Tax Provisions in the CARES Act (COVID-19 "Phase 3" Response): Preliminary Analysis and Observations

March 27, 2020

kpmg.com

This report reflects developments as of 8 PM EDT on March 26, 2020.

Introduction

Overview

Congress has already enacted two coronavirus relief bills and is poised to enact a massive "phase 3" bill, reportedly with a cost approaching two trillion dollars. This third bill, the "Coronavirus Aid, Relief, and Economic Security Act" (CARES Act), includes a significant number of tax items applicable to individuals and businesses.

Legislative process

The U.S. Senate on March 25 passed the CARES Act—H.R. 748 – unanimously (96-0). The four Senators not voting were self-quarantined due to confirmed or suspected exposure to the coronavirus.

- Read **H.R. 748, the CARES Act** [PDF 1.08 KB] (880 pages)
- Read a revenue estimate provided by the Joint Committee on Taxation (JCT): **JCX-11-20**

With Senate approval, the bill now moves to the House of Representatives. Consideration of the bill is scheduled to begin at 9 a.m. on Friday, March 27, 2020. The bipartisan result in the Senate suggests approval in the House as well, although there is no guaranty this will be the case.

Legislative action in the House is complicated by the fact that most members of the House are in their home districts, rather than in Washington, D.C. The House could approve the "phase 3" legislation by unanimous consent of those House members present or by voice vote of those present (instead of a roll call vote)—other alternatives such as proxy voting, may require changes to the House rules.

President Trump has indicated that he would sign the legislation once approved by the House.

This document

As noted above, the CARES Act legislation includes a number of significant tax provisions for both individuals and for businesses.

This document outlines in greater detail significant tax provisions in the CARES Act along with KPMG's initial observations where relevant. This document is organized as follows:

Contents

Delays in general tax filings and payments

There is no provision in the legislation statutorily delaying the general filing and payment deadlines. Instead, the Treasury and the IRS recently issued guidance on these matters, summarized below. The bill, however, does include other procedural rule changes, including a delay in employer and self-employer payroll taxes.

IRS Notice 2020-18 (March 20, 2020), superseding Notice 2020-17

Notice 2020-18 was issued under authority of section 7508A(a), following the Presidential Emergency Declaration regarding COVID-19.

The notice postpones the filing date of specific federal income tax returns and the due date of specific federal income tax payments due on April 15, 2020 until July 15, 2020 for any person with a federal income tax return filing requirement or payment due April 15, 2020. Affected taxpayers, meaning those entitled to relief under the notice, do not have to file extension Forms 4868 or 7004 to qualify for the automatic three-month postponement relief described in Notice 2020-18.

The notice places no limitation on the amount of payment that may be postponed.

The relief in the notice applies only to federal income tax returns and tax payments (including payments of tax on self-employment income) with respect to the 2019 tax year, and federal estimated income tax payments (including payments of tax on self-employment income), due on April 15, 2020 for the 2020 tax year. Forms and schedules attached to and filed with federal income tax returns are covered by the relief afforded under the notice. There is no postponement in the notice for the payment or deposit of any other type of federal tax, for example excise taxes, or for the filing of any federal information return.

The use of the term "postponement" in the notice means that the IRS will disregard the period from April 15, 2020 to July 15, 2020 in calculating interest, penalties, and additions to tax.

Interest, penalties, and additions to tax on postponed federal income tax filings and tax payments will begin to accrue on July 16, 2020.

IRS FAQs (March 24, 2020)

If a federal income tax return for a fiscal year ending during 2019 is due on April 15, 2020, whether that is the original due date or the due date on extension, the due date is postponed to July 15, 2020. The April 15, 2020 due date for income tax filings and payment is the only due date that is entitled to relief under the notice and the FAQs.

The series of forms entitled to postponement relief include forms in the following forms or series of forms (check the FAQs for the exact form or forms): Form 1040 series, Form 1041 series, Form 1120 series, Form 8960, Form 8991, and Form 990-T.

Returns due on March 16, 2020, including returns filed on Form 1065, 1065-B, Form 1066, and Form 1120-S for calendar year taxpayers are not entitled to postponement relief.

Taxpayers who are otherwise entitled to relief under Notice 2020-18 can file a request for an automatic extension to file their income tax returns (Forms 4868 or 7004) on or before July 15, 2020 to extend the due date of their returns until October 15, 2020. Individuals filing Forms 4868 must properly estimate their taxes due and pay the estimated taxes due along with their extension requests in order to avoid interest and penalties. Form 7004 does not extend the time to pay any tax due.

Notice 2020-18 does not postpone the time to file Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax.

Because section 965(h) installment payments due dates are based on return due dates, Notice 2020-18 also postpones the due date of section 965(h) installment payments to July 15, 2020 to the extent the federal income tax filing requirement has been postponed from April 15, 2020 to July 15, 2020.

