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The CARES Act

IMPLICATIONS FOR SMALL BUSINESS OWNERS

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President Donald Trump has signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act. This unprecedented $2 trillion dollar stimulus and incentive package is part of a dramatic effort to mitigate the economic impact of the coronavirus pandemic. The direct stimulus payments to individual taxpayers and families have been much publicized, but a key component of this legislation is focused on helping protect American businesses and their employees.

In fact, nearly half of the allotted funds are reserved for business loans. A $500 billion pool has been set aside to provide emergency funds for businesses, though this is primarily intended for large corporations. Stipulations regarding executive compensation limits, and prohibition against share buybacks and dividend payments for one year after the loans are repaid, are contingencies for companies who opt to draw on these funds.

An additional $50 billion is specifically earmarked for consumer airlines plus another $100 billion to provide testing supplies, equipment, and additional payroll support for hospitals and healthcare providers.

But probably the most important aspect of this legislation is the piece that's getting comparatively little media attention: around $350 billion has been appropriated to support small businesses. This is in addition to the $50 billion allotted to the Small Business Administration (SBA) through previous coronavirus stimulus efforts. Congress rightly sees this as an essential part of jumpstarting the economic recovery: businesses who are struggling with reduced cashflows need a way to sustain operations and retain employees while social distancing and shelter-in-place requirements are disrupting normal business practices.

Here are some of the provisions of the new Act aimed at helping small businesses and their employees:

Delay of Estimated Tax Payments for Corporations

Estimated tax payments that come due after the legislation was enacted may be postponed until October 15, 2020 with no cap on the dollar amount of tax payments that may be delayed.

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Employee Retention Credit

Employers may receive a refundable payroll tax credit equal to the lesser of 50% of qualified wages or $5,000 per employee for wages paid to employees after March 12, 2020 and before January 1, 2021 if business activities were disrupted or suspended due to any government-imposed restrictions related to containing the spread of the virus.

Businesses whose operations were not disrupted, but experienced a decline in revenue due to the virus, can also receive the same credits if gross receipts fell 50% as compared to the same quarter in the previous calendar year. Credits will continue until gross receipts exceed 80% of the same quarter's gross receipts in the previous year or December 31, 2020, whichever comes first.

Eligibility is further contingent based on the level of disruption relative to the number of employees and whether the businessowner has taken an EIDL or PPP loan to pay for payroll expenses.

Social Security Payroll Tax Relief

For self-employed individuals and businessowners who continue to employ workers through the crisis, and don't take loans to cover payroll expenses, the Act includes provisions to provide a deferral of the employer-paid 6.2% Social Security payroll tax until January 1, 2021; half of the deferred liability would be due on December 31, 2021 with the remainder due December 31, 2022. Self-employed individuals must still pay their individual portion of their Social Security tax as usual.

Default on unpaid payroll tax liabilities can carry stiff penalties, including jail time, so businessowners should exercise extreme discipline if taking advantage of this provision.

Modification for Net Operating Losses (NOL) and Alternative Minimum Tax (AMT) Credits

Provisions in the Act reduce the limitations on how a company can deduct operating losses from prior tax years. The Act temporarily eliminates the taxable income limitation to allow NOL's to fully offset income while at the same time allow a loss from 2018, 2019 or 2020 to be carried back five years to reduce income in a prior tax year. This enables companies to generate additional cash flow from a refund of previous tax payments by using losses to amend prior years' tax returns. This provision has been extended to also apply to pass-through businesses and sole proprietors.

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Businesses may also accelerate the recovery of any remaining AMT tax credits to generate additional cash flow.

Increased Interest Expense Deduction

The Act temporarily increases the amount of interest expense that businessowners may deduct from 30% to 50% of earnings (EBITDA) for 2019 and 2020. This is intended to help reduce the burden of carrying or taking on additional debt needed to weather the crisis.

Business Interruption Loans

Businesses were eligible to receive up to $2 million under the Phase 2 aid package previously authorized by the federal government once the coronavirus outbreak was declared a federal disaster. These loans are still available to any small-business owner. In addition, provisions in the Phase 2 package required all business loans to offer a 90-day interest-only payment schedule, but only if the lender receives the request specifically from the borrower.

The Act includes provisions for a third phase of loans to businesses with 500 or fewer employees to help make payroll and prevent layoffs. Loans will be issued at interest rates of 1% in amounts up to the lesser of $10 million or 2.5x the average total gross monthly payroll cost for the 2019 calendar year (or prior 12 months). Payroll costs from January 1 to February 29, 2020 are used to calculate the total amount for businesses that were not in operation in early 2019. The principal of the loans will be forgiven if the funds are used for certain approved purposes – such as payroll, mortgage interest payments, rent, and utilities – and employers maintain the average size of their full-time workforce from the time they received the funds. Businessowners must also use at least 75% of the loan funds for payroll expenses to qualify for forgiveness. Any reduction in employee headcount, or a 25% or greater reduction in employee compensation, will reduce the amount of principal forgiven.

Applications and distribution of funds will be processed through banks to increase the speed of deploying capital and to limit stressing the resources of the SBA. Additional government lending agencies, including a Main Street Business Lending Program created by the Federal Reserve, will be established to meet the needs of borrowers as well. Applicants will need to verify payroll amounts from the previous 6 weeks and verify that payments to employees had taken place for eight weeks after receiving the funds.

For businesses with existing SBA loans, interest and principal payments will be waived for six months.

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The Big Picture

The government is pulling out all the stops to help businesses and their employees overcome the short-term effects of the crisis until they can resume their path to long-term success. This is resulting in an unprecedented array of tax benefits, loan programs, and incentives through private lenders and public institutions. Businessowners should remain in close contact with their lenders and tax professional to identify the options and solutions that provide the best outcome for both their company and their employees.

As always, your Creative Planning wealth manager, financial planner, and tax team stand at the ready to help navigate the myriad of complex options, and we will continue to provide guidance on any additional proposed legislation as it makes its way into law.

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