

A grayscale photograph of the United States flag waving in the foreground on the left, with the dome of the United States Capitol building visible in the background on the right. A solid green horizontal bar is positioned below the photograph.

# **GBQuarterly: Year-End Business Tax Update**

A vertical line of small white dots on the left side of the blue background.

December 8, 2020

# Note

1. This presentation is intended to make participants aware of tax issues that may apply to this audience.
2. Information presented herein is not intended to be tax advice.
3. Please consult with a qualified practitioner for tax advice related to specific transactions.



# Speakers



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# Agenda

- COVID-19 Tax Relief (CARES Act)
- IRS Regulatory Updates
- Biden Business Tax Plan
- IRS Administrative Update



# CARES Act – Paycheck Protection Program (PPP) Loans

- Under Section 1106(i) of the CARES Act, PPP loan forgiveness that would (but for that subsection) be includible in gross income shall be excluded from gross income.
- Loan forgiveness is achieved by incurring certain qualified expenses and submitting the appropriate application, along with required documentation, to the lender.
- Notice 2020-32 (issued on May 2, 2020) stated that the IRS treats expenses related to classes of tax-exempt income as nondeductible under existing Section 265(a) or reimbursed expenses guidance.
- The end result would essentially make the loan forgiveness taxable, although many argue that was not in line with congressional intent.
- Questions also arose as to when the expenses should be recognized as nondeductible. Especially, when the application for loan forgiveness (and the ultimate granting of forgiveness) would not be initiated or resolved in a tax year after 2020.

# CARES Act – Paycheck Protection Program (PPP) Loans

- Revenue Ruling 2020-27 (issued on November 18, 2020) reinforced the IRS position in Notice 2020-32 that expenses paid with forgiven PPP loan proceeds are nondeductible.
- The Revenue Ruling also clarified that the nondeductible expenses would be recognized in the year incurred (2020 for most taxpayers) if the taxpayer has a “reasonable expectation” to receive forgiveness.
- Two examples were provided. One where the taxpayer had applied for forgiveness, but it had not yet been approved by the end of the tax year. Another where a taxpayer had not yet applied for forgiveness by the end of the tax year. In both examples, the Revenue Ruling stated that the expenses were nondeductible in the year incurred.
- The analysis in the Revenue Ruling points to the clear and readily accessible guidance to apply for and receive PPP loan forgiveness as a basis for having a reasonable expectation of forgiveness.

# CARES Act – Paycheck Protection Program (PPP) Loans

- Revenue Procedure 2020-51 (also issued on November 18, 2020) addresses situations where the lender denies all or part of the PPP loan forgiveness.
- Provides a safe harbor for claiming a deduction for expenses if:
  1. The eligible expenses are paid or incurred in the taxpayer's 2020 tax year and the taxpayer reasonably expects to receive forgiveness;
  2. The taxpayer submitted before the end of 2020, or as of the end of 2020 intends to submit in a subsequent tax year, an application for PPP loan forgiveness; and
  3. In a subsequent tax year, (i) the lender denies the taxpayer's request for forgiveness, or (ii) the taxpayer irrevocably decides never to request forgiveness of the taxpayer's PPP loan

# CARES Act – Paycheck Protection Program (PPP) Loans

- A taxpayer satisfying the safe harbor is permitted to deduct otherwise nondeductible expenses:
  1. On the taxpayer's timely filed original 2020 return or amended return, including extensions;
  2. On a tax return for a subsequent tax year
- A taxpayer seeking this relief is not permitted to deduct an amount of otherwise nondeductible expenses in excess of the principal amount of PPP loan for which forgiveness was denied or will never be sought.
- In order to claim the deduction, the taxpayer is required to attach a statement that is prescribed in Revenue Procedure 2020-51 to the return for tax year in which the expenses are deducted (includes grounds for eligibility, year of deduction and certain PPP loan and expenses information).

# CARES Act – Paycheck Protection Program (PPP) Loans

## So what does all this mean and what are the considerations?

- Seems apparent that the Treasury and the IRS are putting the onus back on Congress if there is to be any kind of “fix”.
- Tax projections and cash flow analysis. Pay tax based on the current rules or hope for a legislative fix? Review the safe harbor rules for estimated tax payments. Can you buy some more time to see if Congress acts?
- Consider the following:
  1. Potential escrow requirements if going through a sale transaction and the PPP loan has not yet been forgiven at the time of closing.
  2. Nondeductible expenses will mostly be payroll. Does this have any impact on calculating R&D credits or Section 199A deduction (both include components that include wages)? If negatively impacted, can you use other non-payroll expenses in applying for PPP loan forgiveness?

