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SUBJECT: **Business Tax Relief**

Last night, the Senate approved legislation known as the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which is designed to provide much needed economic relief to individuals and businesses devasted by COVID-19. This bulletin summarizes the business tax relief provisions.

Net Operating Losses:

The Cares Act temporarily repeals certain limitations on net operating loss ("NOL") deductions that were enacted as part of the TCJA. By way of background, the TCJA amended section 172 to limit a taxpayer's NOL deduction for a taxable year to 80 percent of its taxable income. The TCJA also eliminated a taxpayer's ability to carryback an NOL to a prior taxable year. The Cares Act generally reverses these TCJA changes for 2018, 2019, and 2020 taxable years. In particular, for taxable years beginning before January 1, 2021, the 80 percent taxable income limitation does not apply and a taxpayer's NOL can fully offset its income. In addition, an NOL arising in a taxable year beginning after December 31, 2017 and before January 1, 2021 can be carried back to offset income in the preceding five taxable years.

Special carryback rules apply to REITs and insurance companies. In addition, taxpayers that carry back an NOL to a year in which they had an inclusion under section 965 are treated as if they made an election under section 965(n) for that year, meaning any 965 inclusion will not be taken into account in determining the amount of taxable income which may be reduced by the NOL carryback. Alternatively, a taxpayer may elect to exclude a taxable year containing a section 965 inclusion from its carryback period. If a taxpayer elects to waive a carryback with respect to an NOL arising in a taxable year beginning in 2018 or 2019 under section 172(b)(3), it must make the election by the due date (including extensions) for filing its return for the first taxable year ending after March [ ], 2020 [the date of the CARES Act's enactment].

To claim a carryback, individual taxpayers (including estates and trusts) file IRS Form 1045, Application for Tentative Refund, and corporate taxpayers file IRS Form 1139, Corporation Application for Tentative Refund. In general, Form 1045 or Form 1139 must be filed on or after the date the return for the NOL year is filed, and within 12 months after that taxable year. For NOLs arising in taxable years beginning before January 1, 2018 and ending after December 31, 2017, the Cares Act provides that carryback claims filed within 120 days of its enactment will be treated as timely filed.

As noted above, the Cares Act's NOL provisions are temporary. The 80 percent taxable income limitation is restored for taxable years beginning after December 31, 2020, and carrybacks are prohibited for NOLs arising in taxable years beginning January 1, 2021.

Loss Deductions:

The Cares Act modifies section 461(l), which limits a non-corporate taxpayer's loss deductions, to apply to taxable years beginning after December 31, 2020. This change is consistent with the Cares Act's temporary repeal of limitations on NOL deductions in section 172.

Section 461(l), enacted as part of TCJA, provides that a non-corporate taxpayer, including a pass-through entity, individual, trust, or estate, cannot deduct an "excess business loss;" any such loss is treated as an NOL carryover under section 172. For this purpose, "excess business loss" generally is defined as the excess of a taxpayer's aggregate trade or business-related deductions for a taxable year over its aggregate trade or business-related income for that year plus $250,000 (or $500,000 for a joint return), subject to adjustment for inflation. In addition to relaxing the loss limitation rule, the Cares Act makes certain amendments relating to the computation of excess business loss, including specifying that items attributable to a trade or business of performing services as an employee are not taken into account.

Though it is not entirely clear, it appears that a taxpayer must file an amended return to request relief with respect to loss previously disallowed under section 461(l). An individual taxpayer generally can amend a prior year's return by filing Form 1040-X within three years of the date the original return was filed or within two years of the date tax was paid, whichever is later. It is especially unclear how a partnership and its partners would obtain relief; under the new partnership audit rules (effective for taxable years beginning in 2018), a partnership is not permitted to file an amended return but rather must utilize the administrative adjustment request process.

The loss limitation rule is restored for taxable years beginning on or after January 1, 2021 and before January 1, 2026.

