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# **CARES ACT**

## **TAX CONSIDERATIONS FOR BUSINESSES AND INDIVIDUALS**

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# PRESENTERS



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# Overview

1. Net Operating Loss (NOL) provisions (§ 2303; IRC 172)
2. Interest expense deductibility (§ 2306; IRC 163(j))
3. Qualified investment property (§ 2307; IRC 168(e))
4. AMT refundable credit (§ 2305; IRC 53(e))
5. Excess business losses (§ 2305; IRC 461(l))

**CARES ACT - § 2303**

# **MODIFICATIONS FOR NET OPERATING LOSSES**



# § 2303 – Net Operating Losses (IRC 172)

- Prior to the Tax Cuts & Jobs Act (TCJA):
  - NOLs could be carried back 2 years and carried forward 20 years
  - NOLs could be used to fully offset taxable income
- The TCJA narrowed these rules by\*:
  - Repealing the historic two year carryback period
  - Limiting the NOL for a taxable year to 80% of taxable income for the year

§ 2303 of the CARES Act relaxes the rules enacted under the TCJA by:

- Allowing NOLs to fully offset taxable income generated in 2018, 2019, and 2020
- Allowing NOLs generated in 2018, 2019, or 2020 to be carried back 5 years

\* Rules applies to NOLs generated in post-TCJA years

# Considerations

- **Claiming benefit** – Will generally require the filing of an amended return or filing a request for tentative refund – impact on closed years and existing controversies
- **Impact on other existing tax positions:**
  - 965 (transition tax) – Act assumes taxpayers elected not to apply NOLs to § 965 liability (see § 965(n))
  - GILTI – Use of additional NOLs to offset GILTI may “dilute” value of NOLs
  - BEAT – May increase BEAT liability by increasing Modified Taxable Income and reducing regular tax liability
- **Impact on third-party transactions (M&A):**
  - Consider purchase agreement covenants regarding tax attributes

**CARES ACT - § 2306**

# **MODIFICATIONS OF LIMITATION ON BUSINESS INTEREST**



## § 2306 – Deductibility Interest Expense

- Prior to the TCJA the section 163(j) “earnings stripping” rules limited deductions on interest paid to related parties not subject to U.S. tax.
- The TCJA replaced the old “earnings stripping” rules with a broad limitation on the deduction of business interest expense.
  - Business interest expense deductible to the extent of the sum of: (i) business interest income, (ii) 30% of adjusted taxable income, and (iii) floorplan financing interest (disallowed interest expense is carried forward).
  - Rule applies at both the partner and partnership level.
- § 2306 of the Act relaxes the rules enacted under the TCJA by providing the following:
  - For 2019 and 2020, 30% adjusted taxable income limitation increased to 50%
  - Partnerships get a special rule for 2019 – if the partnership had disallowed business interest expense, 50% of a partner’s share of the 2019 disallowed business interest expense will be deductible in 2020 (without limitation) and 50% is still subject to the normal carryforward rules.
  - For 2020, Taxpayer can choose to use 2019 adjusted taxable income for limitation purposes.
  - Taxpayers can elect out of these relief provisions.



# Considerations

- **Claiming benefit** – Will generally require the filing of an amended return – impact on closed years and existing controversies
- **Impact on other existing tax positions:**
  - BEAT – Increasing deductibility of interest paid to foreign related persons may cause taxpayers to become subject to BEAT
    - May also increase BEAT liability by increasing Modified Taxable Income and reducing regular tax liability
- **Impact on third-party transactions (M&A):**
  - Did the parties allocate rights to any potential refunds?

**CARES ACT - § 2307**

# **TECHNICAL AMENDMENTS REGARDING QUALIFIED INVESTMENT PROPERTY**



## § 2307 – Qualified Investment Property (“QIP”)

- TCJA “Glitch” – Bonus depreciation is generally available for property with a recovery period of 20 years or less -- a drafting error left QIP with a 39-year recovery period, and so QIP could not qualify for bonus depreciation.
- QIP is any improvement to the interior portion of a nonresidential building after the building was first placed in service but does not include expenses related to
  - the enlargement of the building
  - elevators or escalators; or
  - the internal structural framework of the building.
- § 2307 of the Act explicitly assigns QIP a 15-year recovery period (making QIP eligible for bonus depreciation).
- § 2307 is effective as if it was originally included in the TCJA (i.e., retroactive).