Business general

Delay in employer and self-employment payroll taxes

The bill allows employers and self-employed individuals to defer payment of the employer share (6.2%) of the social security tax they otherwise are responsible for paying in 2020, effective for payments due after the date of enactment. Fifty percent of the deferred payroll taxes are due on December 31, 2021, and the remaining amounts are due on December 31, 2022. Special rules deal with the acts of third parties and certified professional employer organizations.

KPMG observations

It appears that more guidance may be required on the procedural details of this provision in order to effect operation.

The CARES Act establishes two important lending programs: the paycheck protection program ("PPP") administered by the Small Business Administration ("SBA") and the Treasury Department's economic stabilization fund. The CARES Act provides that a taxpayer who receives a PPP loan and also applies for the loan forgiveness feature of the PPP is not eligible for the payroll tax payment deferral. Thus, taxpayers may want to take into account the potential interaction between the PPP and payroll tax payment deferral in determining whether and how to claim benefits under the CARES Act.

Employee retention payroll tax credit for certain businesses

The bill provides a refundable payroll tax credit for 50% of wages paid by certain employers to employees. The bill provides the credit is available to eligible employers carrying on a trade or business in calendar year 2020 whose:

- Operations were fully or partially suspended during the calendar quarter to comply with orders from an appropriate government authority due to the COVID-19 crisis, or
- Gross receipts declined by more than 50% when compared to the same quarter in the prior year.

In the case of an employer that qualifies by virtue of the gross receipts test, eligibility ceases at the end of the calendar quarter in which gross receipts are greater than 80% of gross receipts for the same calendar quarter for the prior year. For tax-exempt entities, they are eligible if their operations are fully or partially suspended due to COVID-19.

The credit is for "qualified wages." For employers with greater than 100 full-time employees, qualified wages are wages paid to employees when they are not providing services due to COVID-19 circumstances. For eligible employers with 100 or fewer full-time employees, all employee wages qualify for the credit. Average number of full-time employees is determined based on 2019 under section 4980H rules.

Qualified compensation is limited to the first $10,000 of compensation, including health benefits, paid to the employee. Thus, the maximum credit is $5,000 (50% of $10,000) per employee. The credit is refundable to the extent it exceeds the employer portion of social security taxes reduced by the paid sick leave and paid extended FMLA established by the Coronavirus "Phase 2: legislation. The provision is effective for wages paid or incurred from March 13, 2020 through December 31, 2020.

KPMG observations

It appears that the bill uses Sections 52 and 414 aggregation rules to determine which entities are treated as a single employer; likely employers can leverage existing use of these rules in the qualified plan context to identify themselves as a single employer for purposes of this provision.

Under the CARES Act, the employee retention payroll tax credit is not available to an employer who receives a loan under the PPP. Thus, eligible taxpayers may claim the employee retention tax credit or receive an SBA loan under the PPP, but not both. (Note that the "exception" from the employee retention credit for employers receiving loans under the PPP is similar, but not identical, to the "exception" from payroll tax deferral for taxpayers who receive PPP loans and also apply for loan forgiveness under the PPP).

Temporary changes to business interest expense disallowance rules (section 163(j))

Background

As section 163(j) stood before enactment of the bill, in any given tax year, a taxpayer could deduct business interest only up to the sum of:

- The taxpayer's business interest income for the tax year,
- 30% of the taxpayer's adjusted taxable income ("ATI") for the tax year, plus
- The taxpayer's floor plan financing interest for the tax year.

For these purposes, ATI equals a taxpayer's taxable income computed without regard (i) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business, (ii) business interest or business interest income, (iii) the amount of any net operating loss ("NOL") deduction, (iv) the 20% deduction for certain passthrough income, and (v) in the case of tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion.

Generally speaking, business interest that is not allowed as a deduction is carried forward indefinitely.

Temporary changes made by the bill

As indicated below, the bill makes several temporary changes to section 163(j). These amendments apply to tax years beginning after December 31, 2018.

50% of ATI: For tax years beginning in 2019 and 2020, the 30% limit on ATI is increased to 50%.

Partnerships: The 50%-instead-of-30% ATI rule does not apply to a partnership tax year beginning in 2019, but (unless a partner otherwise elects out) for any of the partnership's 2019 excess business interest expense that is allocated to a partner under section 163(j)(4)(B)(i)(II):

- 50% of that excess business interest expense will be treated as business interest that is paid or accrued by the partner in its first tax year beginning in 2020 and will not subject to the limits of section 163(j)(1) and is thus deductible in such tax year (subject to any other limitations that may apply), and
- The other 50% will be subject to the limitations of section 163(j)(4)(B)(ii) in the same manner as any other excess business interest so allocated.

