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Updates on Tax Deadlines and Key Tax Provisions of the CARES Act

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Over recent days, the Internal Revenue Service has extended certain tax filing and payment deadlines and issued guidance on some provisions of the recently-enacted Coronavirus Aid, Relief, and Economic Security Act (the CARES Act). This alert summarizes key parts of this guidance.

Extension of Deadlines

The IRS announced that certain additional tax deadlines would automatically be extended. Previous announcements had extended the deadlines for filing individual and corporate income tax returns and paying related taxes until July 15, 2020. The deadline for making estimated income tax payments otherwise due on April 15 was also extended to July 15. The new guidance extends until July 15, 2020 the filing and payment deadlines for specified obligations that otherwise would have been due on or after April 1, 2020, and before July 15, 2020. In addition to personal and corporate income taxes, the extended deadlines apply to (among others) partnership, estate, and trust income tax returns and payments; estate and generation-skipping tax returns and payments; and certain returns and payments for tax-exempt organizations. Estimated individual income tax payments otherwise due June 15 can now be paid by July 15 (so that the first two quarterly payments will be due on the same date). In addition, deadlines have been extended to July 15 for specified "time-sensitive" actions that otherwise would have been required to be performed on or after April 1, 2020 and before July 15, 2020, including filing a claim for refund of any tax and making an investment in a qualified opportunity fund if the taxpayer's 180-day investment period expires during such period. Notably, such "time-sensitive" actions include Internal Revenue Code Section 83(b) elections and IRS Form 8832, Entity Classification Elections ("check-the-box" elections).

Payroll Tax Deferral

The CARES Act allows employers to defer the employer's portion of the Social Security payroll tax (6.2%) (and certain railroad retirement taxes) on wages paid from March 27, 2020, through December 31, 2020. Fifty percent of the amount deferred must be repaid by no later than December 31, 2021, and the balance must be repaid by December 31, 2022. The IRS issued guidance in the form of FAQs that clarify how the payroll tax deferral operates. In particular, the IRS guidance clarifies that an employer that receives a Paycheck Protection Program (PPP) loan will be eligible for this payroll tax deferral but cannot defer payroll taxes that become due after the date the lender issues a notice of PPP loan forgiveness. For further information about the payroll tax deferral, please see [CARES ACT GUIDANCE: Overview of IRS Guidance Regarding Deferral of Employment Tax Deposits and Payments - by James E. Gregory and Megan Monson].

Employee Retention Tax Credits

The IRS issued guidance in the form of FAQs clarifying the requirements for employee retention tax credits (ERTCs) under the CARES Act. The ERTC is a fully refundable tax credit for employers equal to 50% of qualified wages (including allocable qualified health plan expenses) that eligible employers pay their workers for time that the employees are not providing services due to either (1) a full or

partial suspension of operations by order of a governmental authority limiting commerce, travel, or group meetings due to COVID-19, or (2) a significant decline in gross receipts. For employers that averaged 100 or fewer full-time employees in 2019, the ERTC applies to qualified wages paid or provided during such a period to both active and inactive employees.

The ERTC applies to qualified wages paid after March 12, 2020, and before January 1, 2021. The maximum amount of qualified wages taken into account with respect to each employee for all calendar quarters is $10,000, so that the maximum credit for an eligible employer for qualified wages paid to any employee is $5,000. The same wages cannot be counted for both the ERTC and the refundable tax credit for required sick or family leave established by the Families First Coronavirus Relief Act. Also, an employer may not receive the ERTC if the employer receives a PPP loan.

The IRS guidance provides important information about how to receive the ERTC and answers many questions left open by the CARES Act. The IRS guidance, issued in the form of FAQs, can be accessed at https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act.

When is a business "partially suspended"?
The IRS's guidance provides that the operation of an employer's trade or business may be considered partially suspended if an appropriate governmental authority imposes restrictions upon the business operations by limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 such that the operation can still continue to operate but not at its normal capacity. The IRS guidance did not define what it means to operate at "normal capacity," but given the wide application of governmental COVID-19 orders, this standard would appear to potentially apply to a wide range of businesses adversely affected by such orders.

