

Client Alert

March 26, 2020

UPDATE: Senate Passes Coronavirus Bill Containing Tax Provisions, House of Representatives to Vote Soon

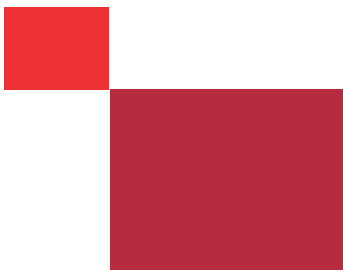
On Sunday, March 22, 2020, the United States Senate circulated a draft of the Coronavirus Aid, Relief, and Economic Security Act or the “CARES Act” (the “Proposed Bill”). On Wednesday, March 25, 2020, the Senate released an updated version of the Bill (the “Final Bill”), which retains many of the tax provisions that were included in the Proposed Bill, and added some additional provisions (as discussed further below). The Senate passed the Final Bill on Wednesday evening with a vote of 96-0, and we expect the U.S. House of Representatives will vote to pass the Final Bill on Friday.

This client alert updates our [prior alert](#) and provides a high-level summary of certain tax provisions the Final Bill contains and raises key considerations for interested stakeholders. Many, if not all, of the tax provisions will require Treasury and the Internal Revenue Service (“IRS”) to issue guidance interpreting the provisions. Among other things, Treasury and the IRS must provide instructions on how to make the elections the Final Bill allows taxpayers to make. We expect Treasury and the IRS to begin working on this guidance as soon as the Final Bill is enacted into law. Companies that are interested in the content of this guidance should contact the authors of this alert or their Baker & McKenzie counsel to discuss engaging with Treasury and IRS on these matters.

Tax Credit for Worker Retention

Section 2301 is a new provision in the Final Bill. It provides a refundable payroll tax credit equal to 50 percent of the wages paid by employers to employees for each calendar quarter during the COVID-19 crisis. The credit applies to, and is limited to, the first \$10,000 of compensation, including health benefits, paid to an eligible employee. The credit applies to wages paid from March 13, 2020 through December 31, 2020, and is allowed against the employer’s 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 tax.

The credit is available to two categories of employers. The first is an employer with business operations in 2020 that are partially or fully suspended due to a government order limiting commerce, travel, or group meetings as a result of COVID-19. The second category is an employer with business gross receipts in a calendar quarter in 2020 that are less than 50 percent of the business gross receipts for the same calendar quarter in 2019. An employer that receives a Small Business Interruption Loan is ineligible for the credit.





The credit is based on “qualified wages” paid to the employee. For employers with greater than 100 full-time employees in 2019, “qualified wages” are wages paid to employees when they are not providing services due to COVID-19-related circumstances. For eligible employers with 100 or fewer full-time employees in 2019, all employee wages qualify for the credit without regard to whether the employee is performing services during the relevant period.

Section 2301 directs Treasury to issue forms, instructions, regulations, and guidance to allow the advance payment of the credit, recapture of the credit if an employer receives a Small Business Interruption Loan, application of the credit to third party payors, and application of the 50 percent business gross receipts test if the employer was not carrying on business in 2019.

Deferral of Employer Payroll Taxes

Proposed Bill: In another effort to provide taxpayers with liquidity, Section 2301 of the Proposed 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 2102 and 2105 of the Proposed Bill or in connection with a short-term compensation agreement addressed in Section 2109 of the Proposed Bill.

Final Bill: Except for being redesignated as Section 2302 and updating cross references, these provisions remain substantively unchanged in the Final Bill. In particular, the deferral provision does not apply in the case of taxpayers who have indebtedness forgiveness under Section 1106 (as added by Section 1102) or Section 1109 of the Final Bill, both of which deal with small business loans.

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 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.

Proposed Bill: Section 2302 of the Proposed Bill relaxes some of these limitations on the use of NOLs. Under the Proposed 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 Proposed 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 Proposed 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.