Electing out of the 50%-of-ATI rule: Taxpayers can elect not to have the 50%-of-ATI rule apply to any tax year. Such an election will need the Secretary's consent to be revoked. This is a partnership-level election and may be made only for tax years beginning in 2020.

Using 2019's ATI in 2020: For any tax year beginning in 2020, taxpayers can elect to use their ATI from their last tax year beginning in 2019 for their ATI in the 2020 tax year. This is a partnership-level election. If such an election is made for a short tax year, the taxpayer's 2019 ATI will be prorated.

KPMG observation

The increase in the ATI limit from 30% to 50% would allow taxpayers to deduct more of their business interest and, as a result, reduce their tax liability for tax years beginning in 2019 (except for partnerships) and 2020. While a partner would not benefit from the increased section 163(j) limitation for a partnership's business interest expense until 2020, the ability to deduct 50% of the partner's 2019 excess business interest expense in 2020 may, in certain circumstances, result in a greater aggregate interest expense deduction. Certain partnership transactions, however, such as the disposition of a partnership interest with respect to which the partner had excess business interest expense in 2019, may preclude a partner from deducting the excess business interest expense in 2020.

For those taxpayers that recognize an NOL in 2019 or 2020, the ability to deduct additional business interest expense would increase the NOL. Taxpayers with an NOL may be able to recognize the benefit from the additional interest deduction through their NOL carryback potentially to a pre-tax reform tax year, reducing income taxed at a higher rate. In the case of an individual, the excess business loss limitation will no longer apply to tax years beginning prior to 2021.

The ability to use 2019 ATI for 2020 would be welcome news for taxpayers that may face reduced earnings in 2020. As taxpayers prepare their 2019 tax returns, they should be mindful of certain positions taken in 2019 (e.g., elections, method of accounting changes) that impact the calculation of both their 2019 and 2020 section 163(j) limitation.

Changes to NOL rules, including NOL technical correction

The bill includes several changes to the net operating loss (NOL) rules.

Five-year carryback of NOLs generally permitted for 2018, 2019, and 2020

The bill grants taxpayers a five-year carryback period for NOLs arising in tax years beginning after December 31, 2017 and before January 1, 2021 (i.e., calendar years 2018, 2019, and 2020).[1] Taxpayers may elect to relinquish the entire five-year carryback period with respect to a particular year's NOL, with the election being irrevocable.[2]

KPMG observation

As a result of the extended carryback provision, a corporation can carry back its 2018, 2019, and 2020 NOLs to offset pre-2018 ordinary income or capital gains that were taxed at rates of up to 35%, thereby generating a current refund and a favorable rate differential. In addition, taxpayers with significant carryback capacity that anticipate generating losses into calendar year 2021 might consider altering their tax years, for example to a November 30 year-end, to ensure that some portion of calendar year 2021 is within a tax year that starts prior to January 1, 2021. The bill does not modify the rules relating to capital losses, which continue to qualify for three-year carryback and five-year carryforward periods.

Taxpayers may also obtain permanent cash tax savings by filing accounting method changes for either 2019 or 2020 to accelerate deductions or defer revenue and increase the NOLs in those years. Under the bill, the NOLs can be carried back to higher tax rate, profitable years (for example, the 35% corporate rate in effect prior to 2018). Another option is to file reverse planning method changes (i.e., to defer deductions or accelerate revenue) for 2019 and thereby generate greater losses in 2020 and allow for a correspondingly greater NOL carryback amount. Note also that certain disaster losses sustained in 2020 may be reported on either the 2019 or 2020 return under section 165(i) and contribute to NOLs for either year.

We note that one consequence of carrying back losses to earlier years is that various calculations for those carryback years will need to be redone. For example, a carryback of an NOL to 2018 or 2019 could require a recalculation of various taxable income limitations applicable in the carryback year, such as the section 163(j) interest deduction limitation and the section 250(a)(2) limitation on the global intangible low-taxed income ("GILTI")/foreign-derived intangible income ("FDII") deduction.

The bill provides that life insurance companies treat loss carrybacks to pre-2018 tax year as operating loss deduction carrybacks (a special type of loss deduction allowed to life insurance companies under section 810 as in effect in those years).[3]

---

[1] Bill, section 2303(b)(1), adding section 172(b)(1)(D)(i) to the Code. Under the timing rules of section 172(b)(2) and Treas. Reg. § 1.172-4(b)(1), losses that are carried back are carried to the earliest of the tax years to which the loss may be carried.

[2] Section 172(b)(3). Elections to forgo the five-year carryback of NOLs arising in tax years beginning in 2018 and 2019 must be made by the due date (including extensions) for filing the taxpayer's return for the first tax year ending after the date the bill is signed into law. Bill section 2303(b)(1), adding section 172(b)(1)(D)(v)(II) to the Code. Elections to forgo the five-year carryback of NOLs arising in tax years beginning in 2020 must be made by the due date (including extensions) for filing the return for the tax year of the loss (e.g., 2020). Section 172(b)(3).