Refundable AMT Credits:

The Jobs Act repealed the alternative minimum tax ("AMT") on corporations and also allowed corporations to offset their regular tax liability by any minimum tax credit ("MTC") they may have had for any tax year. Beginning in 2018, a portion of MTC was permitted to be refunded. The Act adds a new Code section 53(e)(5) which provides that a corporation may make an election to take its entire MTC refundable amount in 2018.

A corporation that makes this election can apply for a tentative refund under the rules applicable to tentative carrybacks and refunds under Code section 6411 (the so-called "Quickie Refund" rules.) The corporation may file an application for a refund providing that the refund is due by reason of new Code section 53(e)(5) prior to December 31, 2020.

The application should include (i) the amount of the refundable MTC claimed under section 53(e)(5); (ii) the amount of refundable MTC claimed for any previously filed return for such taxable year; and (iii) the amount of the refund claimed. The IRS will review it, and determine the amount of the overpayment and then apply, credit or issue a refund to the corporation within 90 days of the application. The overpayment is first applied to any unpaid taxes for 2018, then credited against any unpaid taxes for 2017, then credited against any tax liability or installment then due or refunded to the corporation.

Payroll Tax Deadline Deferrals:

The Act defers payment of the employer share of social security taxes, both for employers and self-employed individuals. More specifically, this includes: (i) 50% of the 12.4% tax on self-employment income under § 1401(a) (including any quarterly installments of estimated taxes due under § 6654); and (ii) 100% of the 6.2% tax on wages imposed on employers under § 3111(a) (including to the extent incorporated by reference in the tier 1 taxes due under §§ 3211(a) and 3221(a) under the Railroad Retirement Tax Act). 50% of such deferred amounts must be paid by December 31, 2021 and the balance must be paid by December 31, 2022. The deferral of taxes due under § 3111(a) is not available, however, for any taxpayers who take advantage of certain provisions in the Act providing partial loan forgiveness for certain SBA guaranteed loans, generally up to the cost of rent, utilities, and maintaining payroll continuity from February 15, 2020 through June 30, 2020.

Business Interest Expense Limitation:

The Act increases taxpayers' ability to deduct trade or business interest expense, raising the 30 percent adjusted taxable income limitation to 50 percent. Under § 163(j), interest expense is generally limited to the sum of business interest income, floor plan financing interest (applicable only for taxpayers selling various motorized vehicles), and 30% of the taxpayer's adjusted taxable income ("ATI," which is generally EBITDA through 12/31/2021 and EBIT thereafter). For partnerships, the limitation applies at the partnership level. To the extent the partnership's interest expense is limited by § 163(j), the excess business interest expense ("EBIE") that is disallowed is carried forward to future taxable years. Each partner is allocated its distributive share of EBIE and must reduce (but not below zero) its outside basis by that amount. The partners may treat EBIE as business interest paid or accrued by that partner in the next taxable year in which the partner is allocated excess taxable income from the partnership. The Act increases the 30% of ATI limitation to 50% for taxable years beginning in 2019 and 2020. This provision does not apply, however, to partnerships for any taxable year beginning in 2019. But, unless a partner elects otherwise, 50% of any EBIE allocated to a partner for such taxable year is treated as paid or accrued by such partner in its first taxable year beginning in 2020, regardless of whether the partner is allocated any excess taxable income from the partnership in such year. The other 50% shall continue to be subject to the generally applicable rules on EBIE.

Additionally, for the taxable year beginning in 2020, the Act permits (but does not require) a taxpayer to use its ATI from its previous taxable year beginning in 2019 to calculate the interest expense limitation. For any short taxable year beginning in 2020, the substituted ATI must be prorated based on the number of months included in the short taxable year.

Electing real property trades and businesses who depreciate their assets over longer recovery periods under the Alternative Depreciation System are not subject to the interest expense limitation. Although such assets are generally not "qualifying property" eligible for bonus depreciation under § 168(k), the real property trade or business election was almost always advantageous for qualifying taxpayers, due to a technical error in prior legislation which prohibited bonus depreciation on qualified improvement property. This error has been eliminated by the Act, as further discussed below.

