Client Alert
March 23, 2020

Senators Struggle to Reach Agreement on Tax Provisions in Coronavirus Bill

On Sunday, March 22, 2020, the United States Senate circulated a draft of the CARES Act (the "Bill"). This client alert provides a high-level summary of certain tax provisions included in the Bill and raises key considerations for interested stakeholders.

Limitations on NOLs Relaxed

As suggested below and in our other articles, the Internal Revenue Code ("Code") currently treats corporations that generate net operating losses ("NOLs") harshly. For years, the Code allowed companies to carry NOLs back 3 years and forward 15 years. In more recent times, Congress has limited the carryback rules as a revenue raiser. The Tax Cut and Jobs Act ("TCJA") eliminated carrybacks altogether and added the rule that permits taxpayers to offset only 80% of taxable income with NOLs. In the current environment, where liquidity is crucial for the survival of many companies, the inability to carry losses back to prior years is a particularly important and painful change from prior law.

Section 2302 of the Bill relaxes some of these limitations on the use of NOLs. Under the Bill, there is no limit on the use of carryovers from years beginning before January 1, 2018. For NOLs taxpayers generate in taxable years starting after December 31, 2017 (i.e., taxable years subject to the TCJA), the 80% limitation remains in modified form. The Bill applies the 80% limitation to taxable income computed without regard to the deductions in Code Sections 172, 199A, and 250. This approach fully preserves these deductions.

In an effort to provide some much-needed liquidity to struggling businesses, the Bill would allow taxpayers to carry certain losses back five years. This rule applies to losses taxpayers generate in taxable years beginning in calendar years 2018, 2019, and 2020. There are also special rules for REITs, life insurance companies, and for the Code Section 965 year that we are not addressing here.

Modification of Limitation on Losses for Non-Corporate Taxpayers

As part of the TCJA, Congress denied non-corporate taxpayers a deduction for "excess business losses." Code Section 461(l) defines an "excess business loss" as the excess of a taxpayer's deductions from all trades or businesses over aggregate gross income from the taxpayer's trades or businesses plus $250,000 (or $500,000 if a joint return is filed). For partnerships or S corporations, the loss limitation applies at the partner or shareholder level, and not at the entity level. Any excess business loss is treated as a net operating loss carryover to the following taxable year under Code Section 172. The excess business loss limitation rule applies for the taxable year of a non-corporate taxpayer beginning after December 31, 2017, and before January 1, 2026.

Section 2303 of the Bill essentially eliminates the limitation on excess business losses for taxable years beginning in 2018, 2019, and 2020. This change delays the limitation of the use of excess business losses for three years from the effective date for the TCJA.

Section 2303 also contains some technical corrections that we do not cover in detail. Among other things, it fixes the carryforward rule for excess business losses, and takes certain deductions, capital losses, and capital gains out of the calculation for excess business losses. Perhaps, the most important technical correction is to the rules for income from providing services as an employee. Under the Bill, any deductions, gross income, or gains attributable to any trade or business of performing services as an employee are disregarded in determining a taxpayer's excess business loss. This technical correction resolves an inconsistency between the IRS's interpretation of an employee's salary income and the Joint Committee on Taxation's interpretation.

Acceleration of Refundable Alternative Minimum Tax ("AMT") Credits

The TCJA repealed the corporate AMT, but permitted taxpayers to claim a refund of their AMT credits over tax years beginning in 2018, 2019, 2020, or 2021. Section 2304 of the Bill accelerates a taxpayer's ability to claim a refund of its AMT credits by making an election to claim the entire amount of the credit in their 2018 taxable year and, therefore, provides taxpayers with an opportunity for increased liquidity. Alternatively, instead of electing to claim the entire amount in the 2018 taxable year, a taxpayer may claim the refund in its 2018 and 2019 taxable years. The Bill instructs taxpayers to file a tentative claim for refund and instructs Treasury to process those refund claims within 90 days of the date that the claim is filed.

Section 163(j) Limitation on Interest Expense Relaxed

Section 2305 of the Bill modifies Code Section 163(j) by adding a new Section 163(j)(10), titled, "Special Rule for Taxable Years Beginning in 2019 and 2020." If enacted, the new rule would increase the amount of the limitation from 30% of adjusted taxable income ("ATI") to 50% of earnings before interest, taxes, depreciation, and amortization ("EBITDA") for tax years beginning in 2019 and 2020. A special rule exists for partnerships. A taxpayer may elect not to have the increased 50% limitation apply to any taxable year. Once an election is made, it cannot be revoked without the Secretary's consent.

In addition, a taxpayer may elect to substitute their ATI from their 2019 tax year for their ATI in 2020. Taken together, these two changes would allow a taxpayer to claim an interest deduction for up to 50% of ATI in 2019 and 2020 and would allow taxpayers to substitute their (presumably higher) 2019 ATI for their 2020 ATI to further increase the amount of their interest deduction. Because these changes allow taxpayers to make an election, we expect Treasury and the IRS to issue guidance on how to make those elections. We understand that issuing guidance implementing this legislation is a top priority for Treasury.