[3] Bill, section 2303(b)(1), adding section 172(b)(1)(D)(iii) to the Code.

In general, as a result of the bill (including the provisions discussed below), there are now three buckets of federal NOLs, as shown in the following table:

NOL Generated in Tax Years	Eligible for Carryback	Eligible for Carryforward	Eligible to Offset % of Taxable Income
Beginning on or before December 31, 2017	Two tax years	20 tax years	100% of taxable income
Beginning after December 31, 2017 and beginning before January 1, 2021	Five tax years	Indefinite	100% of taxable income (prior to 2021) 80% of taxable income (after 2020)
Beginning on or after January 1, 2021	Generally, no carryback	Indefinite	80% of taxable income

Limitations on use of carrybacks by REITS

Under the bill, (1) NOLs of a taxpayer may not be carried back to any year in which the taxpayer was a real estate investment trust (REIT), and (2) NOLs of a REIT may not be carried back to any tax year, regardless of whether the taxpayer was a REIT in that tax year.

Suspension of NOL 80% of taxable income limitation for 2018-2020

Prior to its amendment by the 2017 legislation commonly called the Tax Cuts and Jobs Act (or "TCJA"), section 172(a) allowed taxpayers to claim an NOL deduction in an amount equal to the aggregate of the NOLs that could be carried forward and back to that year. The TCJA altered this rule by imposing an 80% of taxable income limitation on the use of NOLs, which applied to NOLs arising in tax years beginning after December 31, 2017.[4] Pre-TCJA law continued to apply to NOLs arising in pre-effective date years.[5]

The bill temporarily suspends the 80% of taxable income limitation on the use of NOLs for tax years beginning before January 1, 2021, thereby permitting corporate taxpayers to use NOLs to fully offset taxable income in these years regardless of the year in which the NOL arose.

KPMG observation

[4] Section 172(a), under the TCJA and prior to its amendment by the bill, allows a taxpayer to claim an NOL deduction for a tax year in an amount equal to the lesser of (i) the taxpayer's NOL carryovers to the year, or (ii) 80% of the taxpayer's taxable income for the year, computed without regard to the NOL deduction.

[5] The application of this limitation in a tax year in which the taxpayer would be able to claim both pre-TCJA and post-TCJA NOLs was addressed in a prior ***What's News in Tax*** article.

The bill's suspension of this limitation is retroactive. A taxpayer whose utilization of NOLs was affected by the 80% limitation should consider the impact of this change. For a calendar year taxpayer without a short period, the removal of the 80% limitation could potentially affect its deduction on its 2019 return for NOLs generated in 2018.

Reinstatement of NOL 80% taxable income limitation in 2021 – Modified calculation

The bill reinstates the NOL 80%-of-taxable-income limitation for tax years beginning after December 31, 2020. This limitation will apply with respect to the use of post-TCJA NOLs (i.e., NOLs arising in tax years beginning after December 31, 2017).[6] In addition, the bill makes two changes to this limitation, the first of which is a potentially unfavorable technical correction, and the second of which is a substantive change that can be either favorable or unfavorable, depending on the taxpayer's circumstances.

First, incorporating a technical correction to the TCJA, the bill provides that the limitation is to be calculated based on 80% of taxable income after giving effect to the use of pre-2018 NOLs.[7] In other words, taxable income for this purpose is to be determined after reduction to reflect absorption of pre-TCJA NOLs. Second, the bill provides that taxable income for purposes of section 172(a) is determined without giving effect to the deductions for qualified business income, FDII and GILTI under sections 199A and 250, respectively.

KPMG observation

The bill's directive to calculate the 80% limitation without regard to the section 250 deduction for GILTI and FDII is consistent with the approach taken by the government in proposed regulations, and precludes other, potentially more favorable approaches to administering the interaction of the circular taxable income limitations in sections 172 and 250.[8]

Calculating taxable income without regard to deductions under section 250 for purposes of the 80% limitation under section 172 is likely to be favorable to taxpayers whose section 250 deductions are not expected to be income limited.

> **Example 1:** Assume in 2021 a corporate taxpayer has $140 of regular taxable income from operations, plus $10 of GILTI, and also has a $180 NOL carryforward from the prior year (e.g., an NOL carryover subject to the 80% limitation). The taxpayer's tentative section 250 deduction is $5 (50% of its $10 of GILTI). For simplicity, assume the taxpayer has no FDII and has not deducted any interest expense (i.e., the section 163(j) limitation is inapplicable).

---

[6] NOLs arising in tax years beginning before January 1, 2018 are not subject to the 80% of taxable income limitation. Bill section 2303(a)(1), adding section 172(a)(2)(A) of the Code.

[7] This technical correction was discussed in a prior ***What's News in Tax*** article.

