Tax Update

Top 5 Opportunities of the CARES Act

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Objective

PROVIDE INSIGHT TO BUSINESS OWNERS ON THE KEY OPPORTUNITIES OF THE CARES ACT, AND THE ACTIONS YOUR BUSINESS CAN TAKE NOW.

Polling question

TOP 5 OPPORTUNITIES

1	PPP – Loans – Tax implications
2	Qualified Improvement Property – Eligible for Bonus
3	Changes to Net Operating Loss (NOL) carryback provision
4	Interest Expense Limitation Changes
5	Employee Retention Tax Credit

PAYCHECK PROTECTION PROGRAM (PPP) LOANS

Background:

Provide forgivable loans to small business to pay their employees during the COVID-19 Crisis

To be forgiven:

- Loans must be used at least 60% on payroll, and non-payroll costs of rent, mortgage interest, and utilities
- Borrower generally must restore full-time employment & salary levels by December 31, 2020 (exceptions apply)
- Borrower submits loan forgiveness application within 10 months of completion of the Cover Period

PAYCHECK PROTECTION PROGRAM (PPP) LOANS

Tax considerations:

- Forgiveness of PPP debt is excluded from income (tax exempt income)
- Expenses paid with PPP loans are nondeductible (paid with tax exempt income)

State conformity:

- NH, MA – Forgiven PPP Loan included in taxable income for state tax purposes. Deduction allowed for expenses paid with forgiven PPP Loans
- ME – Same as NH & MA, Administrations considering proposed legislation to conform to Fed on PPP loan forgiveness

PAYCHECK PROTECTION PROGRAM (PPP) LOANS

What action can you take now?

QUALIFIED IMPROVEMENT PROPERTY

Background:

(Old law) Qualified improvement Property (QIP) includes –

- Any improvement to the interior portion of nonresidential building
- Depreciated over **39 years**

Does not include:

- Improvements for enlargement of the building
- Elevators or escalators
- Internal structural framework of building (i.e. load-bearing walls and structural supports essential to the stability of building)

QUALIFIED IMPROVEMENT PROPERTY

CARES Act opportunity:

Qualified improvement Property (QIP) depreciated over **15 years an eligible for 100% bonus depreciation**

- Changes apply retroactively to property place in service in 2018
- Taxpayers can apply 100% bonus depreciation to QIP on their 2019 return
- For QIP place in service in 2018 or 2019 taxpayers may either file amended return to take the deduction
- Or – File Form 3115 with current return to take deduction

QUALIFIED IMPROVEMENT PROPERTY

What action can you take?

Amend prior year return to receive immediate benefit

- OR -

File Form 3115 with 2020 return to fully expense QIP placed in service in 2018 & 2019.

QUALIFIED IMPROVEMENT PROPERTY: AMENDING VS. FORM 3115

Filing Form 3115

Pros:

- Take deduction with current return
- Lower compliance burden on flow through entities

Cons:

No immediate benefit until you file 2020 return

QUALIFIED IMPROVEMENT PROPERTY: AMENDING VS. FORM 3115

Amending

Pros:

- Immediate benefit in the form of refund

Cons:

- If flow-through entity, heavy compliance burden
- Open to statute of limitations
- Long processing times (16 weeks)

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NET OPERATING LOSSES (NOL)

Background:

NOLs were only allowed to be carried forward, carryback of NOLs disallowed

CARES Act Opportunity:

NOL arising in tax years beginning after 12/31/2017 and before 01/01/2021 can be carried back up to five years preceding the year of loss.

NET OPERATING LOSSES (NOL)

Background:

(Old law) NOL deduction limited to 80% of taxable income (could not fully offset taxable income)

CARES Act opportunity:

- For tax years beginning before 2021, NOL deduction equal to 100% of taxable income.
- For tax years beginning after 2021, a 100% NOL deduction of NOLs arising in tax years prior to 2018 and a 80% modified taxable income deduction for NOLs arising in tax years after 2017.

NET OPERATING LOSSES

What action can you take?

If possible carry losses generated in 2018 – 2020 back to tax years before 2018 to received 35% benefit. (i.e. 35 cents for every dollar of deduction)

For NOL incurred in 2019 File Form 1045 for a quick refund related to the NOL carryback claim. (Must file form within 1 year after the year in which the NOL arose)

INTEREST EXPENSE LIMITATION §163(J)

Background:

(Old law) Interest allowed as deduction limited to 30% of adjusted taxable income (ATI)

- Taxpayer could avoid interest limitation by making a *Electing Real Property Trade or Business Election* (ERPTB).
- The election was irrevocable – and the taxpayer elected to be subject to reduced depreciation deductions using an alternative depreciation method.

INTEREST EXPENSE LIMITATION

CARES Act opportunity:

- Limitation increased from 30% to 50% for tax years that begin in 2019 or 2020.
- This means S Corporations and C Corporations will be able to deduct more interest expense in 2019 & 2020.
- Taxpayers can elect to use ATI of 2019 for 2020 limitation.

Special rule for partnerships:

For 2019 still subject to 30% ATI limitation. Partner will be able to deduct half of excess business interest expense allocated to them in 2019 on their 2020 return.

For 2020 the ATI limitation is increased to 50% for partnerships

INTEREST EXPENSE LIMITATION

What action can you take?

Businesses that elected an alternative depreciation method to avoid the interest expense limitation in 2018 & 2019 may want to withdraw election and amend returns to take advantage of the increased limitation.

Considerations:

- Which deduction is greater: disallowed interest expense or foregone depreciation expense?
- QIP not eligible for bonus for taxpayers that made the ERPTB

Polling question

EMPLOYEE RETENTION CREDIT

Refundable payroll tax credit discussed by our colleagues Bill Enck and Kristin Courtemanche

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