100,000 of wages during the deferral period can defer the payment of $3,100 until December 31, 2021 and $3,100 until December 31, 2022. The employee's share of Social Security, employer and employee Medicare, and Federal withholding is deposited and paid when normally due.

Self-employed individuals can defer payment of 50 percent of their self-employment tax on earnings during the payroll tax deferral period. Payment of half the deferred tax is due on December 31, 2021 and the remainder on December 31, 2022. For example, an individual with self-employment tax during the deferral period of $1,000 can defer payment of $250 until December 31, 2021 and $250 until December 31, 2022. The remaining $500 of tax is subject to normal quarterly estimated tax due dates.

Employers may not defer the payment of payroll taxes if they are receiving assistance through the Paycheck Protection Program.

MODIFICATIONS TO LOSSES

Section authored by: Suzanne Leighton, CPA | sleighton@hbkcpa.com
and David Downie, CPA | ddownie@hbkcpa.com

NET OPERATING LOSSES (NOLS)

The Tax Cuts and Jobs Act of 2017 (TCJA) repealed the carryback of NOLs, but enabled taxpayers to carry forward NOLs indefinitely, and limited the deduction of NOLs to 80 percent of taxable income. Section 2303 of the CARES Act temporarily repeals the 80 percent income limitation for net operating loss deductions for years beginning before 2021. Taxpayers will now be able utilize NOLs to offset 100 percent of taxable income in tax years 2018, 2019, and 2020.

For losses arising in 2018, 2019, and 2020, a five-year carryback is allowed. Alternatively, taxpayers can elect to forgo the carryback.

Therefore, any taxpayers with losses arising in 2018, 2019 and 2020 should strongly consider making an election to carrying those losses back to prior years. These carrybacks may then be able to reduce income in years in which the taxpayer was in a higher tax bracket. In addition, they will provide for cash flow in the near future instead of waiting to carry the losses forward.

Generally, in order to take an NOL carryback, an election needs to be made on a timely filed return. Under the CARES Act, in the case of a net operating loss arising in a taxable year beginning before January 1, 2018, and ending after December 31, 2017, an election to: (i) forgo any carryback of such net operating loss, (ii) reduce any period to which such net operating loss may be carried back, or (iii) revoke any election made under IRC § 172(b) to forgo any carryback of such net operating loss, shall not fail to be treated as timely made if made not later than the date which is 120 days after the date of the enactment of the CARES Act.

BUSINESS LOSS LIMITATION FOR NON-CORPORATE TAXPAYERS

Under the TCJA, a new limitation on business losses was added which applies after the passive loss limitation rules. The limitation disallows the use of a business loss in excess of $250,000 for single filers, or $500,000 for joint filers (referred to as the "excess business loss") against nonbusiness income, and treats excess business loss as an NOL carryover to the next tax year.

Section 2304 of the CARES Act repealed the excess business loss limitation for taxable years beginning before January 1, 2021. Non-corporate taxpayers with business losses arising in 2018, 2019, and 2020 can take advantage of the five-year carryback of an NOL without regard to the excess business loss rules. This provides an opportunity for taxpayers to go back and amend their 2018 and 2019 returns (if filed) if they were subject to the excess business loss limitation for these taxable years.

MODIFICATIONS TO THE CORPORATE ALTERNATIVE MINIMUM TAX

Section authored by: Suzanne Leighton, CPA | sleighton@hbkcpa.com
and David Downie, CPA | ddownie@hbkcpa.com

The CARES Act provides companies with the ability to claim refundable AMT tax credits and obtain additional cash flow. Under the TCJA the Alternative Minimum Tax ("AMT") for corporate taxpayers was repealed effective for tax years beginning after December 31, 2017. The TCJA Act allowed taxpayers to claim refundable AMT credits over tax year 2018 through 2021.

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.

MODIFICATIONS TO THE BUSINESS INTEREST EXPENSE LIMITATION

Section authored by: Nicholas Demetrios, CPA, MBA | ndemetrios@hbkcpa.com

BUSINESS INTEREST EXPENSE LIMITATIONS UNDER THE TAX CUTS AND JOBS ACT (TCJA)

Effective for tax year 2018, TCJA enacted a limitation on how businesses can deduct their business interest expense. Certain limitations had existed prior to this in the tax law, but nothing as sweeping as this change under the new IRC 163(j).

Under TCJA, every business, regardless of its form, is limited to a deduction for business interest equal to 30 percent of its adjusted taxable income (ATI). For pass-through entities such as partnerships and S corporations, the determination is made at the entity, i.e., partnership or S corporation, level.

Adjusted taxable income is a new concept introduced by TCJA, which essentially starts with the business' taxable income as adjusted without regard to the following:

- Any item of income, gain, deduction, or loss that isn't properly allocable to a trade or business;
- Any business interest expense or business interest income;
- The amount of any net operating loss (NOL) deduction;
- The amount of any qualified business income deduction allowed under Code Sec. 199A; and
- For tax years beginning before Jan. 1, 2022, any deduction allowable for depreciation, amortization, or depletion.

Any business interest disallowed under this rule is carried into the following year, and, generally, may be carried forward indefinitely. The limitation does not apply to taxpayers (other than tax shelters) with average annual gross receipts of $26 million or less for the three-year period ending with the prior tax year. Real property trades or businesses can elect to have the rule not apply if they elect to use the alternative depreciation system for real property used in their trade or business. There are also elections that can be made by farms to mitigate this limitation. Also, floor plan financing is specifically excluded from this limitation.

