

CARES ACT UPDATE: IRS ISSUES GUIDANCE ON FEDERAL TAX CHANGES

Hodgson Russ Federal-International Tax Alert
April 14, 2020

This is an update to our March 27, 2020 alert summarizing the various federal tax law changes enacted as part of the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). Since, the IRS has been working furiously to issue guidance addressing those federal tax law changes, and we expect further guidance will be issued. Notable recent IRS guidance impacting the business federal tax law changes is addressed below.

Delay of payment of employer payroll taxes – CARES Act Section 2302

Does applying for the Paycheck Protection Program jeopardize the Social Security tax deferral?

The CARES Act provided employers and self-employed individuals the ability to defer payment of the employer share of the Social Security tax obligation (6.2%) for the remainder of 2020 with one-half of the deferred employment tax required to be paid in each of the following two years ending December 31, 2021 and December 31, 2022.

The Act made clear that this deferral was not available to any taxpayer that “has had” indebtedness forgiven as part of the Paycheck Protection Program (PPP) loan. Some cautious practitioners worried that a taxpayer applying for a PPP loan and anticipating forgiveness might jeopardize one or both of these assistance programs if the taxpayer availed itself of the Social Security tax deferral.

Update: In the FAQ released by the IRS on April 10, 2020, the IRS made clear that a PPP loan recipient can still defer the payment of its share of Social Security taxes without penalty through the date the lender issues a decision to forgive the loan. Thereafter, the employer is no longer eligible to defer but any amounts previously deferred will continue to be deferred into 2021 and 2022.

Modifications for net operating losses (“NOLs”) – CARES Act Section 2303

Does a request for a tentative refund apply to 2018 NOLs?

The CARES Act allows NOLs arising in tax years 2018 through 2020 to be carried back to each of the five tax years preceding the loss year. The fastest way to obtain a refund from an NOL carryback is to request a tentative refund by filing Form 1139

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(for corporations) or Form 1045 (for taxpayers other than corporations). Those forms, however, need to be filed within 12 months of the close of the tax year in which the NOL arose, meaning this quick refund procedure was unavailable for losses arising in a taxpayer's 2018 tax year. In other words, taxpayers were unable to take advantage of the expedited tentative carryback procedure for such NOLs and, instead, generally would be required to file an amended return.

Update: In Notice 2020-26, the IRS grants a six-month extension of time to file a Form 1045 or Form 1139, as applicable, to taxpayers that have an NOL that arose in a tax year that began during the 2018 calendar year and that ended on or before June 30, 2019. Thus, for an NOL that arose in a calendar year ending December 31, 2018, the taxpayer now must file the tentative refund claim by June 30, 2020. On the top of the applicable form, "Notice 2020-26, Extension of Time to File Application for Tentative Carryback Adjustment" must be written.

The IRS generally processes those tentative refund claims within 90 days, which ideally means taxpayers will receive much needed liquidity relatively quickly. On April 13, 2020, the IRS released a FAQ which provides as follows regarding the method for filing the applicable form:

"Starting on April 17, 2020 and until further notice, the IRS will accept eligible refund claims Form 1139 submitted via Fax to 844-249-6236 and eligible refund claims Form 1045 submitted via fax to 844-249-6237. Before then, these fax numbers will not be operational. We encourage taxpayers to wait until this procedure is available rather than mail their Forms 1139 and 1045 since mail processing is being impacted by the emergency."

How does a taxpayer apply for a tentative refund claim for an NOL arising in a 2017 straddle tax year?

For taxpayers with NOLs that arose in a tax year beginning before January 1, 2018 and ending after December 31, 2017 (i.e., a 2017 straddle tax year), the CARES Act provides that such NOLs are eligible for the two-year carryback and 20-year carryforward that existed prior to the changes the Tax Cuts and Jobs Act (the "TCJA") enacted for NOLs arising in tax years after December 31, 2017.

Update: Revenue Procedure 2020-24 provides that, for an NOL arising in a 2017 straddle tax year, a taxpayer may apply for a tentative refund on either Form 1045 or Form 1139, as applicable, by July 27, 2020. Also, elections for such tax years with an NOL to waive any carryback period are due by July 27, 2020. A taxpayer files such election where it files its federal income tax return by attaching the statement required to make the election, with "Filed pursuant to Rev. Proc. 2020-24" at the top, to an amended return, Form 1045 or Form 1139 containing only the taxpayer's name, address, and taxpayer identification number. The required statement must indicate the Internal Revenue Code ("Code") section under which the election is being made and must set forth information to identify the election, the period for which it applies, and the taxpayer's basis and entitlement to make the election.

How does a taxpayer elect to waive the NOL carryback?

The CARES Act allows taxpayers to elect to forgo the NOL carryback, and instead treat losses arising in tax years 2018 through 2020 as NOL carryovers.

Update: Revenue Procedure 2020-24 provides guidance to taxpayers regarding this election. Specifically, it provides that a taxpayer may elect to waive the carryback period for an NOL arising in the 2018 or 2019 tax year by attaching a statement to its timely filed federal income tax return for its first tax year ending after March 27, 2020. A taxpayer must include a

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separate statement for each of the tax years (2018 and/or 2019) for which the taxpayer intends to make the election. In addition, the election statement must provide that the taxpayer is electing to apply Code section 172(b)(3) under Revenue Procedure 2020-24 and the tax year for which the statement applies. This election, once made, is irrevocable.

Deductibility of interest expense temporarily increased – CARES Act Section 2306

Can a taxpayer withdraw a real property trade or business election under Code section 163(j)(7)(B) to take advantage of the changes made by the CARES Act?

