COVID-19 Impacts - The CARES Act and the Construction Industry

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Construction Law

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After some tense negotiations, near-misses, and threatened hold-outs, President Trump signed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) H.R. 748, into law on March 27, 2020. This third stimulus bill aims to provide relief and boost the economy via $2 trillion in aid and stimulus money via tax breaks, rebates, small business loans, industry specific aid, and unemployment benefits. Here, we focus on the expansion of two Small Business Administration (SBA) loan programs and the tax provisions of the CARES Act as applicable to the construction industry. For more COVID-19 resources visit Nexsen Pruet's site here.

The Top 10 Executive Summary

The following list and brief explanations cover the Top 10 aspects of the CARES Act as it relates to the construction industry. Additional details and takeaways are included following the list:

1. Expansion of SBA 7(a) Loans – the Paycheck Protection Program – Provides SBA covered loans to businesses with less than 500 employees up to the lesser of 250% of monthly payroll costs or $10 million that may be forgiven to a certain extent (possibly 100%), so long as 75% of the proceeds are used to fund payroll costs. To the extent the PPP loan is not forgiven, the maturity date is two years at an interest rate of 1%. Lenders are required to provide borrowers with complete payment deferment for six months. No collateral or personal guarantee is required, but the borrower must make a series of certifications.
2. Independent Contractors and PPP Loans – Independent contractors and self-employed individuals are eligible to apply for PPP loans under the same terms, but applications cannot be submitted until April 10, 2020.
3. Expansion of SBA 7(b)(2) Disaster Loans – Disaster Loans are now available for businesses with fewer than 500 employees, sole proprietors, and ESOPs. These working capital loans of up to $2 million

come with 3.75% interest rate and max term of 30 years. There is no loan forgiveness, but no personal guarantee is required for loans under $200,000, and they all come with immediate advance (within 3 days) of up to $10,000, which is not required to be repaid even if the request for a disaster loan is denied.

4. Employee Retention Credit – Refundable payroll tax credit for 50% of wages paid by eligible employers to certain employees during the COVID-19 pandemic. An employer is not eligible for the employee retention credit if the employer receives a PPP loan or another SBA 7(a) loan.
5. Delay of Payment/Deposit of Employer Payroll Taxes – The CARES Act allows for the deferral of the employer's share of the 6.2% Social Security tax that would otherwise be due in 2020 from the date of enactment through December 31, 2020, to be paid on December 31, 2021 (50%) and December 31, 2022 (50%). The deferral does not apply to employers who took out a PPP loan or another SBA 7(a) loan.
6. Net Operating Losses – Temporary Carryback Allowance – A temporary five-year carryback period is available for NOLs arising in calendar years 2018, 2019, and 2020, and those NOLs can offset 100% of taxable income until the 2021 tax year.
7. Technical Correction for Qualified Improvement Property – A technical correction was made to QIP by retroactively designating QIP as 15-year property (20-year for ADS) for depreciation purposes; thus, QIP is eligible for 100% bonus depreciation if placed in service after December 31, 2017.
8. Relaxation of the Limitation on Business Interest – The CARES Act increases the ATI limit from 30% to 50% for 2019 and 2020, and allows a business to elect to use its 2019 ATI when computing its 2020 limitation (since many businesses in 2020 will likely not have taxable income in 2020).
9. Individual Recovery Rebates – The new statute provides a $1,200 rebate for single-filers and heads of household and $2,400 for joint filers, along with $500 per qualifying child. Thus, a jointly-filing family of four would get $3,400 before the application of any phase out rules.
10. Relaxation of Retirement Plan Restrictions – The CARES Act provides that the 10% penalty does not apply to any "coronavirus-related distribution" up to $100,000. The loan amount an individual can borrow against his/her plan also increases from $50,000 to $100,000 for the 180-day period starting after March 27, 2020.