This provision also impacts a taxpayer's state tax filing position. Because the composition of a taxpayer's state filing group may not be the same as its federal consolidated group, the manner in which the business interest limitation is calculated for state purposes may not be the same as for federal purposes. Further, whether a particular state adopts the Internal Revenue Code automatically, on a rolling basis or in another manner will impact whether and when this CARES Act provision impacts a taxpayer's state limitation. Whether and how a state's add-back provisions may also confound this state-specific calculation. Finally, because states have taken a wide variety of approaches to making this calculation a taxpayer should consult each state's rules on this topic.

<u>Qualified Improvement Property</u>:

The Act includes a technical correction that makes qualified improvement property eligible for 100% bonus depreciation if placed in service before January 1, 2023. Available bonus depreciation is reduced by 20% per year annually thereafter through 2026. Qualified improvement property generally includes any improvement to the interior of a building placed in service after the building was first placed in service, but excluding enlargements, elevators, escalators, and improvements to the internal structural framework of the building. The Act adds qualified improvement property to the list of 15-year property under § 168(e)(3)(E), which therefore qualifies for bonus deprecation under § 168(k) by virtue of having a recovery period of

20 years or less. The Act also assigns qualified improvement property a 20-year recovery period under the Alternative Deprecation System.

Prior to the Tax Cuts and Jobs Act, categories of qualified leasehold improvement property, qualified retail improvement property, and qualified restaurant property that would otherwise be depreciable under the generally applicable 39-year recovery period for nonresidential real property under MACRS were designated as 15-year property under § 168(e)(3)(E). Also, qualified improvement property was eligible for 50% bonus depreciation in the year in which it was placed in service under § 168(k)(2)(A)(iv). The TCJA attempted to streamline these depreciation incentives by eliminating the separate categories of qualified leasehold improvement property, qualified retail improvement property, and qualified restaurant improvement property and including them all within the umbrella of qualified improvement property, which was supposed to be designated as 15-year property and therefore eligible for bonus depreciation available under § 168(k)(2) for any property with a recovery period of 20 years or less. However, through a drafting error, the TCJA eliminated the separate definitions of qualified leasehold improvement property, qualified retail improvement property, and qualified restaurant improvement property, but failed to assign a 15-year recovery period to qualified improvement property.

<u>Employee Retention Tax Credit</u>:

The Employee Retention Tax Credit (ERTC) is a refundable payroll tax credit against the employer's share of Social Security (OASDI) taxes equal to 50 percent of wages paid from March 13, 2020 to December 31, 2020, up to a total of $10,000 per employee (i.e., maximum credit of $5,000 per employee). The ERTC is structured similar to the payroll credit for sick and family leave available under the Families First Coronavirus Response Act [hyperlink to 3/23 FAQ], although employers may not claim both credits on the same wages. Qualifying wages, which include certain qualified health plan expenses, are paid by businesses during a shutdown order or during a period of significantly declined gross receipts:

- Shutdown Order: a full or partial suspension of operations due to orders from an appropriate governmental authority limiting commerce, travel, or group meetings;

  or

- Period of Significant Decline in Gross Receipts:
  - The first 2020 calendar quarter in which gross receipts have declined 50 percent relative to the same calendar quarter in the prior year, <u>until</u>
  - The next calendar quarter in which gross receipts exceed 80 percent of receipts during the same calendar quarter of the prior year.

For employers with more than 100 full-time employees, the ERTC is available only for wages paid to employees who are <u>not providing services</u> due to these circumstances. The ERTC is available for wages paid by both nonprofit and for-profit businesses (but not government employers). The ERTC is subject to recapture and otherwise unavailable to businesses who receive small business interruption loans [hyperlink to SBA alert]. Certain other limitations also apply, including restrictions on amounts paid to related individuals and “double dipping” of other employment credits (e.g., active duty and empowerment zone credits).

Employer Payment of Student Loans:

The Act expands the existing exclusion for up to $5,250 of employer educational assistance, which currently applies to expenses such as tuition, fees, and books, to include employer repayments of student loans. Employees may exclude employer student loan repayments made between the date of enactment and December 31, 2020, but they are prohibited from deducting any employer-paid student loan interest expense excluded under this provision.