# Considerations

- What does this mean for a taxpayer's prior years?
- Does it make sense to elect out of bonus depreciation?
- If QIP was placed in service in 2018 (and maybe 2019), an amended return is likely required.
- Interaction with section 163(j) business interest limitations
  - Taxpayer in a farming business or real property trade or business can elect out of section 163(j), but loses ability to take bonus depreciation.
  - Change in treatment for QIP could change tax consequences of section 163(j) elections.
  - Revenue Procedure 2020-22 provides relief for prior year elections.
- What if the QIP relates to a leasehold interest?

**CARES ACT - § 2305**

# **MODIFICATIONS OF CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY OF CORPORATIONS**



## § 2305 – AMT Refundable Credit

- Prior to the TCJA:
  - Corporate taxpayers subject to alternative minimum tax (AMT) equal to 20% of AMTI
  - AMT paid in prior years allowed as credit in later years if regular tax liability > AMT
- The TCJA narrowed these rules by:
  - Corporate AMT repealed
  - AMT credit refundable up to 50% of excess minimum tax credit amount; threshold increased to 100% beginning in 2021
- § 2305 of the Act relaxes the rules enacted under the TCJA by:
  - AMT credit refundable up to 100% of excess minimum tax credit amount beginning in 2019 (rather than 2021)
  - Taxpayers may elect to take entire refundable credit in 2018

# Considerations

- **Claiming benefit** – Will generally require the filing of an amended return – impact on closed years and existing controversies
- **Impact on other existing tax positions:**
- **Impact on third-party transactions (M&A):**
  - Consider whether to address in purchase agreement (e.g., treated as refund)

**CARES ACT - § 2304**

# **MODIFICATIONS OF LIMITATION ON LOSSES FOR TAXPAYERS OTHER THAN CORPORATIONS**





## § 2304 – Excess business losses

- Prior to the TCJA:
  - No specific limitation or guidance concerning excess business losses (losses in excess of business income)
- The TCJA limits deduction of certain business losses:
  - Non-corporate taxpayers only permitted to deduct excess business losses against \$250K of nonbusiness income
  - Disallowed loss treated as an NOL that may be carried forward
- § 2305 of the Act relaxes the rules enacted under the TCJA by:
  - Excess business loss disallowance rules postponed until 2021 taxable years

# Considerations

- **Claiming benefit** – Will generally require the filing of an amended return – impact on closed years and existing controversies
- **Impact on other existing tax positions:**
  - Inapplicability of existing business loss limitation for 2018, 2019 and 2020 may allow a non-corporate taxpayer to utilize business losses to offset non-business income (subject to other applicable loss limitation rules)
  - Taxpayers with non-business income in 2020 (for example, on account of gains from sales of securities) may be permitted to offset such income with 2020 business losses

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# Biography



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Casey S. August's practice focuses on US federal tax planning and implementation matters. Representing clients across industries, he advises on structuring and documentation issues for mergers and acquisitions, energy project financings, joint venture collaborations, and intellectual property transfers. Casey also counsels clients on issues involving choice of entity and cross-border structuring and planning, as well as on IRS private letter ruling submissions and securities filings.

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Daniel F. Carmody counsels clients on tax matters involving domestic and international transactions. In particular, his practice focuses on structuring partnerships, limited liability companies, and Subchapter S corporations. He also represents clients in audits and appeals before the Internal Revenue Service.

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Michael Liu advises and counsels multinational corporations with domestic and international tax planning. His clients span a variety of industries, including those in the high technology, semiconductor, software, pharmaceuticals, and biotechnology sectors. Before joining Morgan Lewis, he was a partner in the tax practice of another global law firm, based in Palo Alto. Michael is admitted in California only, and his practice is supervised by Illinois Bar members.