Final Bill: The Final Bill largely follows the Proposed Bill, as described in our previous [Client Alert](#), and redesignates the provision as Section 2303. Importantly, the five-year carry back remains, as well as the language allowing taxpayers to use their NOLs without the 80% limit. The primary difference between the Proposed Bill and the Final Bill relates to Code Section 965. The Final Bill clarifies that taxpayers that wish to carry back NOLs to prior years may exclude the year with the Section 965 transition tax from the carry back. Thus, taxpayers that elect to carry back NOLs will not have to use their NOLs against the Section 965 inclusion, which is taxed at a lower rate. Taxpayers taking this approach retain the full benefit of their NOLs.

The Final Bill does not address the unfortunate interaction between the NOL rules and the BEAT. As a result, if a taxpayer elects the carryback and the NOLs are carried back to a BEAT year, the taxpayer is subject to the effective limitation on the NOLs that the BEAT rules contain. For further details on those rules, please see article, [The TCJA is Not for Losers](#). This interaction makes the ordering rules for determining the year to which the NOLs are carried back critically important. The Final Bill does not change the existing rule in Code Section 172(b) requiring the taxpayer to carry the NOLs back “to the earliest of the taxable years” to which the taxpayer may carry the NOLs. Thus, a NOL arising in taxable 2020 must be carried all the way back to 2015 to the extent of the taxable income in 2015, before being carried forward to subsequent years. In addition to avoiding the negative interaction with BEAT rules, a taxpayer carrying an NOL back to 2015 also benefits from using the NOLs against income that would otherwise be subject to a 35% tax rate, rather than using the NOL to offset income taxed at the lower rates in effect today.

The Final Bill also does not include a means to use NOLs arising in 2020 in the taxpayer’s estimated tax payments. As a result, the taxpayers that wish to carry 2020 NOLs back to prior years must wait until they file their 2021 returns to do so. This choice is unfortunate since most taxpayers have a far greater need for funds now than they will have when they finally file their 2020 returns.



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.

Proposed Bill: Section 2303 of the Proposed 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 Proposed 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.

Final Bill: These provisions remain unchanged in the Final Bill, although this provision has been redesignated as Section 2304 in the Final Bill.

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.

Proposed Bill: Section 2304 of the Proposed 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 Proposed 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.

Final Bill: These provisions remain unchanged in the Final Bill, although this provision has been redesignated as Section 2305 in the Final Bill.

Code Section 163(j) Limitation on Interest Expense Relaxed

Proposed Bill: Section 2305 of the Proposed 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 ATI 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.

Final Bill: Other than being designated as Section 2306 of the Final Bill, the substantive provisions in the Final Bill are identical to the substantive provisions in the Proposed Bill.

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.



Proposed Bill: Section 2306 of the Proposed Bill contains three technical corrections and its effective date is retroactive to the date Congress enacted the TCJA. The Proposed Bill includes the 15-year recovery period for this property. The Proposed 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.

Final Bill: These provisions remain unchanged in the Final Bill, although this provision has been redesignated as Section 2307 in the Final Bill.

Excise Tax Provisions

The Final Bill adds Section 2308, which provides a waiver of the Federal excise tax on distilled spirits used for or contained in hand sanitizer that is produced and distributed in a manner consistent with Food and Drug Administration guidance. Section 2308 applies to spirits removed after December 31, 2019, and is effective only for calendar year 2020.

Section 4007(a) of the Final Bill suspends the air transportation excise tax on amounts paid for transportation of both passengers and cargo after the date of enactment and through December 31, 2020.

Charitable Contribution Limits

Proposed Bill: 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.

Final Bill: The Final Bill includes Section 2205 without changes.