Expansion of SBA 7(a) Loans – the Paycheck Protection Program

The CARES Act expands the SBA 7(a) Loan Program to address working capital needs of small to mid-size businesses, including businesses in the construction industry. This expansion, called the Paycheck Protection Program (PPP), provides covered loans that will be forgiven to a certain extent (possibly 100%), as described below and in the SBA Administrator's Interim Final Rule. If the loan is not completely forgiven (perhaps the borrower terminated some employees during the covered period, or the proceeds were used for something other than the "four forgivable uses"), then the loan continues with a maturity date of two years, an interest rate of 1%, and lenders are required to provide borrowers with complete payment deferment for a period of six months. Further, no collateral or personal guarantee is required.

Eligibility

Construction-related eligible businesses include (nonprofits have been removed):

- A small business with fewer than 500 employees;
- An individual who operates as a sole proprietor;
- An individual who operates as an independent contractor; or
- An individual who is self-employed who regularly carries on any trade or business.

The 500-employee threshold includes all employees – full-time, part-time, and any other status, including employees obtained from a temporary employee agency, professional employer organization, or leasing concern. The threshold includes employees of affiliates in most instances.

In addition, the borrower must have been in operation before February 15, 2020, with employees for whom they paid salaries and payroll taxes or paid independent contractors. Unlike other SBA 7(a) loans, you do not need: (1) proof that you sought credit elsewhere, and were unable to obtain it; (2) a personal guarantee for the loan; or (3) collateral for the loan.

Applying

You can apply for a PPP loan through any existing SBA lender or through any federally insured depository institution (bank), federally insured credit union (credit union), and Farm Credit System institution that is participating. Other regulated lenders may enroll in the program and will be able to provide PPP loans as well. A list of SBA lenders may be found here.

Small businesses and sole proprietorships can start applying for PPP loans on April 3, 2020. Independent contractors and self-employed individuals can start applying for PPP loans on April 10, 2020. The application requires a good faith certification that:

- The uncertainty of current economic conditions makes the loan request necessary to support ongoing operations;
- The borrower will use the loan proceeds to retain workers and maintain payroll or make mortgage, lease, and utility payments;
- Not more than 25% of the forgiven amount may be for non-payroll costs;
- The borrower does not have an application pending for a loan duplicative of the purpose and amounts applied for here; and
- From Feb. 15, 2020 to Dec. 31, 2020,theborrowerhasnotreceivedaloanduplicative of the purpose and amounts applied for here.
    - But, there is an opportunity to fold disaster loans made between January 31, 2020 and April 3 (or 10), 2020, into a new loan.

For independent contractors, sole proprietors, and self-employed individuals, lenders will be looking for certain documents like payroll tax filings, Forms 1099-MISC, and income and expenses from the sole proprietorship.

PPP Loan Amount

PPP loan amounts can be up to 2.5 times the borrower's average monthly payroll costs from year prior to loan, not to exceed $10 million. For businesses not operational in 2019, loan amounts will be 2.5 times the average total monthly payroll costs incurred for January and February 2020.

Payroll costs for employers include:

- Salary, wage, commission, or similar compensation;
- Payment of cash tip or equivalent;
- Payment for vacation, parental, family, medical, or sick leave;
- Allowance for dismissal or separation;
- Payment required for the provisions of group health care benefits, including insurance premiums;
- Payment of any retirement benefit; and
- Payment of state or local tax assessed on the compensation of the employee.

Payroll costs for sole proprietors, independent contractors, and self-employed individuals include the sum of payments of any compensation 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 in an amount that is not more than $100,000 in one year, as pro-rated for the covered period.

Payroll costs do not include:

- Compensation of an individual employee in excess of an annual salary of $100,000, as prorated for the period of February 15, 2020 through June 30, 2020;
- Federal payroll taxes imposed or withheld under the Internal Revenue Code (IRC);
- Any compensation of an employee whose principal place of residence is outside of the United States; or
- Qualified sick leave wages for which a credit is allowed under section 7001 of the Families First Coronavirus Response Act (FFCRA); or qualified family leave wages for which a credit is allowed under section 7003 of the FFCRA because employers get a corresponding refundable tax credit for making these payments.

PPP Loan Forgiveness

PPP loans are forgivable to the amount spent by the borrower on the following items during the eight-week period beginning on the date of the origination of the loan (when funds are disbursed):

- Payroll costs (same definition of payroll costs used to determine PPP loan amount);
- Interest on a mortgage obligation incurred in the ordinary course of business (not principal);
- Rent on a leasing agreement; and
- Payments on utilities (electricity, gas, water, transportation, telephone, or internet).

