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CARES Act v. TCJA; Juxtaposed or Aligned?

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The Internal Revenue Code has one constant; it will always be subject to modification or change. The evolution of the US economy or a change in administration are the two most common forces that will precipitate this change. From 1913 with the ratification of the 16th amendment to the Jobs Act of 2012, this country has seen amendments through tax reform adopted by various sitting administrations. Most of the reform that has been seen from the Kennedy administration forward to the Tax Reform Act of 1986 and later the Tax Cuts and Jobs Act of 2017 have been focused on tax rate reduction.

The Tax Cuts and Jobs Act of 2017 ("TCJA") demonstrates the argument of an ever-changing tax code. The TCJA adjusted the rate structure for individuals and corporations, along with deductions, credits, exclusions as well as provided new taxes for international business activity. In addition, certain aspects of the TCJA were written in to achieve simplification for the tax payer. Certain amendments sunset in 2025 while most of the TCJA is permanent. Notwithstanding the TCJA changes, temporary changes have already been layered on top with the CARES Act of 2020. The COVID-19 pandemic unquestionably changed the economic landscape of the US economy forcing the Federal and certain State governments to put into place changes that would mitigate the financial and social impacts of the pandemic. The CARES Act loosens several business tax restrictions imposed by the TCJA, rescinding them not only for 2020 but also retroactively.

Careful consideration of these aforementioned aspects of the tax code present two simple questions; how impactful is the TCJA on this new economy that we are now

operating in and will some of the CARES Act temporary amendments become permanent. The pandemic, by most accounts is a temporary phenomenon. However, the changes to the economy and the duration of the recovery remains to be seen. Even more uncertain is which industries will need a dramatic shift in their business model, which will continue to operate under the status quo and which will ultimately fail. Fundamental to this comparison is understanding whether the intersection of the TCJA and the CARES Act creates planning opportunities beyond the relief the Trump Administration contemplated through these amendments. Those planning opportunities should be built upon the principle of maximizing the business entities' IRR with the foundation of an uncompromising degree of tax compliance.

The most significant TCJA and related CARES Act amendments are those relative to business operations. The largest of these measures, accounting for almost 30 percent of total CARES Act tax cuts, allows pass-through business owners to offset active losses against other forms of income, such as wages and investments, without limit.[1] The CARES Act also eases TCJA limits on net operating loss (NOL) carrybacks and interest deductions. These changes are unlikely to boost business investment but should improve cash flow, which will help some businesses weather the downturn. These measures are expected to cost $101 billion over the next two years, but just $40 billion over the 10-year budget window, since increased carrybacks of losses and current deductions for interest paid reduce future deductions when these items can be carried forward to future tax years.[2]

The CARES Act amends the TCJA's standards on how a taxpayer can utilize its NOL's. Under the TCJA the business taxpayer could only carry forward the NOL's and the application was limited to eighty (80%) percent of the pretax income of the business taxpayer. The CARES Act now provides for a two-year carryback as well as the carryforward and places the limitation on the NOL utilization to one hundred (100%) percent of the business taxpayer's pre-tax income. For the business taxpayer whom has been historically in the higher tax bracket of thirty-four (34%) percent, TCJA year

[1] Thorton Matheson, Who Benefits from the CARES Act Tax Cuts? Tax Policy Center – Urban Institute & Brookings Institute, April 17, 2020
[2] Id

losses carried back can potentially generate an incrementally higher benefit then the TCJA would afford, given its' twenty-one (21%) highest marginal tax rate.

This added flexibility of NOL utilization creates a number of tax planning opportunities. How to apply the NOL under this new amendment will be predicated in the optimization of the business IRR. Take for example the newly created controlled foreign corporation. Under the current regulatory framework those losses are ostensibly trapped at the foreign subsidiary level. Moreover, under the TCJA, these losses would be limited and only available for future taxable earnings at the foreign subsidiary level. Under the current economic conditions created through the pandemic, these foreign operations are probably sustaining higher losses than contemplated. The business taxpayer who generated losses greater than planned in 2020, on this newly created foreign operation, can make an election to treat the foreign operations as a branch[3]. The branch status then permits pass through of income or losses to the S Corp. parent and therefore utilization of the NOL carryback, under the CARES ACT amendment. The election to make this change from a foreign subsidiary to a branch can be done with a check the box election on form 8832.[4] Once the operations do return to profitability, the business taxpayer will probably consider recategorizing the foreign subsidiary and a controlled foreign company. This can be done however it will not be without consequence. The transfer will be subject to §367(a)(3)(c) and T.R. §1.1503-2(g)(2), which would recapture the loss and reduce any gain into ordinary income. This additional tax should not discourage a taxpayer from taking advantage of the opportunity the CARES Act is providing.