[8] The government has issued proposed regulations addressing the circularity in taxable income calculations under the NOL and section 250 provisions. *See* REG-104464-18, *Deduction for Foreign-Derived Intangible Income and Global Intangible Low-Taxed Income*, 84 Fed. Reg. 8188 (March 6, 2019) (proposing Treas. Reg. §§ 1.250(a)-1(b)(2), -1(c)(4), -1(f)(2) (*Example 2*(ii)(C)), and 1.250(b)-1(d)(2)(ii)). This new ordering rule stands in contrast to the use of simultaneous linear equations (or iterative calculations) to resolve the circularities inherent in the multiple taxable income limitations enacted as part of the TCJA. The simultaneous equations approach is discussed in a prior ***What's News in Tax*** article.

The NOL that would be allowable is limited to 80% of taxable income computed without regard to the section 250 deduction, or $120 (80% x $150). The taxpayer's GILTI deduction is $5; this is less than the taxable income limitation in section 250(a)(2) because the taxpayer's GILTI ($10) is less than its taxable income determined without regard to the section 250 deduction ($150-120). The taxpayer is better off under the bill because its NOL deduction is increased by $4 (80% of the additional $5 in taxable income due to the add-back of the GILTI deduction) and its GILTI deduction is not reduced under the taxable income limitation of section 250(a)(2). Because post-TCJA NOLs may be carried forward indefinitely, the benefit associated with the more rapid use of post-TCJA NOLs is a matter of timing and cash flow.

However, this change is expected to be unfavorable for taxpayers whose deduction for GILTI and/or FDII is or becomes subject to section 250's taxable income limitation. Because the bill effectively stacks the NOL deduction before the section 250 deduction, certain taxpayers may find that they can deduct more of their post-TCJA NOLs, but at the cost of a smaller section 250 deduction. This can be detrimental – while post-TCJA NOLs subject to the 80% limitation can be carried forward indefinitely, section 250 deductions are on a "use or lose" basis, meaning that to the extent an expanded NOL deduction "crowds out" a section 250 deduction, a taxpayer's total deductions over time are expected to be reduced.

Example 2: Assume in 2021 a corporate taxpayer has $100 of regular taxable income from operations, plus $50 of GILTI, and also has a $180 NOL carryforward from the prior year (e.g., an NOL carryover subject to the 80 percent limitation). For simplicity, assume the taxpayer has no FDII and has not deducted any interest expense (i.e., the section 163(j) limitation is inapplicable). Under the rules in effect immediately prior to the Bill and employing a simultaneous or iterative equations approach (in lieu of the approach under the proposed FDII regulations), the taxpayer's section 250 deduction is $25 (50% of its $50 of GILTI) and its NOL deduction is $100 (80% of $125, being $150 less the $25 deduction for GILTI).[9] In contrast, under the bill, the allowable NOL deduction is based on the 80 percent of taxable income limitation computed without regard to the section 250 deduction, or $120 (80% x $150), and the taxpayer's GILTI deduction would be capped at $15 (50% x ($150-$120)). The taxpayer's taxable income after the deductions would be $15 under the Bill ($150 - $120 - $15), which is less than the $25 it would be under the rules in effect immediately before the bill ($150 - $100 - $25). However, in this example, the additional $20 NOL deduction in 2021 comes at the cost of displacing (and thus permanently losing) $10 of GILTI deductions.

Technical correction for fiscal year filers with an NOL arising in the 2017-2018 straddle year

Taxpayers with a tax year straddling December 31, 2017 found themselves unable to carry back losses generated in that straddle year because the TCJA provision that generally terminated the ability to carry back NOLs was made applicable to losses in tax years *ending* after December 31, 2017.[10] This was an apparent drafting error; for example, the accompanying conference report described the carryback provision as applying to losses arising in tax years *beginning* after that date.[11]

[9] Under the 80% limitation prior to its amendment by the bill, the NOL limitation would be based on the taxpayer's taxable income of $150 less its deduction for GILTI. If the GILTI deduction were $25 (50% of $50), the NOL limitation would be $100 (80% x ($150-$25)). Thus, the taxpayer would have taxable income of $25 ($150 - $100 - $25).
[10] Section 13302(e) of the TCJA, prior to its amendment by section 2303(c)(1) the bill.
[11] H. Conf. Rep't. No. 115-466, at p. 394 (December 15, 2017).

The bill corrects the effective date provision, with the result that NOLs that arose in a tax year that straddled December 31, 2017 (a tax year beginning before January 1, 2018 and ending after December 31, 2017) are eligible for the two-year carryback period and 20-year carry forward period of the pre-TCJA law.[12] Affected taxpayers are given 120 days after the date the bill is signed into law to file an application under section 6411(a) for a carryback of that loss, or to elect to forgo the carryback under section 172(b)(3).[13]

Interaction with section 965 transition tax years

The bill provides two special rules for NOL carrybacks that are carried to years in which the taxpayer included income from its foreign subsidiaries under section 965. Most commonly, this would be the taxpayer's 2017 tax year or, in cases of calendar year taxpayers with foreign subsidiaries that had made the one-month deferral election, the 2018 year (collectively, a "965 Inclusion Year").