Any mortgage obligations, lease agreements, and utilities must have been in place before February 15, 2020.

The amount of loan forgiveness is reduced if there is a reduction in the number of employees or a reduction of greater than 25% in wages paid to employees during the 8-week period. The extent of the reduction based on employee count is determined by dividing the average number of full-time equivalent employees per month for the eight-week period by either: (1) the average number of full-time employees per month from February 15, 2019 to June 30, 2019; or, at the borrower/employer's election, (2) the average number of full-time employees per month from January 1, 2020 to February 29, 2020.

The amount of loan forgiveness reduced if there is a reduction in salary is determined by the amount of the reduction in wages that is greater than 25% compared to their most recent full quarter of wage, assuming 2019 wages were less than $100,000 annually.

Reductions in PPP loan forgiveness can be cured. Any reductions in employment or wages that occur from February 15, 2020 and April 26, 2020 shall not reduce the amount of loan forgiveness if by June 30, 2020, the borrower eliminates the reduction in employees or reduction in wages.

Finally, at least 75% of the amount forgiven must be attributable to payroll costs.

A formal application must be submitted to receive PPP loan forgiveness along with substantiation documentation detailing the factors. Lenders will have 60 days following submission to approve or deny the application. To the extent part of a PPP loan is not forgiven, the loan continues on these terms: (1) a maturity date of two years; (2) an interest rate of 1%; and (3) deferment of payment of principal, interest and fees for a period of six months.

Takeaways

1. Keep detailed records during the eight-week covered period of amounts paid for payroll costs, mortgage interest, rent, and utilities (including electricity, gas, water, transportation, telephone, or internet access), and keep copies of checks (along with invoices, bills, and/or bank statements) used to pay the aforementioned sums.
2. Keep meticulous documentation verifying the number of employees on payroll and pay rates during February 15, 2020 to June 30, 2020. This will help you tremendously on the back-end during the application for forgiveness process.
3. The SBA Administrator's Interim Final Rule added another limitation to the forgiveness qualifications – at least 75% of the forgiveness amount must be attributable to payroll costs.
4. If all or part of a PPP loan is forgiven, the amount of the loan forgiveness is not included in the borrower's taxable income (most canceled debt becomes taxable income at the time of cancelation).

5. An employer is not eligible for the employee retention credit if the employer receives a PPP loan. See more details on the employee retention credit in the discussion of the tax provision of the CARES Act below.
6. Example – John's Stone & Tile, Inc. (JST), a stone and tile supplier for commercial and residential construction companies, applies for a PPP loan on April 15, 2020, and makes the requisite certifications. JST had $2.4 million in payroll costs for the period of April 15, 2019 through April 14, 2020, for monthly average payroll costs of $200,000. JST is entitled to a PPP loan of $500,000 ($200,000 in average monthly payroll costs * 2.5). In the first eight weeks after JST receives the PPP loan disbursements, it spends $425,000 on payroll costs, mortgage interest, and utilities. Assume there is no employee loss, no reduced wages, and at least 75% of the $425,000 is attributable to payroll costs. JST is eligible to have $425,000 of the PPP loan forgiven. JST submits the forgiveness application in the amount of $425,000 and it is approved. The forgiveness of the $425,000 does not generate taxable income to JST. The remaining $75,000 of unforgiven PPP loan has a maturity of two years and an interest rate of 1%. In addition, any payments due on the remaining $75,000 will be deferred for six months.
7. Example with Reduced Loan Forgiveness – Same as the example of above, but with the following additional facts:
    1. JST's average employee headcount:
        1. During the eight-week covered period is 50.
        2. From February 15, 2019 - June 30, 2019 was 60.
        3. From January 1, 2020 - February 29, 2020 was 55.
    2. Reduced forgiveness under using the period from February 15, 2019 - June 30, 2019 as the denominator would be – 425,000 * (50/60) = $354,166.67 forgiven with ($70,833.33 + $75,000 =) $145,833.33 to be paid back over 2 years at a 1% interest rate with a six month deferral.
    3. Reduced forgiveness under using the period from January 1, 2020 - February 29, 2020 as the denominator would be – 425,000 * (50/55) = $386,363.64 forgiven with ($38,636.36 + $75,000 =) $113,636.36 to be paid back over two years at a 1% interest rate with a six month deferral.

