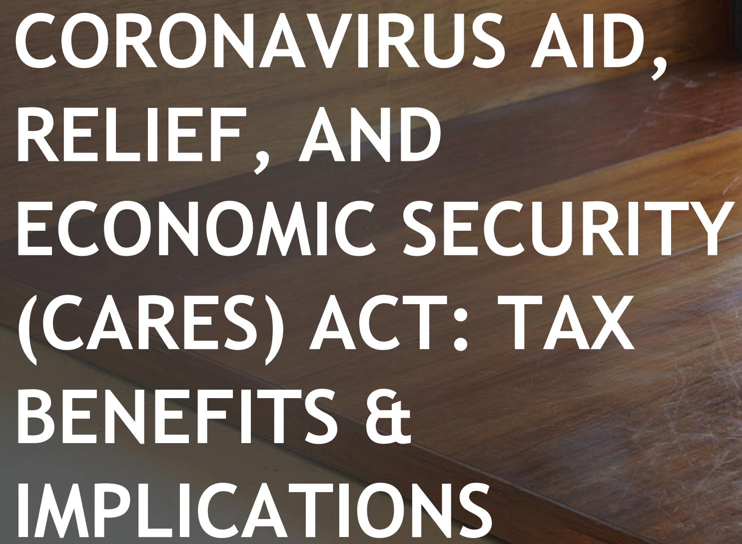
CORONAVIRUS AID, RELIEF, AND ECONOMIC SECURITY (CARES) ACT: TAX BENEFITS & IMPLICATIONS



March 30, 2020

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Agenda

Coronavirus Aid, Relief, and Economic Security Act (CARES Act)

Tax Benefits & Implications

- Individual Tax
- Employer Payroll Tax
- Corporate Tax
- Qualified Improvement Property
- Impact on Tax Provisions ASC 740
- Impact on Partnerships
- Tax Compliance and Other Issues

Traci Pumo

Recovery Rebates for Individuals

- Eligible individuals will receive a refundable tax credit against their 2020 taxable income equal to $1,200 ($2,400 for joint filers) plus $500 per qualifying child.
  - The credit begins to phase out if the individual's adjusted gross income (AGI) exceeds $75,000 ($150,000 for joint filers and $112,500 for head of household filers)
- The credit will be automatically advanced to eligible individuals based on the individual's most recent income tax filing (2018 or 2019 tax filings)
- Individuals who have not filed a tax return in 2018 or 2019 may still receive an automatic advance based on their social security benefit statements (Form SSA-1099) or social security equivalent benefit statement (Form RRB-1099)

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Special Rules for Use of Retirement Funds

- Waives the 10% early withdrawal penalty for distributions up to $100,000 from tax-qualified retirement plan accounts for coronavirus-related purposes during 2020
- Taxable amounts from such distributions can be included in income ratably over 3 years
- Taxpayers may recontribute the funds to an eligible retirement plan within 3 years without regard to that year's cap on contributions
- A coronavirus-related distribution is one made to an individual:
  - who is diagnosed with COVID-19;
  - whose spouse or dependent 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 owned or operated by the individual due to COVID-19, or other factors as determined by the Treasury Secretary
- Also provides flexibility for participant plan loans for coronavirus-related relief
- Some states like California have their own early withdrawal penalty so remember to check your applicable state

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Temporary Waiver of Required Minimum Distribution Rules for Certain Retirement Plans and Accounts

- Waives the required minimum distribution (RMD) rules for certain defined contribution plans and IRAs for calendar year 2020.
- Provides relief to individuals who would otherwise be required to withdraw funds from such retirement accounts during the economic slowdown due to COVID-19.
- Generally, RMDs must begin at age 72 for individuals born on or after July 1, 1949 or at age 70 ½ for individuals born before July 1, 1949.

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Allowance of Partial Above the Line Deduction for Charitable Contributions

- Eligible individuals may take a qualified charitable contribution deduction of up to $300 against their adjusted gross income in 2020. An eligible individual is any individual taxpayer who does not elect to itemize their deductions. A qualified charitable contribution is a charitable contribution (i) made in cash, (ii) for which a charitable contribution deduction is otherwise allowed, and (iii) which is made to certain publicly supported charities.

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Modification of Limitations on Charitable Contributions During 2020

- The CARES Act temporarily suspends the AGI limitation for qualifying cash contributions, instead permitting individual taxpayers to take a charitable contribution deduction for qualifying cash contributions made in 2020 to the extent such contributions do not exceed the excess of the individual's contribution base over the amount of all other charitable contributions allowed as a deduction for the contribution year. Any excess is carried forward as a charitable contribution in each of the succeeding five years.