The first special rule is that when a 2018, 2019, or 2020 NOL is carried back to a 965 Inclusion Year, the bill deems taxpayers to have made the section 965(n) election to "waive off" use of the NOL against the taxpayer's transition tax inclusion.[14]

KPMG observation

In practical terms, this means the taxpayer will only be able to use the NOL carryback to offset its non-965 income, e.g., income from domestic activities and foreign income earned directly rather than through corporate subsidiaries. Thus, the NOL carryback will not be available to reduce the post-foreign tax credit ("FTC") residual section 965 tax liability that taxpayers incurred in their 965 Inclusion Years. Taxpayers will be required to account for the absorption of the NOL carryback on the overall FTC limitation for the 965 Inclusion Year under the rules of Treas. Reg. section 1.904(g)-3.

The bill also does not include an earlier-proposed rule addressing overpayments and refunds for 965 Inclusion Years. Therefore, any reduction in liability for the non-965 income in the carried-back-to 965 Inclusion Year appears likely to be applied against the 965 Inclusion Year section 965 net tax liability, before being available for a refund. This offset will in turn have cascading effects upon the subsequent installment amounts due under the taxpayer's section 965(h) eight-year installment plan.

The deemed section 965(n) election is automatic, without any opt-out available.

The second special rule addresses waivers of NOL carrybacks under section 172(b)(3). In lieu of the general rule that such a waiver applies to the entire carryback period, the bill permits taxpayers to choose a modified method whereby the NOL is carried back, but skips over 965 Inclusion Years.[15]

---

[12] Section 13302(e)(2) of the TCJA, as amended by section 2303(c)(1) the bill.
[13] Bill section 2303(d)(4). Affected taxpayers can also, within the 120-day period, elect to reduce the period to which the straddle year NOL may be carried back, or to revoke any prior election to forgo any carryback of the straddle period NOL.
[14] Bill section 2303(b)(1), adding section 172(b)(1)(D)(iv) to the Code.
[15] Bill section 2303(b)(1), adding section 172(b)(1)(D)(v)(I) to the Code.

KPMG observation

This election may be of interest to taxpayers whose NOL carrybacks to the 965 Inclusion Year would be foreign-sourced and thus affect the FTC limitation, or that had other attributes available to mitigate their non-section 965 income for the 965 Inclusion Year, and in other cases.

Both special rules, and the NOL modifications generally, will require taxpayers to re-assess their FTC and section 965 liability positions over the entire five-year carryback window.

Corporate alternative minimum tax relief

The bill provides corporations with the ability to accelerate their utilization of any of their remaining minimum tax credits ("**MTCs**") under the pre-TCJA corporate alternative minimum tax ("**AMT**") regime. Prior to the enactment of the TCJA, the AMT applied to corporations. The AMT regime allowed taxpayers to generate MTCs in certain circumstances. The corporate AMT was repealed by the TCJA, effective for tax years beginning after December 31, 2017; transition rules were adopted to allow taxpayers to utilize their remaining MTCs before 2022.[16]

Specifically, section 53, as amended by the TCJA, allowed corporations to fully utilize MTCs against regular tax liability (reduced by certain credits).[17] In addition, for tax years beginning in 2018, 2019 or 2020, corporations could receive a refundable credit equal to 50% of the excess of the MTC for the tax year over the amount of the credit allowable for the year against regular tax liability (a "50% credit").[18] For a tax year beginning in 2021, corporations could receive a refundable credit equal to 100% of the excess of the MTC for the tax year over the amount of the credit allowable for the year against regular tax liability (a "100% credit").[19] In other words, any remaining MTC was intended to be fully refundable for a corporation's 2021 tax year.

The bill accelerates the ability of corporations to utilize any remaining MTCs they may have. Instead of allowing a 50% credit for tax years beginning in 2018 through 2020, with a 100% credit allowed in 2021, the bill now allows a 50% credit for 2018 and a 100% credit for 2019.[20] Alternatively, a taxpayer may elect to claim the entire refundable credit amount for 2018.[21]

KPMG observation

Interaction with the 5-year NOL carryback rule: Taxpayers that fully utilized their MTCs to offset regular tax liability for their first tax year beginning after 2017 may be due a refund since the temporary reinstatement of the NOL carryback may eliminate all or a portion of their 2018 federal income tax liability.

