COVID-19: CARES Act Tax Provisions and Opportunities

April 3, 2020

Agenda

- Welcome and introductions
- Employee retention credit
- Employer payroll tax payments
- Net operating loss provisions
- Acceleration of minimum tax credits for corporations
- Changes to interest expense disallowance rules
- Qualified Improvement Property depreciation
- Individual tax considerations and recovery rebates

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CARES Act – Payroll Tax Deferral

- Delays the timing of required federal tax deposits for certain employer payroll taxes and self-employment taxes incurred between March 27, 2020 and December 31, 2020
- One-half of the deferred payroll tax is due by 12/31/2021 and the remainder by 12/31/2022
- Applicable employment taxes:
  - The employer's share of Social Security tax, which is 6.2% of wages up to the wage base ($137,700)
  - For self-employed individuals, the equivalent amount of Self-Employment tax due on earnings from self-employment (50% of the 12.4% tax) is exempt from estimated tax payments
- Available for employers remitting payroll taxes through an agent under IRC Sec 3504 or CPEO

CARES Act - Payroll Tax Deferral

- Available to ALL employers and self-employed individuals with no dollar cap on the wages
- Does not apply to federal income tax withholding, Medicare tax or the employee's portion of Social Security tax
- Deferral is not available to taxpayers that obtain Small Business loan under the Paycheck Protection Program established by the CARES Act IF the loan is later forgiven

CARES Act – Employee Retention Credit

- New credit for wages paid from March 13, 2020 through December 31, 2020 by employers that are subject to closure or significant economic downturn due to COVID-19.
- Separate from paid sick leave and paid family leave established under The Families First Coronavirus Response Act that provides 100% payroll tax credit to certain employers.

Amount of Credit:

- The credit amounts are equal up to 50% of qualified wages paid by a qualified employer to an employee. The maximum amount of wages eligible for the credit is $10,000 per employee.
- Credit is available against Social Security payroll taxes paid by employers.
- If the credit for the quarter exceeds the employer's overall Social Security tax liability, the excess is refunded.

CARES Act – Employee Retention Credit

Eligible Employer:

- Employer must carry on a trade or business during 2020.
- In addition, employer must either experience one of the two following occurrences:

  1. Operations were fully or partially suspended on orders from a governmental authority
  2. 50% reduction in gross receipts year over year that begins with the quarter in which gross receipts declined by more than 50%, and end with the quarter in which gross receipts have recovered by more than 80%.

- Gross receipt test is determined on the aggregated basis for affiliated entities, using the test under IRC Section 448(c).
- Tax-exempt organizations may be eligible; Governmental employers are not.
- Employer who receives Paycheck Protection Program loan is not eligible.

CARES Act – Employee Retention Credit

Eligible Wages (depends on the size of the employer):

- For employers with more than 100 full-time employees, eligible wages are **ONLY** those paid to the employee during the calendar quarter for periods in which the employee is not working. Limited to the wages paid during 30 day prior period.
- For employers with 100 or fewer full-time employees, eligible wages are **ALL** wages paid by the employer during the calendar quarter.
- Qualified wages include qualified health plan expenses paid by the employer.
- Wages paid by an employer that qualifies for the paid sick and family leave, under the Families First Coronavirus Response Act, are not eligible.
- No double-dipping:
    - Wage deduction reduced by the amount of credit.
    - Wages paid to related parties under Sec 51(i)(1) don't qualify.
    - Wages for which employer takes WOTC credit don't qualify.