Treasury Is Authorized to Provide Up To \$500 Billion in Liquidity

Section 4003 of the Final Bill grants the Treasury Secretary authority to provide up to \$500 billion in loans, loan guarantees, and “other investments” to support qualifying businesses, states, and municipalities. “Other investments” is open-ended and includes equity interests in qualifying businesses. The Final Bill



specifies that the Treasury Secretary may provide up to \$25 billion to passenger air carriers (and certain related businesses), up to \$4 billion to cargo air carriers, and up to \$17 billion may to “businesses critical to maintaining national security.” The Treasury Secretary may use the remaining amount, along with the above amounts that are not allocated to those specified industries, to eligible businesses, states, and municipalities. Congress intends for this funding to be short-term and no longer than five years. Funding recipients will be charged interest on the amount of the funding that they receive based on the risk and the current average yield of the outstanding marketable obligations of the United States of comparable maturities.

This funding comes with restrictions. Among other things, loan recipients may not buy back stock or pay dividends until 12 months after the loan or loan guarantee is no longer outstanding. Loan recipients must also maintain employment at pre-March 24, 2020 levels through September 30, 2020 “to the extent practicable.” Even if maintaining employment at pre-March 24, 2020 levels is not practicable, loan recipients may not in any case reduce employment by more than 10% below the level on March 24, 2020.

Section 4003(h) of the Final Bill states that loans made or guaranteed by Treasury will be treated as debt for tax purposes and the stated interest on these loans will be treated as qualified stated interest. In addition, Section 4003(h) contains an explicit grant of authority to Treasury to issue guidance providing that any equity issued pursuant to Section 4003 does not result in a Code Section 382 ownership change.

The funding provisions in Section 4003 of the Final Bill are complicated and provide significant direction to Treasury and the Federal Reserve to operate the funding program, which we do not discuss in detail here.

Filing and Payment Extensions Under Notice 2020-18

Prior to Congress’s release of the Proposed Bill, the IRS 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 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.

Update: On March 24, 2020, the IRS released FAQs on Notice 2020-18. Among other clarifications, the FAQs explain that the April 15, 2020, due date for estimated BEAT payments and Code Section 965(h) transition tax installment payments has also been delayed to July 15, 2020. First quarter estimated



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For additional information please contact the authors of this Client Alert or any member of Baker McKenzie's North America Tax Practice Group.

Anne Batter
+1 202 835 6171
anne.batter@bakermckenzie.com

Christopher Hanna
+1 214 978 3422
christopher.hanna@bakermckenzie.com

Stewart Lipeles
+1 650 856 5502
stewart.lipeles@bakermckenzie.com

Alexandra Minkovich
+1 202 452 7015
alexandra.minkovich@bakermckenzie.com

Josh Odintz
+1 202 835 6164
joshua.odintz@bakermckenzie.com

Vivek Patel
+1 202 835 6124
vivek.patel@bakermckenzie.com

income tax payments for the 2020 tax year are similarly postponed from April 15 to July 15.

On March 25, 2020, the IRS issued an additional FAQ extending the time for a Reporting Model 2 Foreign Financial Institution ("FFI") or a Participating FFI to file the FATCA Report (Form 8966) to the IRS. The filing deadline for the FATCA Report (Form 8966) will be extended from March 31, 2020 to July 15, 2020. FFIs are not required to file Form 8809-I, Application for Extension of Time to File FATCA Form 8966, to benefit from this extension.

Next Steps

On Wednesday night, the Senate passed the Final Bill by a vote of 96-0. The House was in recess, but will convene on Friday, March 27, 2020 at 9:00 am to consider the Final Bill. The House leadership expects the Final Bill to pass by voice vote on Friday. Because the President and the majority of the Senate support the Final Bill, we also expect that the House will pass the Final Bill and send it to the President for signature.

Treasury is already planning to issue guidance to help taxpayers take advantage of the tax provisions in the Final Bill, and it will be incumbent on taxpayers to help Treasury and the IRS identify questions that the guidance must address.

We also 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 Final Bill, or at least some version of it.

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