Expansion of SBA 7(b)(2) Disaster Loans

The CARES Act expands access to SBA 7(b)(2) Economic Injury Disaster Loans (Disaster Loans) to include not only businesses with fewer than 500 employees, but also sole proprietors and ESOPs. Disaster loans are working capital loans of up to $2 million that can be used to pay fixed debts, payroll, accounts payable, and other bills that could have been paid had the disaster not occurred. They are not meant for business expansion. Interest rates on disaster loans are 3.75% for small businesses. The maximum loan term is 30 years. There is no loan forgiveness with a disaster loan.

For any loan made under this program before December 31, 2020, no personal guarantee will be required on loans below $200,000. The CARES Act allows a disaster loan to be taken out between January 31, 2020 and the date on which a PPP is available for reasons "other than paying payroll costs." Presumably, any loan taken out for payroll purposes will be confined to the PPP loans described above, even though disaster loans have historically been available to cover payroll. The exact dynamics between the two loans is still unclear, but it may be possible to apply for both so long as the disaster loan is not used to fund payroll. If a PPP loan is ultimately approved it appears that the disaster loan will be refinanced into the PPP loan.

Applications for disaster loans are submitted directly to the SBA online, with the approval process generally taking about a month. Given this, the CARES Act creates a new Emergency Grant to allow a business that has applied for a disaster loan to get an immediate advance (within three days) of up to $10,000. The advance can be used to pay for any of the above noted allowable disaster loan expenses, and is not required to be repaid, even if the borrower's request for a disaster loan is denied.

Takeaways

1. Most in the construction industry will likely find a PPP loan to be more beneficial, but businesses should consider eligibility, maximum loan amounts, loan forgiveness, maximum maturity, and interest rate before choosing between a PPP and a disaster loan.
2. The CARES Act also provides benefits to those with existing loans under Section 7(a) of the Small Business Act other than the new PPP loans, in the form of a government subsidy whereby the SBA will pay six months of principal, interest, and fees on qualifying loans.

Tax Provisions for Businesses

Employee Retention Credit

The CARES Act provides a refundable payroll tax credit for 50% of wages paid by eligible employers to certain employees during the COVID-19 pandemic. The employee retention credit is only available in 2020 and a business is considered an eligible employer if:

- Business operations were fully or partially suspended due to COVID-19; or
- Business operations continued, but during any quarter in 2020, gross receipts for that quarter were less than 50% of what they were for the same quarter in 2019. The business will remain eligible for the credit in 2020 until the business has a quarter where its gross receipts exceed 80% of what they were for the same quarter in the previous year; and
- The employer has not received a PPP loan or another SBA 7(a) loan.

The credit is for 50% of "qualified wages," the definition of which depends on the employer's size. For employers who had an average number of 100 or fewer full-time employees in 2019, all employee wages are eligible, regardless of whether the employee is furloughed. For employers who averaged more than 100 full-time employees in 2019, only the wages of employees who are furloughed or faced reduced hours as a result of their employers' closure or reduced gross receipts are eligible for the credit. The effective period for paying qualified wages runs from March 13, 2020 through December 31, 2020. The employee retention credit is capped at the first $10,000 of compensation, including health benefits, paid to an employee. It is refundable if it exceeds the business's liability for payroll taxes.

Takeaways

1. Given the credits provided for paid sick leave and family leave in the also recently enacted Family First Coronavirus Response Act (FFCRA) and the impact of the COVID-19 pandemic, the employee retention credit will be refundable to many employers, including those in the construction industry.
2. The CARES Act appears to use the aggregation rules of IRC §§ 52 and 414 to determine which entities are treated as a single employer for determining the employee count.
3. For the employee retention credit in the CARES Act, the window qualified wages runs from March 13, 2020 through December 31, 2020. But, per Notice 2020-21, the IRS established that the effective date of the FFCRA for qualified sick leave and family leave starts on 4/1/2020 and continues through 12/31/2020. So, we have two different effective dates for three credits that impact payroll taxes for 2020.
4. The IRS created a FAQs page concerning the Employee Retention Credit that may be found here.
5. Employers need to understand that this retention credit cannot be claimed if they took out a 7(a) loan under the SBA, including PPP loans.