Net Operating Loss ("NOL") – Overview

- Prior to the Tax Cuts and Jobs Act ("TCJA") of 2017, NOLs incurred were eligible for a 2-year carryback and 20-year carryforward
- TCJA eliminated NOL carrybacks for tax years ending after December 31, 2017
- Post TCJA there were effectively two groups of NOL carryforwards
  - Group 1 – NOLs generated in tax years beginning BEFORE December 31, 2017 (Pre TCJA NOLs)
    - 20-year carryforward and available to offset 100% of taxable income
  - Group 2 – NOLs generated in tax years beginning AFTER December 31, 2017 (Post TCJA NOLs)
    - Unlimited carryforward and available to offset 80% of taxable income
- CARES Act makes significant changes to these NOL rules

Temporary Repeal of 80% Income Limitation

- NOLs generated in tax years beginning before January 1, 2021 receive temporary relief from the 80% income limitation
- 80% limitation reinstated for tax years beginning after December 31, 2020 on post-TCJA NOLs (Note: post TCJA 2018, 2019, 2020 NOLs "hybrid")
- CARES Act clarifies for tax years beginning after December 31, 2020, the 80% limitation on taxable income comes AFTER utilization of pre-TCJA NOLs (Group 1 on previous slide)
    - For this purpose, taxable income is calculated without regard to deduction for qualified business income under section 199A, FDII deduction and GILTI deduction
- Example – assume calendar-year taxpayer has taxable income of $100, a pre-TCJA NOL of $60, and a post-TCJA 2019 NOL of $50
    - For 2020 tax year – taxable income is $0 after NOLs applied (no limitations due to temporary CARES act relief)
    - For 2021 tax year – taxable income is $8 after NOLs applied ($100 - $60 = $40 x 80% = $32. $40 - $32 = $8)

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Five-Year NOL Carryback

- NOLs generated in tax years beginning after December 31, 2017 and before January 1, 2021 are eligible for five-year carryback
- Effectively, NOLs generated in 2018, 2019 and 2020 could be carried back as far as 2013, 2014 and 2015, respectively
- In general, NOL carryback provision is an "all or nothing" exercise – may not pick and choose particular years within the carryback period
    - Exception for IRC §965 Transition Tax Year. Election available to skip
- Unless election is made to opt-out of the entire carryback, an NOL generated in tax years beginning in 2018, 2019 or 2020 must be carried back to the earliest year within the carryback period in which there is taxable income, then forward to the next year and so on
- Separate elections to opt-out of carryback for NOLs generated in 2018, 2019 or 2020 can be made for each year
- Opt-out election must be made by the due date (including extension) for first taxable year ending after March 27, 2020
- Awaiting IRS procedural guidance (Rev. Proc. Expected)

NOL Carryback Does Not Offset §965 Income

- The 2017 Tax Reform Act substantially altered the U.S. tax code with respect to treatment of certain foreign subsidiary income and they were subject to a one-time 'transition tax' under IRC Section §965 on their accumulated earnings at favorable tax rates (8% and 15.5%)
- In general, applicable to 2017 or 2018 tax year depending on facts
- Under the CARES Act, an NOL carried back to a year in which §965 transition tax applied, taxpayer treated as-if a §965(n) election was made to forego NOL offset against transition tax income
    - Example – assume calendar year taxpayer with a 2020 loss of $120. Taxable income in 2015 and 2016 is $0 for both years. Taxable income in 2017 is $100 ($30 of regular income and $70 of §965 transition tax income). Taxable income in 2018 is $90
    - First, the $120 loss is carried back to 2015 (no impact) and then forward (no impact in 2016). For 2017 only $30 is utilized to offset the $30 of regular income. Remaining $90 of NOL is then carried forward to 2018 and fully utilized against the $90 of income

NOL Technical Correction – FYE 2018

- The CARES Act retroactively makes a technical correction to final TCJA language that eliminated NOL carrybacks for tax years ENDING after December 31, 2017 (conflicting with committee report language)
- Thus, losses incurred for fiscal years beginning in 2017 and ending in 2018 were not eligible for carry-back.
- CARES Act corrects this language to allow for NOL carrybacks incurred during this period
- Note 2-year carryback rules apply to this specific fact pattern for a loss year beginning in 2017 and ending in 2018
- ***Special rule on timing under this scenario – taxpayers must request refund for an NOL carryback by September 23, 2020 (180 days after CARES Act signed into law on March 27, 2020)