---

[16] *See* sections 12001(b) and 12002 of the TCJA; H.R. Conf. Rept. No. 115-466, at p. 323 (December 31, 2017) ("Thus, the full amount of the minimum tax credit will be allowed in tax years beginning before 2022.").
[17] Section 53(c), (d).
[18] Section 53(e).
[19] *Id.*
[20] Bill section 2305(a), amending section 53(e) of the Code.
[21] *Id.*

Interactions with limitation rules: The interaction of the AMT transition rules adopted under the TCJA with certain other limitation regimes appears to create situations in which the ability of corporations to utilize all their MTCs as described above may be negatively affected.[22] The bill does not appear to address these interactions.

Revival of MTCs: A taxpayer that goes out of existence in a transaction that is not described in section 381(a)[23] (or in a section 381(a) transaction where attributes are transferred to a acquiring corporation that is not subject to U.S. federal income tax) appears to lose the ability to claim MTC refunds going forward. Any taxpayer that undertook such a transaction in 2019 or 2020 may now have a revived ability to claim its MTCs by claiming the refund in 2018.

If the taxpayer had filed a return for 2018, claiming the refundable MTC credit in 2018 would normally mean filing an amended return for that year. However, section 2305(d) of the CARES Act allows the taxpayer to file an application for a tentative refund to claim its aggregate MTCs for its 2018 tax year. This application, which could accelerate the taxpayer's receipt of the refund attributable to the MTCs, must be filed by December 31, 2020. Unless the IRS prescribes a different form or procedure, this application may be filed on Form 1139, Corporate Application for Tentative Refund. According to section 2305(d) of the CARES Act, the IRS would have 90 days from the date of filing to review the application and refund any overpayment to the taxpayer. If the taxpayer wishes to forgo filing a 2018 amended return (or filing an application for a tentative refund relating to 2018), it may claim its outstanding MTCs on it 2019 return; MTCs not claimed in either 2018 or 2019 would appear to be forfeited.

KPMG observation

By availing itself of the tentative refund procedure (rather than filing a formal amended return), the taxpayer may receive a refund from the IRS more quickly. How quickly the IRS issues the refund will depend on IRS resources.

For taxpayers that have already filed a return for 2019, rather than amending the return, the taxpayer may file a "superseding return" claiming the unclaimed MTCs. Such a return, however, would have to be filed before the original (or extended) due date of the 2019 return. This could be significant because a superseding return is treated as the taxpayer's original return, which in some circumstances could be advantageous.

Changes to loss limitation rules for taxpayers other than corporations

The bill repeals the excess business loss limitation under section 461(l) for tax years beginning prior to January 1, 2021 (i.e., calendar years 2018, 2019, and 2020). This is accomplished by amending the statute to have the excess business loss limitation rule apply for any tax year beginning after December 31, 2020, and before January 1, 2026. This modification has been made on a retroactive basis, back to December 31, 2017.

---

[22] *See,* e.g., Mark Hoffenberg and Stephen Marencik, *Are AMT Credit Refunds Subject to Limitation?*, 158 Tax Notes 1177 (Feb. 26, 2018). *See also* Treas. Reg. § 1.1502-55(h)(4) (setting forth a limitation on a consolidated group member's MTCs arising in separate return limitation years ("SRLYs") that can be included in the consolidated MTCs, without taking into account new section 53(e)).

[23] Section 381(a) transactions include tax-free subsidiary liquidations to which section 332 applies and tax-free asset reorganizations described in section 368(a)(1)(A), (C), (D), (F), and (G).

The bill also includes several technical corrections to section 461(l). The section 461(l) calculation now excludes items which are attributable to the trade or business of performing services as an employee. In addition, net operating loss deductions under section 172 and qualified business income deductions under section 199A are not taken into account in determining excess business losses. Further, deductions for losses from the sale or exchange of capital assets are not taken into account in increasing a section 461(l) limitation. Certain gains from the sale or exchange of capital assets may continue to be taken into account in reducing a potential section 461(l) limitation, but since the gains would first need to be netted with other capital losses, there is the potential for a reduction to this inclusion.

KPMG observation

The retroactive nature of this provision is not elective and would generally require the taxpayer to amend their 2018 tax return (and 2019 tax return, if already filed).

KPMG observation

The technical corrections did not address whether the taxpayer should look through a partnership or S corporation interest to include the associated business capital gains or losses on a sale of such interest, similar to the rules afforded under sections 469 and 1411.

KPMG observation

It is important not to forget the state implications. Some states have static conformity to the Internal Revenue Code as of a given date, which will not automatically take into account these new changes, while some states do not conform to certain provisions of the Internal Revenue Code.

Technical correction regarding qualified improvement property ("QIP")

The bill includes a technical correction to the TCJA with respect to qualified improvement property (QIP). Such property has a 15-year recovery period for purposes of the general depreciation system of section 168(a) and a 20-year recovery period for purposes of the alternative depreciation system of section 168(g). QIP is any improvement made by the taxpayer to the interior of a non-residential building that is placed in service after the building's initial placed in service date other than improvements attributable to elevators, escalators, building enlargements or the building's internal structural framework.