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Joan Vines

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Employee Retention Credit for Employers Subject to Closure Due to COVID-19

- Is a refundable payroll tax credit for employers who are harmed by COVID-19, but retain their employees. The credit is:
  - Equal to 50% of qualified wages paid to employees between March 12, 2020 and December 31, 2020
  - Capped at $10,000 of wages per employee
- The maximum available credit is $5,000 per employee (50% of $10,000)
- Employers qualify for the credit if:
  - Their operations were fully or partially suspended due to a COVID-19 related shutdown order, or
  - Their gross receipts for the quarter were less than 50% of the gross receipts for the same quarter in the prior year
- Employers with more than 100 full-time employees (on average in 2019) would only receive the credit for wages paid to employees who are not working. Employers with 100 or fewer employees would receive the credit for all wages paid to employees
- Sick pay and FMLA wages paid as a result of the Families First Coronavirus Response Act are specifically excluded
- Any employer who receives a loan by virtue of the Small Business Act as extended by this Act is ineligible to receive this credit

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Delay of Payment of Employer Payroll Taxes

- Permits employers to defer payment of the employer portion of Social Security tax (6.2%) that would otherwise be due and payable through December 31, 2020
- Employers would be required to pay 50% of the deferred amount on or before December 31, 2021, with any remaining amount paid on or before December 31, 2022
- During the period of deferral, the employer will be treated as having made timely deposits of applicable taxes as long as payments are made when due under the schedule noted above
- Self-employed individuals would be eligible to defer 50% of self-employment Social Security tax payments
- Taxpayers who have small business loan debt forgiven under Sec. 1106 of this Act are ineligible for this deferral

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Families First Coronavirus Response Act (H.R. 6201)

- Signed by the President on March 18, 2020. The Act:
  - Expands food security initiatives, increases federal Medicaid funding, guarantees free testing for the COVID-19 virus, as well as
  - Established two mandatory paid leave programs with 100% government reimbursement via payroll tax credits effective for days not worked from April 1, 2020 through December 31, 2020
    - Emergency paid sick leave provides 80 hours at two different pay scales depending on COVID-19 self care or care of others
    - Expanded family and medical leave provides 12 weeks protected leave to care of children with closed schools/care providers; 10 of which must be paid at the rate of 2/3 regular wage up to $200 per day
- For more information on this Act and related issues and on other COVID-19 guidance please visit BDO's COVID-19 Resource Hub:
  - https://www.bdo.com/insights/business-financial-advisory/insurance-risk-recovery/covid-19

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Corporate Tax

Kevin Ainsworth

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AMT Credit

- Under TCJA, corporate AMT credits were refundable over a four-year period from tax years beginning in 2018 – 2021
- Under CARES, any remaining corporate AMT credit is fully refundable for the tax year beginning in 2019
- Alternatively, a taxpayer may elect to make the credit fully refundable for the tax year beginning in 2018
- Treasury is directed to provide procedures where a taxpayer electing to make the credit refundable for 2018 can file for a tentative refund of the additional credit amount, and such refund should be granted within 90 days
- Given uncertainty surrounding application of Section 383 rules to AMT credits post TCJA, strong consideration should be given to make the election for 2018

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Net Operating Losses – Pre/Post-TCJA, CARES

Pre-TCJA	Post-TCJA	CARES Act
2-year carryback, 20-year carryforward	No carryback, indefinite carryforward for NOLs generated in taxable years ending after December 31, 2017.	5-year carryback for NOLs in taxable years beginning after December 31, 2017, and before January 1, 2021.
No limitation on ability to offset current taxable income with NOL deduction, 90% AMT limitation.	For taxable years beginning after December 31, 2017, limited to 80% of taxable income computed without regard to NOL deduction. Ordering of pre-2018 NOLs ambiguous.	For years beginning after December 31, 2020, NOL deduction limited to 80% of taxable income following the deduction of any pre-2018 NOLs, before any § 199A or § 250 deduction.