A taxpayer that qualified as a real property trade or business could elect, pursuant to Code section 163(j)(7)(B), to be excepted from the interest limitation rules under Code section 163(j), generally in exchange for being subject to less favorable depreciation rules, including being ineligible to claim bonus depreciation on certain property. Because the CARES Act (1) temporarily increased the general limitation on the deductibility of interest expense from 30% of adjusted taxable income (“ATI”) to 50% of ATI for tax years beginning in 2019 and 2020, and (2) fixed the retail glitch to treat “qualified improvement property” (“QIP”) as 15-year property, meaning it qualifies for 100% bonus depreciation, taxpayers that elected out of the application of Code section 163(j) may be regretting that decision.

Update: Revenue Procedure 2020-22 provides welcome relief to such taxpayers by allowing taxpayers to withdraw a previously made Code section 163(j)(7)(B) election on a timely filed amended federal income tax return, amended Form 1065, or administrative adjustment request (“AAR”), as applicable, for the tax year in which the election was made, with an election withdrawal statement. The withdrawal statement must be titled “Revenue Procedure 2020-22 Section 163(j)(7) Election Withdrawal,” and it must contain the taxpayer’s name, address, and SSN or EIN, and must state that, pursuant to Revenue Procedure 2020-22, the taxpayer is withdrawing its election under Code section 163(j)(7)(B). The amended federal income tax return, amended Form 1065, or AAR, as applicable, must include the adjustment to taxable income for the withdrawn Code section 163(j)(7)(B) election and any collateral adjustments to taxable income or to tax liability (e.g., the amount of depreciation allowed), including any adjustments under Code section 481. In addition, a taxpayer also must file amended federal income tax returns, amended Forms 1065, or AARs, as applicable, including such collateral adjustments, for any affected succeeding tax years.

The ability to withdraw this election may be particularly relevant for taxpayers that had significant QIP placed in service in 2018 or 2019 that is now retroactively eligible for bonus depreciation.

Revenue Procedure 2020-22 also provides the time and manner for certain taxpayers to make other relevant elections, including the following:

- Making a late election under Code section 163(j)(7)(B) to be an electing real property trade or business;
- Electing out of the 50% ATI limitation for tax years beginning in 2019 and 2020;
- Electing to use the taxpayer’s ATI for the last tax year beginning in 2019 to calculate the taxpayer’s Code section 163(j) limitation for tax year 2020; and
- A partner electing out of the 50% excess business interest expense rule.

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Administrative Guidance for Partnerships Claiming Benefits under the CARES Act

Can partnerships subject to the centralized partnership audit regime file amended returns to access CARES Act provisions?

For tax years beginning after December 31, 2017, partnerships subject to the centralized partnership audit regime (referred to as “BBA partnerships”) generally were prohibited from filing an amended return after the due date of the partnership’s return. Instead, such partnerships generally were required to file an AAR. If an AAR were filed, partners generally would not be able to take advantage of CARES Act benefits from an AAR until they file their current year returns, which could be in 2021.

Update: Revenue Procedure 2020-23 expedites partnerships’ access to the CARES Act provisions by permitting eligible partnerships to file amended returns for tax years beginning in 2018 and 2019. A partnership is eligible for this relief if it filed its Form 1065 and furnished Schedules K-1 to its partners for its tax years beginning in 2018 and 2019 prior to the issuance of Revenue Procedure 2020-23.

To take advantage of this simplified procedure, a partnership must file an amended Form 1065 (with the “Amended Return” box checked) and furnish the corresponding Schedules K-1 to its partners before September 30, 2020. The amended Form 1065 must have “FILED PURSUANT TO REV PROC 2020-23” written at the top and a statement with the same notation must be attached to each Schedule K-1 sent to partners. Notably, such amended returns may take into account both tax changes brought about by the CARES Act and any other tax attributes to which the partnership is entitled to by law.

Employee retention credit for employers subject to closure due to COVID-19 – CARES Act Section 2301

With qualifications, this provision makes available a refundable payroll tax credit for 50 percent of qualified wages paid or incurred by employers to employees from March 13, 2020 through December 31, 2020. The credit is limited to the first \$10,000 of compensation, including health benefits, paid to an employee during such period. The credit is generally available to employers (1) whose operations were suspended in full or in part due to the COVID-19 related shut-down order, or (2) whose gross receipts declined by more than 50 percent when compared to the same quarter in the prior year. For employers with a 2019 average of more than 100 full-time employees, qualified wages are wages paid to employees who are not working due to COVID-19 related shut-down orders. For smaller employers, all wages qualify for the credit, whether the employer was open or closed during the crisis. Special rules apply to tax-exempt entities and otherwise eligible employers are denied the credit if they receive a small business interruption loan authorized under Section 1102 of the CARES Act.

Update: On April 10, 2019, the IRS issued a FAQ regarding the employee retention credit provided under the CARES Act. While the FAQ guidance provides a more reader friendly summary of the provisions of CARES Act Section 2301, it does not especially illuminate any open questions. For instance, Section 2301 of the Act requires either a specific reduction in gross receipts or that operations were “fully or partially suspended...due to order from an appropriate governmental authority limiting commerce, travel, or group meetings...”. The FAQ provides the example of a restaurant which has been restricted to only drive-through or carry-out service. As a more obvious example, the guidance does little to elucidate just how broadly the “fully or partially suspended” test can be interpreted.

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The tax professionals at Hodgson Russ LLP will continue to monitor COVID-19 legislative responses and IRS updates and publish additional client alerts and updates as information becomes available. Please contact Brad Birmingham (716-848-1511) or William Turkovich (716-848-1212) for any questions you may have regarding the above IRS guidance or federal tax law changes in the CARES Act.

Please check our Coronavirus Resource Center and our CARES Act page to access information related to both of these rapidly evolving topics.