The utilization of an NOL in a carryback situation for the International business taxpayer also requires analysis. Under the TCJA a number of additional tax calculations are now required and should be modeled together with any NOL elections or other CARES Act elections in determining the impact to the business taxpayer's overall IRR. The global intangible low taxed income ("GILTI"), the foreign derived

[3] Robert Misey, JD, LLM, Reinhart Boerner Van Deuren, s.c. Taking Advantage of Foreign Losses on Form 8832, April 2020

[4] Internal Revenue Service Rev proc. 2009-41 and 2013-30

intangible income ("FDII") and base erosion anti-abuse tax ("BEAT") were all enacted under the TCJA.

Turning to the next important element, the business taxpayer should evaluate how it will make elections in depreciating assets. Under the TCJA the taxpayer may take all or a significant portion of the depreciable base of a capital asset acquired as deductible deprecation expensed. The first significant opportunity under the TCJA is an election under § 179. Upon election to expense certain depreciable business assets any cost so treated shall be allowed as a deduction for the taxable year in which the §179 property is placed in service.[5] There are limitations under this election. The first being that the aggregate cost which may be taken into account under § 179 for any taxable year shall not exceed $1,000,000. This shall be reduced (but not below zero) by the amount by which the cost of §179 property placed in service during such taxable year exceeds $2,500,000. Finally, the §179 deduction shall not exceed the aggregate amount of taxable income of the taxpayer for such taxable year which is derived from the active conduct by the taxpayer of any trade or business during such taxable year.

Alternative to §179 a taxpayer can elect to make a deduction for bonus deprecation if certain requirements are met. Under the TCJA IRC §168(k) was amended to increase the bonus depreciation percentage from 50% to 100% for qualified property and to modify the definition of property that is considered to be qualified.[6] The TCJA allows businesses to immediately deduct 100% of the cost of eligible property in the year it is placed in service, through 2022. The amount of allowable bonus depreciation is then phased down over four years: 80% will be allowed for property placed in service in 2023, 60% in 2024, 40% in 2025, and 20% in 2026. (For certain property with long production periods, the above dates will be pushed out a year.) Bonus depreciation is also allowable for specified plants planted or grafted after Sept. 27, 2017, and before Jan. 1, 2027. In considering the accelerating the depreciation deduction, the CARES Act made a technical correction to the TCJA providing for Qualified Improvement Property to be included in the basis for calculating bonus deprecation and §179 deductions.

[5] 26 U.S. Code § 179
[6] (TCJA), P.L. 115-97

In this current business environment, with expectations of lower than normal profits, the need for accelerating deductions will probably not be critical. In fact, this poses an interesting phenomenon. The business taxpayer could forgo the bonus deprecation deduction or even the accelerated methods provided under §179(a), since it will have either lower or no taxable income. This would create opportunity in the future as any disposition or sale of the capital asset would have lower deprecation recapture and/or capital gain as the result of the higher tax basis.

The final major element of the TCJA subject to this analysis is interest expense incurred by the business taxpayer. Under the TCJA the interest expense deduction is limited to 30% of the adjusted taxable income of the business taxpayer for such taxable year.[7] The amount of interest determined not to be allowed as a deduction for any taxable year shall be treated as business interest paid or accrued in the succeeding taxable year.[8] The CARES Act amends the limitation from the 30% noted above to 50%. The additional leverage that business taxpayer will be taking on in order to finance the business disruption caused by the pandemic will have the added benefit of deducting more of its' interest expense if applicable.

The CARES Act provides a number of new tax planning strategies that enable the business taxpayer to better pivot to the current business environment. Most of which are acceleration of the timing of deductions. Unlike the direct grants and credits made available under the CARES Act, the tax amendments require an analysis of how to best apply these amendments in bolstering the business taxpayer's IRR.

[7] 26 U.S. Code § 163(j)(1)

[8] 26 U.S. Code § 163(j)(2)