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NOL Carryovers/Carrybacks

NOLs generated in taxable years beginning after December 31, 2017, and before January 1, 2021, may be carried back 5 taxable years

- Technical correction to the TCJA – indefinite carryover and prohibited carryback (other than for special 5-year carrybacks) effective for taxable years *beginning* after December 31, 2017
- Special carryback does not apply to NOLs generated by REITs
- Life insurance company carrybacks to years beginning before January 1, 2018, treated as § 810 operations loss carryback
- CERT rules eliminated by the TCJA not revived in CARES Act
- Carryback claims for 2018 and fiscal/short-periods timely if filed no later than 120 days following enactment
- Short periods from M&A activity are treated as a full carryback year – carryback may not span 5 calendar years

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NOL Carryovers/Carrybacks (continued)

NOLs generated in taxable years beginning after December 31, 2017, and before January 1, 2021, may be carried back 5 taxable years

- Carryback cannot offset § 965 income; Carryback to taxable year with § 965 income results in deemed § 965(n) election
- Election to forego carryback (Schedule K, box 11)
  - Superseded return by July 15, 2020
  - Regular file by July 15, 2020
  - Amend 2018 and carryback

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NOL – 80% Limitation

For taxable years beginning after December 31, 2020, the NOL deduction is limited to the sum of:

- NOLs generated in taxable years beginning before January 1, 2018, plus
- The lesser of
  1. NOLs generated in taxable years beginning after December 31, 2017, or
  2. 80 percent of taxable income computed after the reduction for any pre-2018 NOLs but before any deduction pursuant to §§ 199A and 250
- NOLs generated in 2018 through 2020 are subject to the limitation, but the limitation only comes into effect in 2021
- 80 percent application *after* the reduction for pre-2018 NOLs – clarifies ambiguity in TCJA noted in the JCT Blue Book

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Variables in NOL Utilization

Maximizing a carryback involves understanding how the NOL deduction interacts with other provisions and the effective rate

- Carryback from a 21 percent federal rate NOL back to a 35 percent federal rate year (pre-2018)
- DPAD (repealed for 2018 and later) limited to taxable income, potentially reduced by carryback
- § 179 election to expense depreciable assets limited to taxable income, but otherwise carried forward
- Charitable contribution deduction pursuant to § 170(b)(2)(A) limited to 10 percent of taxable income, carries forward up to a maximum of five years
- § 250 deduction relating to GILTI and FDII income limited to 50 percent of taxable income

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Reminders on NOL Carrybacks

- Consolidated NOLs attributable to a group member with taxable income in a separate return year may be carried back to such year
- Situation may be trickier where separate year involved separate consolidated return – the parent of the old group must file the claim
- Reg. § 1.381(c)(1)-1 applies restrictions on carrybacks generated by successor/surviving entities in tax-free reorganizations

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Reminders on SALT Considerations

- Certain states ("fixed-date" IRC conformity states) that adopted the 80% limitation must update their IRC conformity dates to adopt the CARES Act modifications to the limitation
- Many states do not permit NOL carrybacks

Corporate Tax Charitable Contributions

- The former 10% of taxable income limit on deductions for charitable contributions is increased to 25%
- Excess contributions can be carried forward to the next five tax years
- To qualify, the contribution must be paid in cash during calendar year 2020
- The limit on deductions for contributions of food inventory is increased from 15% to 25% of taxable income

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Section 461(*l*) – Limitation on Business Losses

Current Section

- Limits annual deduction for net business losses of non-corporate taxpayers to a specified maximum amount
- Annual maximum for 2018, indexed annually for inflation, is $500,000 for married filing jointly and $250,000 for all other taxpayers
- Amounts in excess of annual limitation are carried forward as a net operating loss
- Limitation applies for calendar years 2018 through 2025, consistent with most other individual income tax provisions

CARES Act Provisions

- Defers the application of section 461(l) limitations until calendar year 2021
- Removes separate application of section 461(j) limitation on farm losses until 2026
- Clarifies application of post-2020 limitation in the case of wages from employment, capital gains and losses from sale of business assets, net operating loss deductions under section 172, and section 199A deductions for qualified business income

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Section 461(*l*) – SALT Considerations

- “Fixed-date” IRC conformity states that do not update their IRC conformity date will not adopt the CARES Act provisions and deferral of the section 461(l) limitation will not apply in these states
- In these states, the excess annual limitation still applies resulting in a separate state NOL

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Pre- and Post- TCJA Section 163(j)

- The TCJA replaced the pre-2018 version of Section 163(j) with a new version
- The old Section 163(j) disallowed thinly capitalized corporations (i.e. debt-to-equity ratio greater than 1.5 to 1) to deduct certain disqualified interests
- The new Section 163(j) is significantly broader in its application, as it applies to all business related debts and all taxpayers regardless of the taxpayer's choice of entity (C corporation, partnership, S corporation, single-member LLC or sole proprietorship)
- The new Section 163(j) limit is calculated as the sum of a taxpayer's:
  - Business interest income
  - 30 percent of adjusted taxable income (ATI)
  - Floor plan financing interest
- ATI starts with taxable income but it excludes items not related to a trade or business, business interest income, any NOL or Section 199A deduction for non-corporate taxpayers, and deductions for depreciation, amortization and depletion through 2021

