Insight

Tax Provisions in the Coronavirus Aid, Relief, and Economic Security (CARES) Act -FINAL VERSION

GORDON GRAY | MARCH 25, 2020

Executive Summary

- The CARES Act includes substantial – in excess of $300 billion – individual rebates, among other relief provisions.
- The Act also includes nine business tax provisions, including a credit to retain workers during COVID-19 -related closures, a change to the tax treatment of business losses, delays in payroll tax payments, and some technical corrections to the Tax Cuts and Jobs Act.
- Combined, the individual and business tax provisions provide a substantial fiscal response to the COVID-19 pandemic.

Introduction

On March 25, the Senate considered a revised "phase 3" of the legislative response to the COVID-19 pandemic, the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The Act includes forgivable loans to small businesses, direct payments and tax relief for individuals, tax relief for businesses, financial assistance for vulnerable industries, additional health funding and policy, and additional assistance for financial markets. With respect to the tax provisions, the bill provides direct payments, among other provisions, to individuals at a time when millions of Americans will likely face disruptions to their employment. The bill also provides business tax relief, including a new tax credit to incentivize firms to retain employees, a delay of payroll tax payments, as well as a number of adjustments and technical corrections to changes made by the Tax Cuts and Jobs Act (TCJA).

Individual Tax Provisions

Direct Payments

The CARES Act provides one-time direct payment to individuals and families. For individuals with incomes up to $75,000, the Act provides a $1,200 payment, phasing out at a rate of $5 for every $100 in income above $75,000. The payment is thus phased out entirely for an individual making $99,000. Married couples with combined incomes up to $150,000 would receive $2,400, subject to the same phaseout as that applying to individuals. Thus, for married couples making $198,000, the payment would be phased out. The provision also provides an additional $500 per child, though also subject to phaseout. Eligibility and benefit levels would be based on 2019 income tax filings, where possible. 2018 tax data and Social Security data can be used in lieu of 2019 data if it is unavailable. Individuals will not be required to repay any overpayment when filing their 2020 taxes.

For individuals and families with low or zero net tax liabilities, including the disabled, the full benefit is refundable, which means that taxpayers with no income or income tax liability are eligible to receive the credit – a key change from the initial draft.

According to the Internal Revenue Services’ Statistics of Income, there were about 120 million taxpayers with tax returns in those income brackets in 2017. According to the Tax Foundation, this policy will cost in excess of $300 billion.

Additional Income Tax Provisions

In addition to the direct payments, the Act provides additional relief to individuals and families. Additionally, consistent with other disasters, the Act waives the 10 percent early withdrawal penalty for qualifying individuals, who may withdraw up to $100,000 from retirement accounts without facing penalty. The Act provides for flexible tax treatment of that withdrawal and allows taxpayers to restore any withdrawn funds. The Act waives required minimum distribution rules for retirement accounts, preventing retirees from having to sell retirement assets during the downturn. The Act would enhance charitable giving by providing individuals with a new $300 above-the-line deduction on charitable donation and increasing previously enacted limitations on charitable deductions. Last, the Act creates a new incentive that allows employers to provide up to $5,250 annually toward employee student loan payments on a tax-free basis for one year.

Business Provisions

The Act contains nine major business relief tax provisions that broadly hew to three categories: direct tax relief to businesses, relief from certain TCJA provisions, and technical corrections to the TCJA. The Act creates a new tax credit to incentivize firms to retain their workforce, which is available through the end of the year. This provision provides employers with a refundable tax credit equal to 50 percent of employee compensation (inclusive of health insurance) up to $10,000 per employee. Employers with greater than 100 employees are eligible to receive the credit if they have been closed due to the coronavirus. Employers with fewer than 100 employees may receive the credit whether they are closed are not.

The Act allows employers (including the self-employed) to delay the payment of the employer portion of the Social Security payroll tax. Under current law, employers pay a 6.2 percent rate on covered employee payroll. Under the proposal, employers would be able to defer the payment for the remainder of the year and pay back the liability over the next two years. The Social Security trust fund would be made whole from the reduced payments with a general fund transfer – essentially additional borrowing. The Committee For a Responsible Federal Budget estimated that the cost of these forgone payments would amount to $275 billion, but under this provision those payments would ultimately be restored in future years.

The Act also provides businesses with additional tax relief by temporarily unwinding some of the revenue-raising reforms in the TCJA. One such reform was the limitation on net operating losses. Prior to the enactment of the TCJA, firms could deduct net operating losses (NOLs) to smooth out income tax payments both in the recent past (two years) and in the future. The TCJA eliminated the ability of firms to "carry-back" losses and offset prior years' income taxes, and thus receive a rebate. The TCJA further limited the share of taxable income that can be offset by NOLs. The proposal would allow businesses to carry-back an NOL from 2018, 2019, or 2020 for 5 years – thus a firm could use a loss realized in 2020 to reduce a tax liability as far back as 2015. The proposal also eliminates the income limitation on the deduction for losses in 2020. The Act also includes a provision extending this tax treatment of losses to pass-through entities. Combined, these provisions are designed to enhance firms' liquidity during the COVID-19 crisis.

The CARES Act proposes to temporarily unwind two additional TCJA provision. The TCJA eliminated the corporate alternative minimum tax (AMT). Payment of the corporate AMT had generated credit against future payments. When the corporate AMT was repealed, these credits – $10.2 billion – were made refundable over the next several years. The CARES Act allows firms to accelerate recovery of these payments. Last, the Act would loosen one of the larger revenue raisers in the TCJA. Prior to the TCJA, firms could deduct interest on loans. The TCJA reduced the deductibility of interest to 30 percent of a firm's taxable income, raising about $250 billion over the next 10 years. The CARES Act would relax that limitation to 50 percent for tax years 2019 and 2020.

The CARES Act includes a technical correction to the TCJA. Specifically, the Act would correct an error that requires certain firms to depreciate investment over a longer period than was intended by Congress. As a technical correction, this provision does not have a "scorable" cost.

The final version of the Act includes a new provision that would exempt manufacturers from the federal excise tax on alcohol for the remainder of the year if that alcohol is being used to make hand sanitizer.

Last, the CARES Act suspends the collection of all federal excise taxes on commercial aviation, including those on tickets, cargo, and aviation fuel until 2021.

Conclusion

The final CARES Act is the third phase of Congress's response to the COVID-19 pandemic. In addition to other major interventions, the Act provides significant tax relief – including at least $300 billion in payments to individuals and families. The CARES Act provides significant administrative and liquidity enhancements for firms. While the costs are substantial, this is likely not the last fiscal intervention Congress will need to enact as the United States grapples with the current crisis.