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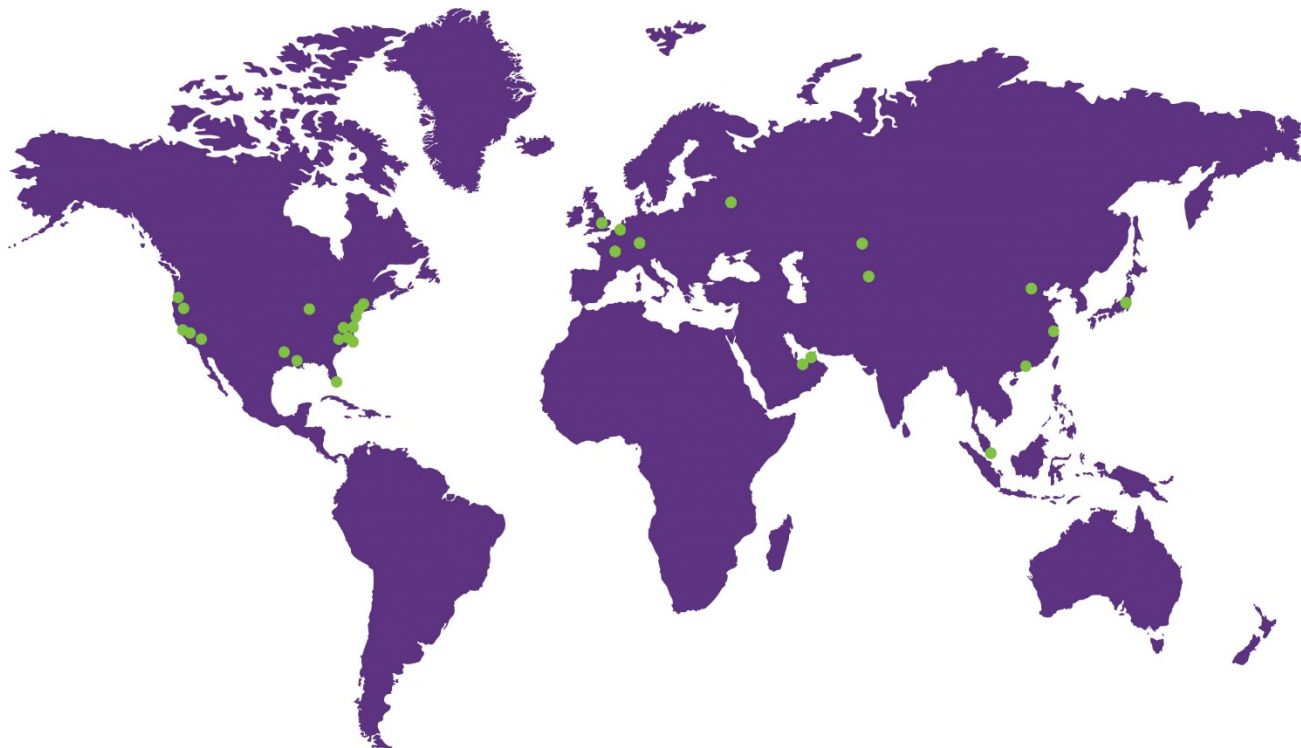
Sarah-Jane Morin focuses her practice on representation of public and private companies, private equity funds, venture capital funds, real estate funds, portfolio companies, and alternative investment vehicles in the tax aspects of complex business transactions and fund formations, including domestic and cross-border investment strategies, sponsor investment strategies, limited partner investment strategies, mergers, acquisitions, integrations, buyouts, recapitalizations, debt and equity restructurings, and ongoing operations and tax compliance issues. Additionally, she advises on international tax issues, including the tax aspects of offshore vehicles (CFC/PFIC/GILTI regimes), anti-deferral rules (Subpart F), withholding, cost sharing, and transfer pricing.

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