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Section 163(j)

Increased Section 163(j) Limit for 2019 and 2020

- With the exception of partnerships, and solely for taxable years beginning in 2019 and 2020, taxpayers may deduct business interest expense up to 50% of ATI, an increase from 30% of ATI under the TCJA
- Taxpayers may elect out the increased Section 163(j) limit, but the election may be revocable only with the consent of the Secretary

Substitute 2019 ATI for 2020 ATI

- For any taxable year beginning in 2020, the taxpayer may elect to substitute the ATI for the last taxable year beginning in 2019 for the 2020 ATI
- In the case of a partnership, the election shall be made by the partnership
- If 2019 is a short taxable year, the taxpayer is allowed to annualize its 2019 ATI based on the number of months (as opposed to the number of days) of the short taxable year
- Unanswered: How shall the election be made?

Benefits

- Additional business interest deduction equal to 20% of ATI for 2019 and 2020
- If 2019 return was already filed, taxpayers can file a superseding return/amended return to claim refund, if applicable
- Manage financial projections and estimated tax payments for 2020

Special Section 163(j) Rules for Partnerships and Partners

- In the case of partnerships, the increased Section 163(j) limit from 30% to 50% of ATI does not apply to taxable year beginning in 2019, but it does apply to taxable year beginning in 2020
- In lieu of the increased Section 163(j) limit for taxable years beginning in 2019, the CARES Act provides that:
  - In the case of any excess business interest expense ("EBIE") allocated from a partnership for any taxable year beginning in 2019, 50% of such EBIE shall be treated as business interest which is paid or accrued by the partner in the partner's first taxable year beginning in 2020 and which is not subject to the partner's Section 163(j) limit in 2020.
  - The remaining 50% of EBIE shall be subject to the limitations in the same manner as any other EBIE
- Each partner has the ability, under regulations to be prescribed by Treasury, to elect to have this special rule not applied
- No rules are provided for application of this rule in the context of tiered partnership structures
- See detailed example illustration in the BDO CARES Act Alert

Benefits

- Substantial tax savings in 2020.
- Manage financial projections and estimated tax payments for 2020.
- Reduces complexities for partnerships by eliminating the need to amend 2019 partnership returns.

Section 163(j) and Real Estate Businesses

- In 2018, real estate businesses that made an election to be excepted from section 163(j) are bound to use longer depreciation lives. Had bonus depreciation been allowed for these companies, they may not have made this election. In the absence of relief, the section 163(j) election is irrevocable. It’s not clear whether Treasury will promulgate regulations allowing taxpayers to revoke this election.

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Section 163(j) – SALT Considerations

- “Fixed-date” IRC conformity states that do not update their IRC conformity – no benefit of increased 20% deduction; no elections
- States that follow “old” section 163(j) (California, Georgia, Tennessee in 2020) – no elections
- States that already decoupled (CT, IN, MO, SC, WI) – no direct impact, but must still manage elimination of excess interest carryovers
- Partnerships – CARES Act creates additional layer of complexity, especially for states that tax partnerships at entity level, composite returns.
- Section 163(j) was already very complex at the state level; CARES Act makes it even more complex

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Connie Cunningham

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Accounting Methods

Correction of “Retail Glitch”

Clarifies that Qualified Improvement Property (QIP) placed in service after 12/31/17 is treated as 15-year property and eligible for bonus depreciation

- Taxpayers that placed QIP in service during 2018 and 2019 may now claim bonus depreciation on such property, rather than depreciating over 39 years as previously required under the 2017 tax reform bill
- Taxpayers with QIP in 2018 that filed their 2018 return treating the assets as bonus-ineligible 39-year property should consider amending that return to claim additional depreciation. C corporations taxpayers that amend their 2018 return can potentially generate NOLs and carry the losses back five years under the new provisions of the CARES Act to tax years when the tax rates were 35% and fully offset income to generate immediate cash savings
  - Alternatively, taxpayers may file an automatic Form 3115 with their 2019 return to claim the missed depreciation as a favorable Section 481(a) adjustment
- Taxpayers with QIP placed in service during 2019 can claim bonus depreciation prospectively on their 2019 return; corporate taxpayers should also consider filing Form 4466 for quick refund of 2019 overpaid estimated taxes