# CARES Act – Paycheck Protection Program (PPP) Loans

## So what does all this mean and what are the considerations?

- Consider the following (continued):
  3. Is there another code section that trumps CARES Act (language that makes forgiveness tax-exempt **IF** includable in gross income)? For instance, Section 108 exclusion from gross income for cancellation of debt in cases where taxpayer is insolvent or in bankruptcy.
  4. Basis considerations if nondeductible expenses in 2020 and tax-exempt income in 2021. Can this create a pitfall with basis ordering rules (particularly with S-corps)? Run the math and consider mitigating factors (distributions timing, election under Reg. 1.1367-1(g), etc.).

# CARES Act – Employee Retention Credit (ERC)

- The ERC is a refundable tax credit against certain employment or payroll taxes equal to 50% of the qualified wages an eligible employer pays to employees after March 12, 2020, and before January 1, 2021.
- The ERC is available to employers of any size. The number of employees an employer does not affect whether it is an Eligible Employer that may claim the credit. It will, however, determine the amount of eligible wages.
- The credit amounts are equal to 50% of qualified wages paid by an Eligible Employer to an employee. The maximum amount of wages eligible for the credit is \$10,000 per employee. In other words, the maximum credit amount is \$5,000 per employee.
- 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

- Eligible Employers that are entitled to claim the ERC are private-sector businesses and tax-exempt organizations that carry on a trade or business during calendar year 2020 and either:
  - Have operations that were **fully or partially suspended** during any calendar quarter in 2020 due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19 (in Ohio this is the stay-at-home order); or
  - Experienced a significant decline in gross receipts during the calendar quarter. This is measured as a 50% decline in gross receipts in a quarter compared to the same quarter in 2019.
- If an employer receives a Small Business Interruption Loan under the Paycheck Protection Program, authorized under the CARES Act, then the employer is **not** eligible for the ERC.

# CARES Act – Employee Retention Credit

## Considerations:

- If you did not receive a PPP loan, do you meet the other requirements?
- If you did not experience a significant decline in gross receipts, did you have operations that were fully or partially suspended? Facts and circumstances are important. Are you an essential business under state or local government guidance?
- Do you have more than 100 employees? If so, need to pay close attention to how credit is calculated.
- IRS issued numerous FAQ's in summer of 2020 that provide further guidance on many key issues  
(<https://www.irs.gov/newsroom/faqs-employee-retention-credit-under-the-cares-act>)

# 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.
- Potential opportunities to increase NOL's and carry back

# 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.

# CARES Act – Qualified Improvement Property

- What is Qualified Improvement Property (QIP)?
  - Improvements made by the taxpayer to the interior portion of a nonresidential building
  - Building must already be in service
  - Does not apply to building enlargements, elevators and escalators, or internal structural framework
- Prior to the TCJA (2017 and before), QIP was eligible for 50% “bonus” depreciation, with the remainder depreciated over 15 years.
- Due to a drafting error in the TCJA, QIP was no longer eligible for bonus depreciation and was required to be depreciated over 39 years.
- CARES Act allows for 100% “bonus” depreciation (immediate expensing) to be taken on QIP
  - Retroactive to tax years 2018 and 2019
  - Method changes to lower 2020 taxable income
  - Amend returns to request refunds

# CARES Act - Net Operating Losses (NOL)

- 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 made significant changes to these NOL rules

# CARES Act - Net Operating Losses (NOL)

- 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 ( $\$100 - \$60 = \$40 \times 80\% = \$32$ .  $\$40 - \$32 = \$8$ )

# CARES Act - Net Operating Losses (NOL)

- 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

# CARES Act - Net Operating Losses (NOL)

## How does the 80% Limitation on Carryforwards Apply?

	Tax Years Before 2018	Tax Years 2018-2020	Tax Years After 2020
Pre-2018 NOL	Not Limited	Not Limited	Not Limited
2018-2020 NOL	N/A	Not Limited	80% Limitation
Post-2020 NOL	N/A	N/A	80% Limitation

# CARES Act - Net Operating Losses (NOL)

## Considerations:

- Tax Rate Arbitrage (Corporations 21% vs. 34/35%)
  - Tax methods review – timing differences can have a permanent tax benefit
- Be wary of NOL carryback impacts relative to other tax deductions and credits – for example:
  - 'Old' §199 Domestic Production Activity Deduction
  - General Business Credits (R&D/WOTC/etc)
  - Foreign Tax Credits
  - GILTI/FDII §250 Deduction
- 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).
  - 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.