Delay of Payment/Deposit of Employer Payroll Taxes

On top of the credits in the FFCRA and the employee retention credit noted above, the CARES Act allows for the deferral of the employer's share of the 6.2% Social Security tax that would otherwise be due in 2020 from the date of enactment through December 31, 2020, to be paid on December 31, 2021 (50%) and December 31, 2022 (50%). Similarly, a self-employed taxpayer can defer paying 50% of his or her self-employment tax that would be due from the date of enactment through the end of 2020 until the end of 2021 (25%) and 2022 (25%).

Takeaways

1. Employers will be able to: (1) defer payment of its share of Social Security tax until 2021 and 2022, but (2) receive immediate credits against those to-be-paid later payroll taxes in through the sick leave and family leave credits in the FFCRA and the employee retention credit. Who knows how this will be administered on income and payroll tax filings for 2020? Good luck, IRS.
2. Social Security Trust Funds will be held harmless under this provision.
3. The CARES Act includes special rules for third-party payroll providers and professional employer organizations.
4. The deferral does not apply to employers who took out a loan under section 7(a) of the SBA, including PPP loans.

Net Operating Losses – Temporary Carryback Allowance

The CARES Act provides for a temporary five-year carryback period for net operating losses (NOLs) arising in calendar years 2018, 2019, and 2020 and allows NOLs for those calendar years to offset 100% of taxable income until the 2021 tax year. Taxpayers may elect out of this five-year carryback regime, but that election is irrevocable. Real Estate Investment Trusts (REITs) are carved-out of the CARES Act carryback rules. The creation of this temporary five-year carryback regime will require some taxpayers to track three different groupings of federal NOLs:

- → Incurred prior to 2018 (pre-TCJA) – 2-year carryback, 20-year carryforward, and eligible to offset 100% of taxable income.
- → Incurred after 12/31/2017 and before 1/1/2021 (CARES Act) – 5-year carryback, indefinite carryforward, eligible to offset 100% of taxable income when carried forward to 2019 and 2020, but only eligible to offset 80% of taxable income when carried forward to 2021 and subsequent years.
- → Incurred after 12/31/2020 (TCJA adjusted by CARES Act) – no carryback, indefinite carryforward, and eligible to offset 80% of taxable income.

Takeaways

1. A corporation can carryback 2018, 2019, and 2020 NOLs to offset pre-2018 ordinary income or capital gains that were taxed at a rate up to 35%, which generates a current refund and a significant favorable rate differential. In other words, to the extent NOLs can be increased in 2020 via accelerated deductions, deferred revenue, or the impacts of COVID-19, permanent cash tax savings could be generated if those NOLs can be carried back to profitable, higher tax rate years. In addition, if NOLs were already on the books in 2018 and 2019, prior income tax liabilities could be offset as far back as 2013 or 2014.
2. Corporations in the construction industry may have some flexibility to defer revenue and accelerate deductions depending on the long-term contract accounting method they utilize, or they could potentially change accounting methods.
3. Basically, this provision aims to provide cash flow and liquidity during the COVID-19 pandemic.
4. The CARES Act does not modify the rules related to capital losses.

Technical Correction for Qualified Improvement Property

The TCJA amended IRC § 168(k) to allow for 100% bonus depreciation for certain qualified property. Then the TCJA eliminated pre-existing definitions for several categories of property generally eligible for bonus depreciation and replaced them with one category called qualified improvement property (QIP). It was intended by the drafters that QIP have a 15-year recovery period and be eligible for bonus depreciation, but a specific recovery period was not reflected in the TCJA. Thus, under the TCJA, QIP technically had a 39-year recovery period and was ineligible for 100% bonus depreciation.