Qualified Improvement Property Technical Correction

As part of the TCJA, Congress eliminated the separate definitions of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, and provided a general definition of qualified improvement property ("QIP"). Congress intended QIP to be depreciable property with a recovery period of 15 years. By having an applicable recovery period of 20 years or less, QIP would be "qualified property" under Code Section 168(k) and thus taxpayers could immediately expense the cost of QIP through their 2022 taxable year.

In the TCJA, Congress defined qualified improvement property, but failed to include the 15-year recovery period for it. As a result, immediate expensing was not available.

Section 2306 of the Bill contains three technical corrections and its effective date is retroactive to the date Congress enacted the TCJA. The Bill includes the 15-year recovery period for this property. The Bill clarifies the definition of QIP to limit QIP so that it only includes improvements made by the taxpayer. Finally, for purposes of the alternative depreciation system, QIP is given a class life of 20 years.

Unless Treasury issues guidance providing a different mechanism (such as a notice allowing taxpayers to make an automatic change to their method of accounting, which would allow taxpayers to take this change into account when calculating their next estimated income tax payment), taxpayers may have to file an amended return to benefit from this change. Requiring taxpayers to file an amended return and wait for the IRS to process their refund claims may slow the liquidity infusion that Congress intended.

Deferral of Employer Payroll Taxes

In another effort to provide taxpayers with liquidity, Section 2301 of the Bill delays the payment due date for the employer share of social security taxes (the 6.2 percent tax borne by employers on wages up to the social security wage base) and railroad retirement act taxes, for the period from enactment until December 31, 2020. These taxes will be due 50 percent on December 31, 2021, and 50 percent on December 31, 2022. Deposit penalties will not apply due to the delayed payment. As currently drafted, the relief does not apply to taxpayers that have indebtedness forgiven under certain section 7(a) Small Business Act loans addressed in Sections 2012 and 2105 of the Bill or in connection with a short-term compensation agreement addressed in Section 2109 of the Bill.

Charitable Contribution Limits

Section 2205 allows corporate taxpayers to elect to raise the limitation on qualifying charitable contributions under Code Section 170(c) from 10% of taxable income to 25% of taxable income. Contributions must be paid in cash during 2020 to qualifying organizations.

Filing and Payment Extensions Under Notice 2020-18

Prior to Congress's release of the proposed Bill, the Internal Revenue Service issued guidance under its authority in Code Section 7508A to delay the filing date for tax returns and the payment of any taxes due. Taxpayers that previously were required to file U.S. Federal income tax returns and make accompanying payments on or before April 15, 2020, are now not required to file such returns or pay such taxes until July 15, 2020. There is no limitation on the amount of tax payment that may be postponed, and taxpayers are not required to file Form 4868 or Form 7004 to take advantage of the postponement. Interest, penalties, and additions to tax will not accrue during the postponement period.

What's Missing?

The TCJA is still not for losers (see link below). Although the Bill addresses net operating loss carrybacks and provides some relief under Code Section 163(j), the Senate has opted not to address other rules that penalize companies with NOLs. Congress introduced many of these rules in the TCJA.

For instance, the base erosion and anti-abuse tax (BEAT) will carve back part of the NOLs by applying a base erosion percentage. This rule can reduce the NOL benefit or drive a company further into the BEAT. Similarly, NOLs apply first and reduce the amount of income that can qualify for Foreign Derived Intangible Income. The same issues arise with the deduction under Code Section 250 that a taxpayer receives in connection with its Global Intangible Low-Taxed Income. The Bill is silent on these issues.

Similarly, taxpayers who avail themselves of the change to Code Section 163(j) may have more borrowing capacity, but the BEAT may swoop in and deny additional interest deductions.

There are several other issues the TCJA created for loss companies that Congress did not address in this Bill. For a discussion of these issues, please see the article, The TCJA is Not for Losers.

Next Steps

As of Sunday evening, a key procedural vote failed in the Senate, which further delays when the Senate is expected to vote on the Bill. Senate Leader Mitch McConnell (R-KY) had previously anticipated a final vote on the Bill no later than Monday close of business, but that vote is now likely to slip into Tuesday or even Wednesday.

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Speaker Nancy Pelosi (D-CA) has indicated that the Bill is a Senate product and does not reflect the House's views. She said the House is working on its own version of stimulus legislation. It is unclear if Speaker Pelosi's comments are a negotiating position or the House intends to respond with its own proposal. Senate Democrats are also expressing concerns with the Bill.

In any event, Congress will try to pass a stimulus bill for the President to sign by the end of this week. Treasury is already planning to issue guidance to help taxpayers take advantage of the tax provisions in a stimulus bill, and it will be incumbent on taxpayers to help Treasury and the IRS identify questions that the guidance must address.

We understand that Congress is looking ahead to additional legislation to address COVID-19, and plans to begin working on legislation that will focus on healthcare provisions once Congress has passed the Bill, or at least some version of it.

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