CPA
Practice Advisor

Hello. It looks like you’re using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

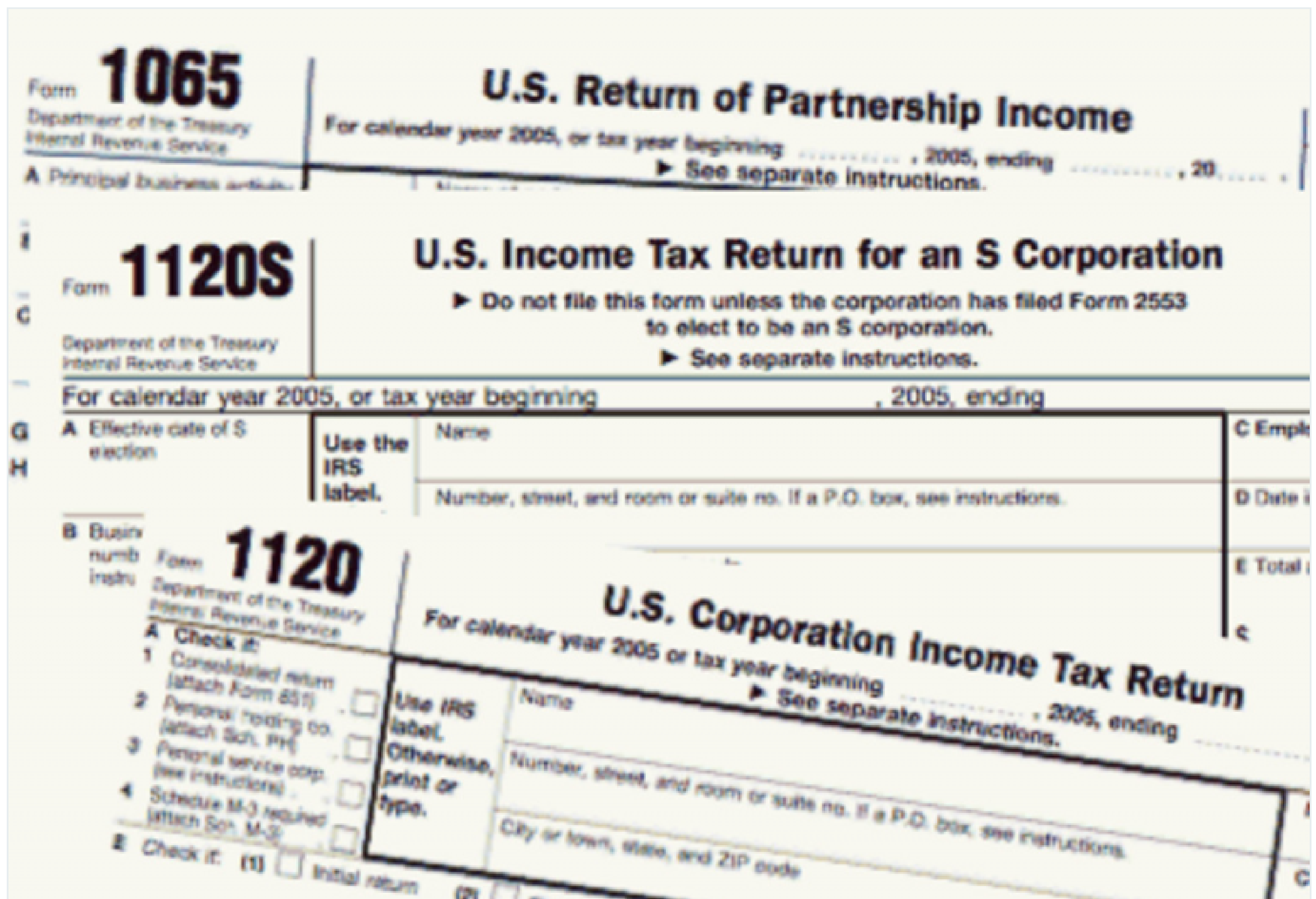
If you have any questions or need help you can email us

COVID-19

CARES Act Changes Rules for Business Interest Deductions

The new Coronavirus Aid, Relief, and Economic Security (CARES) Act provides some much-needed relief for businesses hindered by a cap on business interest deductions. Icing on the cake: The tax changes are retroactive to 2019.

Apr. 20, 2020



The new Coronavirus Aid, Relief, and Economic Security (CARES) Act provides some much-needed relief for businesses hindered by a cap on business interest deductions. Icing on the cake: The tax changes are retroactive to 2019.

Here's a quick recap: Prior to the Tax Cuts and Jobs Act (TCJA), a business entity could generally deduct its business interest expenses without restriction. However, the TCJA limited the annual net interest deduction to 30% of its adjusted taxable income (ATI), beginning in 2018. Net interest is the amount of interest paid or accrued by the business during the year less the amount of interest income included in taxable income for the year.

For these purposes, ATI is defined as your business income without regard to the following:

- Income, deduction, gain or loss not properly allocable to a business
- Business interest income and expense;
- Net operating losses (NOLs);
- The qualified business income (QBI) deduction for pass-through entities; and
- For tax years beginning before 2022, any deduction allowable for depreciation, amortization or depletion. Real estate operations can opt out of this rule.

Any excess may be carried over and offset taxable income in a future year within the allowable limit.

The TCSA did, however, provide an exemption for a qualified small business. The business interest limit doesn't apply to a business with average gross receipts of $25 or million or less (indexed to $26 million for 2019) for the three previous tax years.

New law changes: The CARES Act raises the limit on business interest deductions from 30% of ATI to 50% of ATI for the 2019 and 2020 tax years. Therefore, a business may amend its 2019 return. In addition, a business can elect to calculate the 50% limit for 2020 based on its ATI in 2019. This could provide a bigger deduction for businesses that expect to have reduced taxable income in 2020 due to the COVID-19 outbreak.

The election may be especially beneficial to a business with a short 2019 tax year. By "grossing up" the deemed ATI based on the entire year, it may be entitled to a more favorable deduction.

Note: Due to quirk in the CARES Act, the 50%-of-ATI limit applies to partnerships in 2020, but not in 2019. In other words, the partnership is stuck with the 30% limit for

the 2019 tax year. Any business interest expense that is disallowed is passed to the partners and is suspended at the partner level under the TCJA rules.

However, 50% of the suspended business interest is fully deductible at the partner level on a 2020 return. This special tax treatment is automatic unless a partner elects on a 2020 tax return for it not to apply. The remainder from 2019 is suspended until the partnership generates enough taxable income or excess interest income is passed to a partner. This can be advantageous if the partnership elects to use its 2019 ATI to compute its 2020 business interest limit.

Finally, businesses engaged in real estate activities may have elected to avoid the 30%-of-ATI limit by forgoing favorable depreciation write-offs on their 2018 return. This election was irrevocable and the CARES Act doesn't provide any other remedy. Accordingly, real estate taxpayers that made the election for 2018 are still bound by it and may continue to deduct 100% of their business interest expenses in the wake of the CARES Act.

Recommendation: Promptly notify clients affected by these changes. This is especially important for partners in partnerships who should consider their options. They will likely require your expert guidance going forward.

COVID-19 • Product & Service Guide • Tax • News • coronavirus small business • coronavirus tax relief • coronavirus taxes • COVID-19

CPAPA is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors.

© 2023 Firmworks, LLC. All rights reserved