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Congress Passes Massive \$2T Stimulus Package – What Canadian Businesses Need to Know about Tax Relief in the CARES Act

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The COVID-19 pandemic has prompted wave upon wave of governmental responses in the United States designed to mitigate damage and stimulate economic activity. The most recent and most significant of these is the *Coronavirus Aid, Relief, and Economic Security Act* (the “CARES Act”) signed into law by President Trump on Friday March 27, 2020.

While this governmental action is intended to be helpful, the layers of federal and state action as well as the velocity at which these changes have rolled out have created a complex patchwork of rules that is challenging to navigate. Many U.S. businesses are finding it difficult to assess options and make informed business decisions in this environment. Moreover, given the substantial integration between the U.S. and Canadian economies, these U.S. developments inevitably impact Canadian businesses and investors. Thus far, there is very little guidance geared towards non-U.S. companies with U.S. subsidiaries regarding the considerations that are applicable to them in light of the U.S. governmental response to the COVID-19 pandemic.

This update provides a summary of the key U.S. federal income tax developments arising during the last two weeks that are relevant to Canadian businesses with U.S. operations, with a particular emphasis on tax provisions in the CARES Act.

THE CARES ACT

The CARES Act is a \$2T multi-pronged stimulus package designed to increase access to key medical resources and help soften the economic blow caused by the pandemic to individuals, families, and businesses. For Canadian companies with U.S. subsidiaries, the legislation offers a number of tax-related levers that may allow U.S. subsidiaries to generate near-term liquidity and retain its workforce. The key takeaways from this legislation are the following:

1. **Expanding Use of Net Operating Losses:** The CARES Act temporarily carves back numerous limitations to the availability of net operating losses (“NOLs”). The removal of these NOL limitations (which were enacted by the *Tax Cuts and Jobs Act of 2017* or “TCJA”) are designed to help create liquidity by (a) suspending, for tax years prior to 2021, the rule that restricts NOL

carryforwards to sheltering only 80 percent of taxable income, and (b) allowing the carryback of NOLs generated in the 2018, 2019, and 2020 tax years to any of the five preceding tax years (thereby allowing taxpayers to file amended returns for those past tax years and, if appropriate, claim cash refunds).

- Special rules apply to real estate investment trusts, life insurance companies, partnerships, and taxpayers subject to repatriation tax pursuant to the Section 965 of the Internal Revenue Code of 1986, as amended (the “Code”).
 - For corporate taxpayers, NOLs carried back to pre-TCJA years could create a greater cash tax benefit than NOLs carried back to post-TCJA years given the pre-TCJA corporate tax rate of 35 percent (versus 21 percent post-TCJA).
 - Canadian businesses with U.S. operations should consider the potential impact of the expanded use of NOLs, including the possibility of amending prior year tax returns to claim cash refunds where applicable. They should also consider whether relevant U.S. states conform with this federal law.
2. **Relaxing Interest Deduction Limits:** Section 163(j) of the Code limits annual “business interest” deductions to 30 percent of adjusted taxable income (“ATI”). For taxable years before 2022, ATI is generally defined to mean earnings before interest, taxes, depreciation, and amortization. For tax years beginning in 2019 or 2020, the CARES Act allows taxpayers to increase the amount of allowable “business interest” deductions from 30 percent to 50 percent, allowing greater throughput to deduct business interest. Additionally, taxpayers can elect to substitute their 2019 ATI for their 2020 ATI in calculating their Section 163(j) limitation for their 2020 tax year.
- Canadian businesses should model the impact of the higher cap on interest deductions, taking care to account for the knock-on impact that greater deductibility may have on their base erosion anti-abuse tax (“BEAT”) liabilities.
3. **Technical Correction to Immediate Expensing:** The CARES Act changes the cost recovery period of improvement to an interior portion of a nonresidential real property building (a “qualified improvement property”) to 15 years. This allows qualified improvement property to be eligible for the 100 percent first-year bonus depreciation election enacted in the TCJA for certain property placed into service before January 1, 2023. This change is effective for qualified improvement property placed in service after September 27, 2017. This provision will increase access to cash flow for certain taxpayers by allowing them to amend prior year returns and apply for cash refunds.
4. **Other Potentially Important Provisions in the CARES Act:** The CARES Act provides additional tax benefits that may be available to particular U.S. corporations depending on their circumstances.
- **Employee Retention Credit for Certain U.S. Employers.** Employers that have either (i) been subject to a government ordered closure, or (ii) endured a decline in gross revenues of more than 50 percent (measured against the quarter from the previous tax year), are eligible to claim a refundable tax credit against applicable employment taxes. To the extent the credit exceeds the amount of applicable employment taxes, the employer may apply for a cash refund in accordance with the CARES Act. The mechanics for this credit are complex and operate on a quarter-by-quarter basis.
 - In general, the credit is equal to 50 percent of “qualified wages” paid to employees (capped at \$10,000 per employee, annually). The definition of “qualified wages” depends on whether the employer has (a) 100 or fewer employees (in which case all employee wages paid during