The CARES Act provides a needed and much anticipated technical correction concerning QIP. It specifically and retroactively designates QIP as 15-year property (20-year for ADS) for depreciation purposes; thus, QIP is eligible for 100% bonus depreciation if placed in service after December 31, 2017.

Takeaways

1. Automatic accounting method changes will likely need to be filed to comply with this technical correction and obtain the benefit through an IRC § 481(a) adjustment. Taxpayers are generally required to file a change of accounting method when the depreciation method changes. Here, QIP placed in service after 2017 that has initially been depreciated as 39-year building property, will need to be changed to 15-year property that is eligible for 100% bonus depreciation.

2. However, if a QIP asset was only depreciated on a single tax return, it was placed in service in 2018, and the 2019 return has not yet been filed, the depreciation method may be corrected with an amended 2018 return.
3. Hopefully, the IRS will issue some procedural guidance concerning the filing of automatic accounting method changes or amended returns under these circumstances. Particularly concerning partnerships subject to the centralized audit regime of the Bipartisan Budget Act of 2015, as many partnerships will likely need to file Administrative Adjustment Requests with the benefit accounted for in 2020.
4. The CARES Act does not permit the ability to change prior-year elections concerning the depreciation of QIP. Nothing in the CARES Act allows for a taxpayer to go back and elect out of bonus depreciation for property placed in service in 2018 or election to use ADS.
5. This technical correction will create a multimillion swing in depreciation deductions available for many taxpayers, including those in the construction industry, particularly architectural and engineering firms with larger or multiple offices that make tenant improvements to office space they lease.

Relaxation of the Limitation on Business Interest

The TCJA added IRC § 163(j), which limits the ability of a business to deduct its interest expense to 30% of its adjusted taxable income (ATI) while any excess interest is carried forward. ATI equals a taxpayer's taxable income computed without regard to: (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) business interest or business interest income; (3) the amount of any NOL deduction; (4) the 20% deduction for certain pass-through income; and (5) for tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion.

The CARES Act increases the ATI limit from 30% to 50% for 2019 and 2020, and allows a business to elect to use its 2019 ATI when computing its 2020 limitation (since many businesses in 2020 will likely not have taxable income in 2020). Taxpayers are allowed to elect-out of the application to the temporary new rule.

For partnerships, the 50% ATI limitation does not apply to 2019. Instead, interest disallowed at the partnership level is allocated to the partners and suspended at the partner-level under the normal rules. However, in 2020 there is a bifurcation: 50% of the suspended interest becomes available and deductible, while the other 50% 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).

Takeaways

1. The ability of a business to elect to use its 2019 ATI limitation in 2020 could generate some significant tax savings. For example, if a business had ATI of $8 million in 2019 but a negative ATI in 2020, it could elect to deduct $4 million of interest expense in 2020 (50% of $8 million), generate a bigger loss, and then use the favorable new NOL provisions to carryback the loss to 2019 (or prior years) and recover taxes paid in that year (or prior years).
2. If NOLs arise in 2019 or 2020 on account of either the increased IRC § 163(j) limitation or the treatment of excess business interest expense allocated to a partner for a taxable year beginning in 2019, those NOLs are now

available for carryback and are not subject to the 80 percent limitation pursuant the CARES Act changes to the NOLs rules discussed above.

Temporary Reversal of the Limitation of Excess Business Losses

The CARES Act removes the excess business loss limitation (the fourth limitation on an individual's ability to use losses from a business added via the TCJA) under IRC § 461(l) for the calendar years 2018, 2019, and 2020, by changing the effective date of the excess business loss limitation rule to apply for any tax year beginning after 12/31/2020, and before 1/1/2026. This modification is retroactive back to December 31, 2017. Further, the CARES Act includes some technical corrections to IRC § 461(l), namely that wages will not be considered business income, which should result in more losses being limited in most cases when it becomes effective again in 2021.

Takeaways

1. Amended returns will need to be filed for 2018 (and 2019 if already filed) to account of the retroactive nature of the removal of IRC § 461(l).
2. These amended returns will likely report larger losses given the removal of the limitation leading to potential refunds for the individual owners of the pass-through entities.
3. Given the delay of the effective date of IRC § 461(l) until after 2020, pass-through entities may not even need to report IRC § 461(l) information on Schedules K-1 until the 2021 tax year.