What is a "significant decline in gross receipts"?
An employer experiences a significant decline in gross receipts beginning with the first quarter in which its gross receipts for a calendar quarter in 2020 are less than 50 percent of its gross receipts for the same calendar quarter in 2019. The significant decline in gross receipts ends with the first calendar quarter that follows the first calendar quarter for which the employer's 2020 gross receipts for the quarter are greater than 80 percent of its gross receipts for the same calendar quarter during 2019. The IRS published the following example to demonstrate how this operates:

Example: An employer's gross receipts were $100,000, $190,000, and $230,000 in the first, second, and third calendar quarters of 2020, respectively. Its gross receipts were $210,000, $230,000, and $250,000 in the first, second, and third calendar quarters of 2019, respectively. Thus, the employer's 2020 first, second, and third quarter gross receipts were approximately 48%, 83%, and 92% of its 2019 first, second, and third quarter gross receipts, respectively. Accordingly, the employer had a significant decline in gross receipts commencing on the first day of the first calendar quarter of 2020 (the calendar quarter in which gross receipts were less than 50% of the same quarter in 2019) and ending on the first day of the third calendar quarter of 2020 (the quarter following the quarter for which the gross receipts were more than 80% of the same quarter in 2019). Thus the employer is entitled to a retention credit with respect to the first and second calendar quarters.

How can an employer obtain the ERTC?
The IRS's guidance instructs eligible employers to report their total qualified wages and the related credits for each calendar quarter on their federal employment tax returns, usually Form 941, Employer's Quarterly Federal Tax Return (used to report income, Social Security, and Medicare taxes withheld by the employer from employee wages as well as the employer's portion of Social Security and Medicare tax). The IRS explained that in anticipation of receiving the credits, eligible employers can fund qualified wages by accessing federal employment taxes, including withheld taxes, which are required to be deposited with the IRS or by requesting an advance on the credit from the IRS.

The IRS further explained that an eligible employer that pays qualified wages to its employees in a calendar quarter before it is required to deposit federal employment taxes with the IRS for that quarter may reduce the amount of federal employment taxes it deposits for that quarter by half of the amount of the qualified wages paid in that calendar quarter. The following example based on IRS guidance is illustrative:

Example: An eligible employer paid $10,000 in qualified wages (including qualified health plan

expenses) and is therefore entitled to a $5,000 credit, and is otherwise required to deposit $8,000 in federal employment taxes, including taxes withheld from all of its employees, for wage payments made during the same quarter as the $10,000 in qualified wages. The eligible employer may keep up to $5,000 of the $8,000 of taxes the eligible employer was going to deposit, and it will not owe a penalty for keeping the $5,000. The eligible employer is required to deposit only the remaining $3,000 on its required deposit date. The eligible employer will later account for the $5,000 it retained when it files Form 941 for the quarter.

Can an employer receive advance payment of the ERTC?

Yes. As the IRS guidance explains, if the anticipated credit for qualified wages exceeds the remaining federal employment tax deposits for that quarter, the eligible employer can file a Form 7200, Advance Payment of Employer Credits Due to COVID-19, to claim an advance refund for the full amount of the anticipated (excess) credit. The following example is based on the IRS guidance:

Example: An eligible employer paid $20,000 in qualified wages and is therefore entitled to a credit of $10,000 and is otherwise required to deposit $8,000 in federal employment taxes, including taxes withheld from all of its employees, on wage payments made during the same calendar quarter. The eligible employer can keep the entire $8,000 of taxes that it was otherwise required to deposit without penalties as a portion of the credits it is otherwise entitled to claim on the Form 941. The eligible employer may file a request for an advance credit for the remaining $2,000 by completing Form 7200.