the period of the COVID-19 emergency may be included), or (b) more than 100 employees (in which case “qualified wages” include only wages paid to employees during the period when they are not providing services due to the COVID-19 emergency). Certain aggregation rules apply for purposes of determining whether an employer has more than 100 employees. In certain cases, Canadian employees of a Canadian corporate affiliate may “count” for purposes of determining whether a U.S. subsidiary meets this 100 employee threshold.

- Importantly, taxpayers that receive a small business interruption loan (see below) are not eligible for the employee retention tax credit. This means taxpayers must make an informed assessment of which relief program is more beneficial to them in their circumstances.
- **Deferral of Certain Social Security Taxes.** Employers are permitted to defer their Social Security payroll tax payments of the employer share of such taxes (i.e., 6.2 percent of employee wages). The deferred employment tax would be required to be paid over a two-year period, with half of such amount due by December 31, 2021, and the remaining half due by December 31, 2022. Importantly, this deferral is not available to taxpayers who have benefited from loan forgiveness under the expanded small business loan programs made available under the CARES Act (see below).
- **Accelerated Corporate AMT Credits.** The corporate alternative minimum tax (“AMT”) was repealed as part of the TCJA, but taxpayers with pre-repeal corporate AMT credit carryforwards were allowed to refund these credits over a period of several years, ending in 2021. The CARES Act allows taxpayers to recover these AMT credits immediately.
- **Small Business Loans.** The CARES Act sets aside approximately \$349 billion in funds for certain guaranteed loans under the federal government’s small business administration loan program.
 - The CARES Act relaxes certain loan eligibility requirements through June 30, 2020 under the “paycheck protection program”. This program, which is available for employers with 500 or fewer employees, requires the borrower to certify that the loan proceeds will be used to retain workers and maintain payroll or make certain mortgage, rent, and utility payments. The amount of these loans is subject to a hard cap of \$10 million but may be subject to lower limitations based on average monthly payroll costs. The portion of the loan used for permitted purposes during the 8-week period beginning when the loan is granted is eligible for tax-free forgiveness. As a result, the paycheck protection loan can function as an outright grant of the “borrowed” amounts.
 - Canadian taxpayers should know that, for purposes of measuring the 500-employee eligibility requirement for the paycheck protection loan, special aggregation rules apply. In particular, chains of corporations connected through 50 percent common ownership are generally treated as a single employer for this purpose.
 - The CARES Act also expands the “Economic Injury Disaster Loan” program by relaxing eligibility requirements. This expanded program generally applies to employers with 500 or fewer employees through December 31, 2020.

DEFERRAL OF CERTAIN FEDERAL TAX RETURNS AND TAX PAYMENTS

On March 20, 2020, the Internal Revenue Service issued Notice 2020-18 (the “Notice”). The Notice postpones the April 15, 2020 U.S. federal income tax payment and U.S. federal income tax return filing deadlines to July 15, 2020. This relief currently only applies to federal income tax payments and income tax returns that would otherwise have been due on April 15, 2020, such as 2019 federal income tax payments and 2020 estimated federal income tax payments (including any BEAT payments) due on April

15, 2020.

There is no limit on the amount of payment that may be postponed and the postponement occurs automatically (taxpayers do not have to file a request for extension form or demonstrate impact from the COVID-19 pandemic). The period beginning on April 15, 2020 and ending on July 15, 2020 will be disregarded in the calculation of any interest, penalty, or addition to tax for failure to pay federal income tax or file a federal income tax return. The Notice does not provide an extension for the payment of other types of federal tax or for the filing of any other type of federal tax return.

LOOKING FORWARD

We expect that, over the coming weeks, the U.S. government may issue additional U.S. tax measures (and related guidance) designed to mitigate hardship associated with the COVID-19 emergency. There is already speculation that an additional legislative vehicle with further tax-related initiatives is under discussion.

In the interim, Canadians that have questions about how the provisions outlined above may affect them should feel free to contact any of the authors of this update to discuss further.

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