Accounting Methods

Correction of "Retail Glitch"

The QIP fix presents significant opportunities to many taxpayers and cost segregation studies are vital tools that can provide a supportable breakdowns between eligible and ineligible costs

- QIP includes improvements a taxpayer makes to an interior portion of an existing building that is nonresidential real property (residential rental property is excluded); Examples of such qualifying improvements include installation or replacement of drywall, ceilings, interior doors, fire protection, mechanical, electrical and plumbing. Excluded improvements are internal structural framework, enlargements to the building, and elevators or escalators
- Under the Tax Cuts and Jobs Act of 2017, taxpayers who make the real property trade or business election under Section 163(j) must depreciate nonresidential real property, residential rental property, and QIP using the Alternative Depreciation System (ADS), and as such are not permitted to claim bonus depreciation on these assets; However, cost segregation studies can still help to identify personal property still eligible for bonus depreciation
- Increased IRS scrutiny must be assumed

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Impact on Tax Provisions – ASC 740

Dan Newton

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ASC 740 Implications

Changes in Tax Law

- ASC 740 requires an entity to adjust current and deferred tax assets and liabilities for the effects of changes in tax laws or rates
- The adjustment should be included in income from **Continuing Operations** in the **interim period** that includes the enactment date
- **CARES Act was enacted on Friday, March 27, 2020 making this a Q1 event for calendar year companies**
- Numerous Non-US jurisdictions are also enacting and proposing measures to deal with the COVID-19 pandemic
  - Many Non-US jurisdictions are introducing measures that impact income taxes and non-income based taxes
  - ASC 740 deals with income taxes so careful attention needs to be paid to the various measures enacted and proposed outside the US to ensure proper accounting for US GAAP purposes

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ASC 740 Implications – NOL Carrybacks

- The impacts of tax law changes are recorded to continuing operations
- Companies should consider the impact of this provision on valuation allowance assessments in light of this additional source of income.
- Consideration should be given to the impact on interim tax provisions, specifically whether the impacts should be recorded discretely or part of the annual effective tax rate.
- Balance sheet reclasses between current and deferred taxes may be appropriate due to the carryback of losses
- Consideration should be given to recognition of the tax benefit for the difference between the 35% tax rate applicable to certain periods to which losses can be carried and the current rate of 21%, along with the expected complexities involved with the interplay with pre-TCJA tax law
- Assessment of management's position with respect to certain elections available for this provision should be made

ASC 740 Implications – AMT Credits/Section 163(j)

AMT Credits

- Balance sheet reclasses between current receivable and non-current receivable/deferred taxes should be considered

Section 163(j)

- The impacts of tax law changes are recorded to continuing operations
- Companies should consider the impact of this provision on valuation allowance assessments for non- deductible interest
- Whether the impact of this change should be recorded as discrete or as part of the annual effective tax rate should also be considered
- Balance sheet reclasses between current and deferred taxes should be considered.
- Assessment of management's position with respect to certain elections available for this provision should be made

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ASC 740 Implications

Leasehold Improvements

- Adjustments between taxes payable/receivable and deferred taxes should be considered in light of this change in temporary difference
- The impact on Unrecognized Tax Positions, if applicable, should be considered in connection with the ability to file Form 3115 to effectuate the change
- Assessment of management's position with respect to certain elections available for this provision should be made

Charitable Contributions

- The CARES Act temporarily increases the limitation on the deductibility of cash charitable contributions during 2020 from 10% to 25% of the taxpayer's taxable income
- The Act also increases the limitation on deductions for contributions of food inventory from 15% to 25%
- Consideration should be given to the current and deferred tax consequences of the temporary increase in the limitation as part of the determination of a company's annual effective tax rate calculation and valuation allowance implications

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Partnership Considerations

Amending Partnership Returns

- General Considerations
  - If the partnership has extended its calendar year 2019 tax return, it may file a superseding return until September 15, 2020
  - An amended return or Administrative Adjustment Request (AAR) needs to consider all known issues, i.e., we can’t cherry-pick issues to be amended
  - Most amended returns are likely to be filed with respect to partnerships subject to the Centralized Partnership Audit Regime (CPAR)
  - These rules apply to all partnerships beginning in years starting after December 31, 2017 unless an eligible partnership elects out of CPAR