NOL Planning Considerations

- Tax Rate Arbitrage (Corporations 21% vs. 34/35%)
  - Tax methods review – timing differences can have a permanent tax benefit
- Many taxpayers will have clear facts and NOL carryback will be straight-forward
- Be wary of NOL carryback impacts relative to other tax deductions and credits – for example:
  - 'Old' §199 Domestic Production Activity Deduction
  - AMT – notwithstanding changes under CARES Act (IRS Notice Relief?)
  - General Business Credits
  - Foreign Tax Credits
  - GILTI/FDII §250 Deduction
  - Charitable Contributions

NOL Procedural Considerations

- ***Disclaimer*** Forthcoming IRS guidance expected
- Preliminary thoughts:
  - Use of Form 1139 (Corp) or Form 1045 (Individual) – quickest way to obtain refund from NOL carryback. IRS is required to make tentative refund within 90 days of the later of the date of filing Form 1139/1045 or 90 days after due date of return (including extension if filed). NOTE new 7/15 deadline for calendar year 2019.
  - Form 1139 or Form 1045 required to be filed within 12 months of the last day of the tax year from which the NOL occurs
  - For calendar year 2018, that deadline was December 31, 2019 – expectation the IRS will extend the deadline
  - Alternatively could amend with Form 1120X (Corp) or Form 1040X (Individual) – BUT SLOWER processing of tax refund.
  - May have to amend with Form 1120X in certain scenarios (for example §965 Transition Tax Year) **Need IRS guidance.
  - Special considerations for NOL carrybacks to years under IRS audit or for years closed to statute

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Refundable Corporate Minimum Tax Credit

- TCJA eliminated the AMT tax regime for Corporations for tax years beginning after December 31, 2017
  - For tax years beginning after December 31, 2017, Minimum Tax credit carryovers were first available to offset regular tax liability and then refundable up to 50% of the remaining Minimum Tax Credit balance
  - Any remaining Minimum Tax Credits were fully refundable by tax year 2021
- CARES Act allows for 100% refund of Minimum Tax Credit carryover for tax years beginning in 2019 after any credit applied to regular tax liability
- In addition, the CARES Act provides ability to claim 100% refund of any excess Minimum Tax Credit carryover available for 2018 via special rules to be prescribed by the Treasury Secretary. Refund claim must be filed prior to December 31, 2020.

CARES Act – 163(j) Limitation

- Amends Section 163(j) as applied to taxable years beginning in 2019 and 2020.
- **General Rule** - Section 163(j) limits deduction for business interest to the sum of:
    1. Business interest income
    2. 30 percent of adjusted taxable income
    3. Floor plan financing interest
- CARES Act increases the 30% adjusted taxable income threshold to 50% for taxable years beginning in 2019 and 2020.
- Allows taxpayers to elect to use their 2019 adjusted taxable income as their adjusted taxable income in 2020.
- Taxpayers may make irrevocable election not to have 50% threshold apply to 2019 or 2020.

CARES Act – 163(j) Limitation

Partnership Rules:

- Increased 50% taxable income threshold would not apply to taxable years beginning in 2019.
- Excess business interest (the amount exceeding 30% of adjusted taxable income) allocated to a partner from 2019 would be bifurcated.
  - 50% of that excess business interest would be treated as paid or accrued in 2020 and deductible without regard to the Section 163(j) limitation.
  - The remaining 50% would be subject to existing rules (generally deductible when partner receives excess taxable income or excess business interest income in a later year from the same partnership).
  - Partners can elect not to apply the special rule for excess business interest expense for taxable years beginning in 2019.
- Partnerships may elect not to apply the 50% threshold for 2020.