Acceleration of the Ability to Use Corporate Minimum Tax Credits

The CARES Act allows corporations to accelerate the utilization of their remaining minimum tax credits (MTCs) from the pre-TCJA alternative minimum tax (AMT) regime. The TCJA repealed corporate AMT and allowed corporations to claim outstanding AMT credits or MTCs subject to certain limits for tax years prior to 2021, at which time any remaining AMT credit may be claimed as fully-refundable. The CARES Act allows corporations to claim 100% of MTCs in 2019 as fully refundable and provides an election to accelerate claims to 2018, with eligibility for accelerated refunds.

Takeaways

1. Taxpayers that used MTCs to offset regular tax liabilities in 2018 may be able to use the new NOL carryback rules to get a refund.
2. The accelerated refund claims for 2018 will be treated as tentative carryback refund claims under IRC § 6411. The application must be filed before 12/31/2020. An amended return is not required.
3. These CARES Act amendments are intended to provide a cash refund for carryforward MTCs following the TCJA's elimination of corporate AMT.

Tax Provisions for Individuals

Individual Recovery Rebates

Perhaps the most discussed provision of the CARES Act concerns the direct individual stimulus payments, officially dubbed "recovery rebates" also known as "economic impact payments," which involves the IRS sending over $500 billion via check or direct deposit to most American adults. The new statute provides $1,200 for single-filers and heads of household and $2,400 for joint filers, along with $500 per qualifying child (using the Child Tax Credit provisions). Thus, a jointly-filing family of four would get $3,400 before the application of any phase out rules.

The direct payments start to phase out at a 5% rate above adjusted gross incomes (AGI) of $75,000 for single-filers, $122,500 for heads of households, and $150,000 for joint-filers. The point at which a taxpayer no longer will receive any direct payment depends on filing status and qualifying children. For example:

- → Single-filer with no children is completely phased out if AGI exceeds $99,000 I (1,200 / 5%) = 75,000 = 99,000).
- → Head of Household with one child completely phased out if AGI exceeds $156,500 I ((1,200 + 500) /5%) + 122,500 = $156,500.
- → Joint-filer with no children is completely phased out if AGI exceeds $198,000 I (2,400 / 5%) + 150,000 = 198,000.
- → Joint-filer with two children is completely phased out if AGI exceeds $218,000 I ((2,400 + 1,000) / 5%) + $150,000 = $218,000.

Generally, taxpayers must submit the SSNs for each family member claiming the direct payments. But, since these direct payments are going to be advanced refunds for 2020 and the IRS is supposed to send these direct payments as soon as possible, a taxpayer's AGI will initially be determined by referencing the 2019 tax return. If a 2019 tax return has not been filed, the IRS will look at your 2018 return. Non-filers generally need to file a tax return to claim the rebate, unless you are not required to file but information if available to the IRS via Forms SSA-1099 or RRB-0199. More information for non-filers is available here. Note, the direct payment credit will be recomputed again on the filing of taxpayer's 2020 return in calendar year 2021 based on 2020 data.

Takeaways

1. For most taxpayers, no action will be required on their part to receive the direct payment. However, the credit payment amount must be recalculated on the filing of 2020 tax returns.
2. The recalculation of the direct payment amount on your 2020 tax return based on your 2020 data could lead to significant differences between the 2020 calculation and the direct payment you actually received based on a 2018 or 2019 tax return. If the advance payment was less than what you are owed in 2020, i.e., you were phased out in 2019 but not 2020 or you had another child or different filing status, the excess will be treated as a credit that reduces your 2020 tax liability.
3. If the advance payment received is greater than what you're owed on your 2020 tax return, or you're completely phased out per your 2020 tax return, you should not have to repay or return the excess. The CARES Act does not explicitly require any income recognition on the excess advanced payment received, and it says that the credit cannot be reduced below zero by the advanced payments. This could create some planning opportunities if you

have not yet filed your 2019 return.