Allowing Amendments of Partnership Tax Returns to Take Advantage of CARES Act

The IRS issued guidance allowing partnerships that already filed tax returns for 2018 or 2019 to file amended returns to expediently pass-through CARES Act benefits to their partners. The new partnership audit rules that went into effect in 2018 otherwise prevent partnerships and their partners from amending prior-year returns, thereby delaying the benefit to partners of realizing CARES Act tax benefits until after the filing of the current year partnership return (in 2021). Partnerships availing themselves of the guidance may file amended returns and issue corresponding Schedules K-1 before September 30.

Procedures for Carrying Back Net Operating Losses

The IRS issued guidance providing procedures for carrying back net operating losses (NOLs) under the CARES Act. The CARES Act requires taxpayers to carry back NOLs arising in 2018, 2019, and 2020 over the preceding five years unless the taxpayer elects to waive or reduce the carryback period. If a year to which NOLs are carried back was one in which income was included as a result of the transition tax on earnings of certain foreign corporations that had not been repatriated (a Section 965 inclusion), special rules apply. Notably, an election to waive the carryback period in the case of an NOL arising in tax years beginning in 2018 or 2019 and elections relating to the application of NOL carrybacks arising from 2018 and 2019 tax years to years that contain a Section 965 inclusion amount must be made no later than the due date, including extensions, for the first tax year of the corporation that ends after March 27, 2020. Notably, the special procedures for tentative refund claims, which normally do not apply where a Section 965 inclusion amount is implicated, are permitted for NOL refunds resulting from the special CARES Act provisions (see IRS FAQs: https://www.irs.gov/newsroom/temporary-procedures-to-fax-certain-forms-1139-and-1045-due-to-covid-19), and the IRS has granted a six-month extension to file tentative refund claims with respect to NOL carrybacks that arose in any taxable year that began during calendar year 2018 and that ended on or before June 30, 2019.

Interest Deduction Limitations: Procedures for Making Elections

Starting in 2018, deductions for business interest expenses were limited to 30% of the taxpayer's adjusted taxable income. The CARES Act retroactively increased the limit to 50% of adjusted taxable income for 2019 and 2020 (just 2020 for partnerships). Certain real property and farming businesses are permitted to elect out of this limitation on business interest deductions, but if they choose to take an increased interest deduction, they are prohibited from taking accelerated depreciation and are instead subject to an alternative depreciation system under which property is depreciated more slowly. The CARES Act also provides more favorable (and retroactive) depreciation rules, such that real property and farming businesses that previously elected out of the business interest expense limitation now may want to reverse such election (so that they can get the benefit of accelerated depreciation). The IRS has provided guidance for taxpayers that made such elections but now would now like to withdraw

them in light of the CARES Act provisions. The new guidance provides that such an election modification can be done by filing an amended tax return by October 15, 2021, for the year the election was made. The guidance also describes how to make other related elections, including using a taxpayer's adjusted taxable income for 2019 for applying the interest deduction limitation to 2020.

Guidance for REMICs

The CARES Act provides that borrowers of certain federally backed mortgage loans may obtain forbearance for financial hardship. Many such loans are held by investment trusts and real estate mortgage investment conduits (REMICs). REMICs are subject to particular requirements in order to maintain a favorable tax status that otherwise might be jeopardized as a result of forbearance. The IRS has issued guidance under which, for mortgage loans held by REMICs, loan modifications resulting from the CARES Act forbearance program will not be treated as resulting in a newly issued loan, are not prohibited transactions (as defined), and do not result in a deemed reissuance of regular interests. In addition, delays and shortfalls associated with or caused by the forbearance are contingencies (as defined) that can be disregarded by the REMIC without causing it to fail to be a regular interest. For mortgage loans held by investment trusts, the forbearance will not manifest the power to vary the investment of the certificate holders if certain requirements are satisfied. Further, if such loans are acquired by a REMIC, the forbearance will not be treated as improper knowledge of an anticipated default.

To see our prior alerts and other material related to the pandemic, please visit the Coronavirus/ COVID-19: Facts, Insights & Resources page of our website by clicking here.

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