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Partnership Considerations

Amending Partnership Returns

- Overview of CPAR Rules
  - When subject to CPAR, the partnership will file an AAR and provide relevant information to their partners
  - Each partner will then determine the tax benefit resulting from the AAR by re-calculating their tax liability for the affected tax year
  - The calculated benefit will be treated as taxes paid during the year in which the AAR is filed, e.g., 2020. This will result in an effective benefit by lowering the partners 2020 estimated tax liability
- Other Amended Return Rules
  - If a partnership amends a return for 2016 or 2017, it is necessary to determine whether the partnership is subject to TEFRA
  - Under TEFRA, the partnership files an amended return but the partners do not file an amended return. Instead the partners wait for the IRS to take action
  - If the partnership is not subject to TEFRA or CPAR, then the partnership is responsible for filing an amended return. Each partner then files an amended return based on the information provided on the amended Schedule K-1

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Partnership Considerations

General Implications

- **Real Property Trade or Business Election:** Taxpayers that made the section 163(j) real property trade or business election cannot claim bonus depreciation. Further, the real property trade or business election is irrevocable, however, comments are being prepared and submitted to Treasury requesting a waiver. Stay tuned. . .
- **Section 163(j) for Partnerships:** Special rules attributable to partnerships are intended to alleviate the need for partnerships to file an Administrative Adjustment Requests for already filed 2019 tax returns. While still complicated, these rules will be easier to implement than filing an AAR.
- **Form 3115 to Claim Bonus Depreciation:** When bonus depreciation is claimed via filing a Form 3115, careful consideration should be given to the allocation of these benefits. Changes in partner composition and liquidating distribution waterfall provisions can impact the allocation of the increased depreciation deductions.
- **Partner-Employee Claiming "Wage" Based Benefits:** Under existing guidance, partners cannot be treated as employees. A profits interest member without any capital account balance is considered a partner. Benefits based on "wages" paid to partners likely creates risk to the partnership and partner. Under CPAR, this can create partnership-level exposure. This treatment may also impact a partner's ability to claim unemployment benefits.

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Tax Compliance and Other Issues

Todd Simmens

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Tax Compliance and Reporting

- IRS Notice 2020-18, postpones by 90 days income tax filings and income tax payments that would be due April 15, 2020
  - This July 15, 2020, income tax filing and income tax payment date applies to "Affected Taxpayers," who are any persons with a federal income tax return or federal income tax payment due April 15, 2020
  - There is no limitation on the amount of payment that may be postponed to July 15, 2020
  - The relief is provided to individuals, trusts, estates, partnerships, associations, companies, and corporations
  - Any interest or penalty that is postponed by the Notice will once again begin to accrue on July 16, 2020
  - No extension is provided for the payment or deposit of any other type of federal tax – or for the filing of any federal information return
- IRS Form 4466 allows corporations that have overpaid estimated taxes for the prior taxable year to apply for a quick refund of the overpaid taxes where the overpayment is at least 10 percent of the expected tax liability and at least $500
  - Form 4466 is due by the original due date of the corporate return (i.e., excluding extensions)
  - Due April 15, 2020, for calendar-year corporations – the Coronavirus IRS relief does not apply to postpone the due date of Form 4466

Other CARES Act Provisions for Employers and Employees

- Paycheck Protection Program – Small Business Administration (SBA) Loans
  - SBA Loans for Employers with 500 or fewer employees
  - Up to 2.5 times payroll costs with maximum loan of $10 million
  - Loan is forgivable to the extent employees are still employed at June 30, 2020 and compensation is not reduced more than 25%
- Unemployment Insurance
  - Many different provisions that provide increased benefits, etc.

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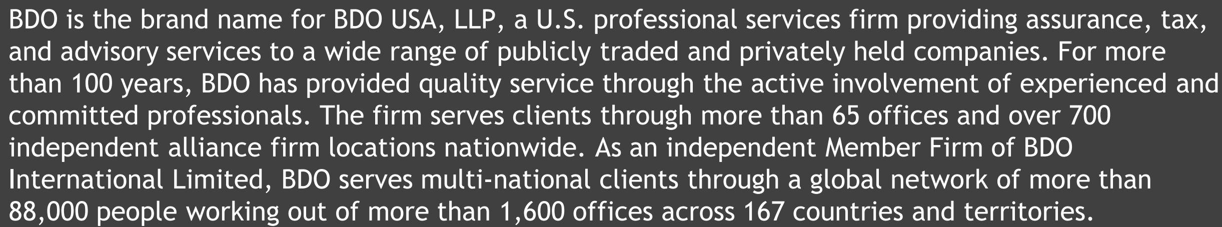
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