4. The expected expedited calculation and processing of this direct advanced payment/rebate is going to be an administrative nightmare for an already understaffed IRS. Even though the IRS has paused some compliance and collection efforts during the COVID-19 pandemic, it is still being asked to perform what seems to be an impossible task. Will the IRS stagger the issuance of the checks over several months like it did with the 2008 stimulus checks to prevent overwhelming its staff and technology? Treasury wants them issued in three weeks. We'll see what happens.

Relaxation of Retirement Plan Restrictions

Generally, if you receive a distribution from a qualified retirement plan before the age of 59 ½, you pay income tax on the distribution and IRC § 72(t) imposes a 10% penalty (or additional tax) on the distribution unless an exception is applicable. The CARES Act adds a new exception by providing that the 10% penalty does not apply to any "coronavirus-related distribution" up to $100,000. A "coronavirus-related distribution" is a distribution made during 2020 to an individual:

→ Who is diagnosed with COVID-19 with a test approved by the Center for Disease Control (CDC);

→ Whose spouse or dependent (as defined by IRC § 152) is diagnosed with COVID-19; or

→ Who experiences adverse financial consequences as a result of being quarantined, furloughed, laid off, having work hours reduced, being unable to work due to lack of child care due to COVID-19, closing or reducing hours of a business because of COVID-19, or other factors determined by Treasury.

While a "coronavirus-related distribution" avoids the 10% penalty, it is still subject to income tax; however, the CARES Act allows you to spread the income tax burden over a three-year period starting with 2020. Income recognition can be avoided entirely by repaying the distribution to the retirement plan within three years of receipt. This repayment does not apply against contribution limitations. In addition, the loan amount an individual can borrow against his/her plan increases from $50,000 to $100,000 for the 180-day period starting after the CARES Act is enacted, while certain outstanding loans that were previously due on or before December 31, 2020, will be delayed for one year. Finally, for individuals 72 and older that are normally required to withdraw a "required minimum distribution" from the retirement plan, the CARES Act waives the minimum distribution rules for calendar year 2020.

Takeaways

1. While it's generally best to leave your retirement plan alone, the waiver of the 10% penalty and the spread of income recognition over three years will soften the impact of 2020 early withdrawals.
2. For more specifics on the employee/retirement related benefits read this.

Charitable Contributions

The enactment of the TCJA in December of 2017 almost doubled the applicable standard deduction, but curtailed many itemized deductions, like the one for state and local taxes paid. This led to less than 10% of taxpayers itemizing their deductions in 2018. To account for this and provide some extra relief, the CARES Act provides a new “above the line” deduction of up to $300 to individual taxpayers who do not itemize their deductions.

For individual taxpayers that do itemize their deductions, the CARES Act temporarily raises the AGI limitations on charitable giving to public charities and donations from 60% to 100%. Excess contributions may be carried forward for five years. The limitation on corporation donors is increased from 10% of adjusted taxable income to 25%. In all cases the charitable contribution must be made in case to a public charity or foundation as defined in IRC § 170(b)(1)(A).

Takeaways

1. Taxpayers who itemized are not permitted to claim the $300 above the line deduction allowed to taxpayers who do not itemize. Taxpayers who itemize must still report on charitable contributions on Schedule A, but the AGI limitations were increased to 100%.
2. There is no requirement that the contribution be used in COVID-19 relief efforts in order to take advantage of the above the line deduction or higher percentage limitations as applicable.

Conclusion

While the CARES Act provides approximate $2 trillion in stimulus money to combat COVID-19 and help people and businesses absorb the impact of COVID-19, many think additional relief is needed, particularly those in the hospitality and construction industries. The House is already discussing another package. It remains unclear how many of the Federal agencies, including the IRS, will be able to implement some of these sweeping changes in an expedited manner while their own employees are impacted by COVID-19 just like everyone else. Time will tell.

David McCallum represents individuals, fiduciaries, partnerships, corporations, and other entities - in tax controversy matters before the IRS both administratively, including the Appeals Office, and in litigation before the Tax Court. He may reached at dmccallum@nexsenpruet.com.

If you have any other Construction issues related to COVID-19, feel free to contact Eric Biesecker.

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