# CARES Act – Corporate AMT Refunds

- 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.

# IRS Regulatory Highlights

- Civics refresher – Congress writes and passes laws (Internal Revenue Code), President signs into effect
- U.S. Department of Treasury (Internal Revenue Service) subsequently issues Regulations to help codify, explain, and provide examples to taxpayers
- 163(j) Business Interest Expense Limitation
  - Definition of interest expense narrowed to exclude commitment fees and debt issuance costs
  - Computation of adjusted taxable income (ATI) for tax years beginning before 2022
    - Cost of Goods Sold Depreciation Change
- Qualified Business Income
  - Previously suspended loss guidance
- Global Intangible Low-Taxed Income (GILTI)
  - New High-Tax Exclusion (annual election)

# IRS Regulatory Highlights

- Meals and Entertainment
  - Generally, 50% of allowable food or beverage expenses remain deductible, even those incurred in an entertainment setting, if substantiation requirements are met
  - All or Nothing Rule
    - Food and beverages provided during an entertainment activity must be stated separately from the entertainment on invoice/receipts
    - If not stated separately, entire amount is nondeductible entertainment expenditure
  - Definitions provided for entertainment, food or beverages, business associate
- 263A UNICAP (Tax Inventory Capitalization)
  - Taxpayers with gross receipts exceeding \$50 million that are currently on the simplified production method (SPM), must change to the new modified simplified production method (MSPM)

# Biden Business Tax Plans - Highlights

- Raise corporate tax rate to 28%
  - Currently 21% as set by the Tax Cuts and Jobs Act
  - Was 35% prior to TCJA
- Eliminate Section 199A Deduction for high-income earners
  - Deduction of up to 20% of pass through income enacted by TCJA
  - Top marginal tax rate on most pass-through business income would increase to 39.6% compared to 29.6% under the TCJA
- “New” Alternative Minimum Tax
  - Corporate AMT was repealed as part of TCJA
  - New AMT would be 15% tax on GAAP net income for companies whose GAAP net income exceed \$100 million
- Foreign tax reporting
  - Doubles rate of Global Intangible Low Tax Income (“GILTI”) tax to 21%
  - Impose 10% surtax on income earned from offshoring production
  - Establish a “Made in America” tax credit
- Close “loopholes” for oil & gas, real estate industries

# Biden Business Tax Plans (Continued)

- Restore top rate on pass-through ordinary income to 39.6%
  - Currently 37% as set by the Tax Cuts and Jobs Act
- For income above \$1MM, capital gains rate = ordinary rate
  - Currently, LT capital gains and qualified dividends are taxed at 20% in the highest tax bracket (before net investment income tax)
- Changes to itemized deductions
  - Reinstate the Pease limitation
  - Cap benefit of itemized deductions at a 28% rate
  - Remove \$10,000 cap on SALT deduction

# Biden Business Tax Plans - Payroll Tax

## Current:

- Social Security tax is 12.4% and split between employer and employee on first \$137,700. Income above this threshold is not taxed for SS. Self-employed individuals pay the full 12.4%.

## Proposal:

- Biden plans to expand this tax to apply to wages and self-employed earnings greater than \$400,000, creating a “donut hole” between \$137,700 and \$400,000



# The State of the IRS

- COVID hit the IRS hard
  - Shut its physical offices, reopened them, and then shut some down again
  - Employees worked from home
  - Had to quickly implement CARES Act and other stimulus provisions
  - Was responsible for sending out 160 million stimulus payments
  - April 15th and June 15th deadlines were extended to July 15<sup>th</sup>
- IRS is still implementing significant portions of the TCJA
  - Writing regulations
  - Publishing forms
- Continued funding struggles
  - Since peaking in 2010, IRS funding has been reduced by about 20%
  - IRS staffing has also decreased 20% during that time
  - Only 1% of the IRS budget goes to technology modernization

# The State of the IRS



## Piles of unopened mail

- 23 million pieces as of April
- 12.3 million pieces as of late June
- 5.3 million pieces (including 2.5 million returns) as of October

**The Bottom Line:  
Be Patient**

# Questions



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