MODIFICATION UNDER THE CARES ACT

Section 2306 of the CARES Act temporarily and retroactively increases the limitation on the deductibility of interest expense under IRC 163(j)(1) from 30 percent to 50 percent for tax years beginning in 2019 and 2020 for everyone but businesses taxed as a partnership. Partnerships have their limitations increased for the 2020 tax year (see below).

This means that for tax returns being filed right now, or those that have already been filed, there is an opportunity to deduct more business interest expense for those taxpayers that were subject to and dealing with the 30 percent limitation.

For example, a calendar year S Corporation has taxable income in 2019 of $2 million. This taxpayer is highly leveraged and has business interest expense of $4 million. However, included in the 2019 tax year is depreciation and amortization expense of $3.5 million. The adjusted taxable income would have been calculated as follows for 2019:

Taxable income	$2,000,000
Plus business interest	$4,000,000
Plus depreciation/amortization	$3,500,000
Adjusted taxable income	$9,500,000
ATI limitation %	30%
Allowable business interest	$2,850,000

Under the CARES Act, the allowable business interest for 2019 will now be:

Taxable income	$2,000,000
Plus business interest	$4,000,000
Plus depreciation/amortization	$3,500,000
Adjusted taxable income	$9,500,000
ATI limitation %	50%
Allowable business interest	$4,750,000

That is an additional 2019 tax deduction of $1.9 million that can result in Federal tax savings of over $700,000 depending on the effective rate of the shareholders.

SPECIAL RULE FOR PARTNERSHIPS

Under a special rule for partnerships, the increase in the limitation will not apply to partners in partnerships for tax year 2019 (it applies only in 2020). For partners that do not elect out, any excess business interest of the partnership for any tax year beginning in 2019 that is allocated to the partner will be treated as follows:

- 50 percent of the excess business interest will be treated as paid or accrued by the partner in the partner's first tax year beginning in 2020 and is not subject to any limits in 2020. This means that 50 percent is freed up and immediately deductible in 2020.
- 50 percent of the excess business interest will be subject to the limitations. In other words, it will remain suspended until the partnership allocates excess taxable income or excess interest income to the partner (or the partnership is no longer subject to IRC 163(j).

SUMMARY

We expect that the IRS will issue guidance on how to implement these changes for the current 2019 tax year as well as 2020. However, with the large potential impact on many taxpayers, we suggest taking full advantage of the extended filing deadline of July 15, 2020 or extending tax returns until the fall of 2020 to ensure that this increase is utilized efficiently. If returns have already been filed, there will be opportunities for amending.

TEMPORARY EXCEPTION FROM EXCISE TAX ON ALCOHOL USED TO PRODUCE HAND SANITIZER

Section authored by: Cassandra Baubie, JD | cbaubie@hbkcpa.com

In response to the COVID-19 pandemic, distilleries and breweries alike are now shifting their production process from making distilled spirits for consumption, to creating hand sanitizer. The Center for Disease Control and Prevention states that hand sanitizer must contain at least 60 percent alcohol content to be effective against COVID-19. Current federal law imposes an excise tax on liquor products at $13.50 per proof gallon, or $2.70 per proof gallon for qualifying small distilleries on the first 100,000 proof gallons they make. A proof gallon is a gallon of 100-proof or 50 percent alcohol content liquor.

In order to promote the production of hand sanitizer, Section 2308 of the CARES Act states that any distilled spirit used after December 31, 2019 but before January 1, 2021 will not be subject to the federal excise tax so long as the spirits are used or contained in hand sanitizer produced and distributed under the regulations provided by the Food and Drug Administration ("FDA") due to COVID-19.

Along with this change, the CARES Act also added that no qualified distilled spirit purchases will be subject to any of the labeling or bulk sale rules found in §§ 105 and 106 of the Federal Alcohol Administration Act, nor are they subject to § 204 of the Alcoholic Beverage Labeling Act of 1988. These provisions are intended to provide relief to those distilleries and other businesses who have modified their production process to produce hand sanitizer to aid in the COVID-10 pandemic.

TECHNICAL CORRECTIONS FOR QUALIFIED IMPROVEMENT PROPERTY

The TCJA put in place a major change which resulted in the recharacterization of certain interior building improvements. Prior to the TCJA, taxpayers were permitted to categorize these improvements as either qualified leasehold improvement property, qualified restaurant property or qualified retail improvement property, each with lives of 20 years or less and eligible for 50 percent bonus depreciation. Property within these categories was also eligible for a 15-year cost recovery period compared to the standard 39-year period.

Under the TCJA, these categories were eliminated, and one singular category of qualified improvement property (QIP) was created. QIP was intended to have a 15-year recovery period and be eligible for the bonus depreciation provisions created under the TCJA, however the actual language of the TCJA failed to provide a recovery period. This unintended mistake resulted in QIP becoming ineligible for bonus depreciation and subject to a recovery period of 39 years.

Under Section 2307 of the CARES Act, a technical correction is made to fix the language of the TCJA. This technical correction now classifies all QIP as 15-year property, which also enables businesses to take bonus depreciation on these costs. It is important to note that the CARES Act makes this retroactive to January 1, 2018, which is the date that the QIP provisions of the TCJA went into effect, thus creating an opportunity for taxpayers to amend their 2018 return to take advantage of this correction.

HBK®