Individual Provisions – Recovery Refund Checks

- Each eligible individual can receive a refund up to $1,200 ($2,400 for joint filer) plus $500 for each qualifying child
  - Qualifying child is typically any child eligible to be claimed as a dependent whom is under the age of 17
  - Eligible individuals exclude non-resident aliens and individuals who may be claimed as a dependent on on another individuals tax return
  - Each individual must have a valid social security number
- Benefit is subject to phase-out limitations based on Adjusted Gross Income as follows:
  - $75,000 for single filers
  - $112,500 for head of household
  - $150,000 for joint filers
- Phase out is $50 for each $1,000 that AGI exceeds threshold

Individual Provisions – Recovery Refund Checks

- Refunds are the advance of a credit to be claimed on the taxpayers 2020 individual income tax return
- Refunds will be paid out based on AGI, filing status and number of qualifying children based on 2018 or 2019 (if filed) tax returns
  - Any excess credit will not be required to be repaid on the 2020 return, but taxpayers could claim an additional credit on the 2020 return based on the change in AGI or number of qualifying children
  - If a return has not been filed for 2018 or 2019, the IRS will issue rebate checks based on social security benefit statements (Form 1099-SSA)
  - If no social security statement is on file, the individual will need to file a 2020 tax return to claim the credit
  - GBQ recommends evaluating your 2018 and 2019 filings to evaluate if deferring the filing of the 2019 return could result in a larger Recovery Refund payment

Individual Provisions – Miscellaneous Provisions

Charitable Contributions

- Eligible individuals may take an "above the line" deduction for charitable contributions up to $300
- AGI limitation is suspended for qualifying cash contributions (i.e. now permitted to claim cash contributions up to 100% of AGI vs. 60%). Any excess is carried forward to 2021 subject to the 60% limitation.

Retirement Plans

- Eligible individuals may withdraw up to $100,000 from tax-qualified retirement plans during 2020 without the application of the 10% early withdraw penalty if they have been impacted by the Coronavirus
  - Taxable income as a result may be spread ratably over a three year period (i.e. 2020, 2021, and 2022) or be repaid over the next three years
- The Required Minimum Distribution ("RMD") from retirement plans is suspended for 2020.

Individual Provisions – Excess Business Loss

- Enacted in 2017 and effective for years 2018 through 2026, the Excess Business Loss provision limited the amount of deductible business losses (i.e. Schedule C and pass-through loss) to $250,000 for single filers and $500,000 for joint filers.
  - Any excess loss was carried forward as a net operating loss
- The CARES Act defers the effective date of the Excess Business Loss provision to 2021 (i.e. suspended for 2018, 2019 and 2020 returns)
  - Also closes "loophole" of treating wages as business income for purpose of the limitation
- Taxpayers should consider amending 2018 (and possibly 2019) returns to claim relief from any business losses which were limited by the rule.
  - Creates an opportunity to claim additional losses or generate Net Operating Losses, which can now be carried back five years

Qualified Improvement Property ("QIP") – Technical Correction

- Pre enactment of the TCJA, QIP included Qualified Leasehold Improvement Property, Qualified Restaurant Property and Qualified Retail Improvement Property, all which had a depreciable life of 15 years
- In drafting of the TCJA, Congress created QIP to replace all above designations, but failed to assign a 15 year class life to the asset (instead assigned a default class life of 39 years).
    - QIP is defined as an improvement to an interior portion of a building, which is nonresidential real property if the improvement was placed in service after the original in service date of the existing structure.
    - It does not include:
        - Enlargement to the building
        - Internal structural framework of the building
        - Any elevator or escalator

Qualified Improvement Property (“QIP”) – Technical Correction

- The CARES Act now assigns QIP a 15 year class life eligible for bonus depreciation
    - Effective for any asset placed in service after December 31, 2017
- Taxpayers should review if any QIP was placed in service in 2018 and 2019 to determine if amendments are in order to take advantage of the new QIP definition
    - Amending now could provide immediate cash flow relief for 2018 returns already filed
- Taxpayers could also file an automatic accounting method change in 2019 to “catch-up” on any missed depreciation from 2018 on their 2019 tax returns

Questions

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