Because it has a recovery period of 15 years, QIP is eligible for the additional first-year depreciation deduction ("bonus depreciation") under section 168(k). Note that any "electing real property trade or business"—i.e., a real property trade or business that has elected out of the interest limitation provisions of section 163(j)—is required to use the alternative depreciation system ("ADS") for QIP and thus cannot claim bonus depreciation on QIP.

The provision is effective as if it had been included in the TCJA section that changed certain real property recovery periods. That section was effective for assets placed in service after 2017. Accordingly, to comply with this provision, taxpayers are required to change the depreciation methods of QIP placed in service after 2017 that has been depreciated as 39-year building property. Taxpayers should generally be able to change QIP depreciation methods by filing an automatic accounting method change. If a QIP asset was only depreciated on a single tax return—e.g., it was placed in service in 2018 and the 2019 return has not yet been filed—the asset's depreciation method may also be corrected with an amended return.

KPMG observation

Although taxpayers may wish to revisit prior year elections affecting the depreciation of QIP, there is no provision in the bill that allows this. For example, taxpayers may wish to elect out of bonus depreciation for QIP placed in service in 2018 or elect to depreciate it using ADS. Alternatively, taxpayers may wish to revise such elections to exclude QIP, if they were written to apply to "all assets." While the bill does not allow taxpayers to make or revoke prior year elections, the IRS could grant taxpayers this ability in the form of administrative transition relief.

Modification of charitable contribution limitation for corporations

The bill increases the limitations on deductions for charitable contributions for corporations who make cash contributions in 2020 from 10% of taxable income to 25% of taxable income. Contributions must be made to a public charity or private operating foundation described in section 170(b)(1)(A), but contributions to a supporting organization or a donor-advised fund would not qualify for the increased limits. The relevant percentage limitation applicable to certain donations of food inventory (namely, those that are eligible for an enhanced charitable deduction) are also increased for donations made in 2020, from 15% to 25%.

KPMG observation

Congress commonly raises the percentage limitation for Presidentially declared disasters, but, when it does so, it typically requires the charitable contribution to be made for disaster relief efforts and requires the taxpayer to obtain a written acknowledgment of the use of the contribution for this purpose. However, in this case, there is no requirement that a contribution be used in COVID-19 relief efforts in order to take advantage of the higher percentage limitations.

Emergency paid sick leave act limitation

The bill amends the Emergency Paid Sick Leave Act (part of the COVID-19 "phase 2" legislation) by limiting amounts employers are required to pay as part of sick leave to not more than: (i) $511 per day and $5,110 in the aggregate for each employee when employees are experiencing symptoms of COVID-19 or subject to a quarantine or (ii) $200 per day and $2,000 in the aggregate for each employee for taking leave to care for a child or quarantined individual.

Advance refunding of paid sick leave and extended FMLA credits

The bill provides that the new payroll credits for required paid sick leave and paid family leave (including the refundable portion) may be advanced to the employer in accordance with forms and instructions to be provided by the Secretary pursuant to the bill. Any penalties for failure to deposit the tax under section 3111(a) or 3221(a) of the Code are waived if such failure is due to the anticipation of the credits.

KPMG observation

It appears that the IRS and Treasury issued a statement on March 20, 2020 in IR-2020-57 allowing employers to seek an expedited advance from the IRS by submitting a streamlined claim form that will be released in the near future.

Individuals

"Recovery rebate" credits

The bill provides that all U.S. resident individuals with adjusted gross income up to $75,000 ($150,000 married), who are not a dependent of another taxpayer and have a work eligible social security number, are eligible for the full $1,200 rebate ($2,400 married filing jointly). In addition, they are eligible for an additional $500 per qualifying child, provided the qualifying child has a social security number or adoption taxpayer identification number. This is true even for those who have no income, as well as those whose income comes entirely from non-taxable means-tested benefit programs, such as SSI benefits.

For the vast majority of Americans, no action on their part will be required in order to receive a rebate check as the IRS will use a taxpayer's 2019 tax return if filed, or in the alternative their 2018 return. If a taxpayer has not filed a 2019 or 2018 tax return, the IRS may use information provided on Form SSA-1099, Social Security Benefit Statement, or Form RRB-1099, Social Security Equivalent Benefit Statement, for the 2019 calendar year.

This includes many low-income individuals who file a tax return to take advantage of the refundable Earned Income Tax Credit and Child Tax Credit. The rebate amount is reduced by $5 for each $100 that a taxpayer's income exceeds the phase-out threshold. The amount is completely phased-out for single filers with incomes exceeding $99,000, $146,500 for head of household filers with one child, and $198,000 for married taxpayers filing jointly.

This provision does not have an effective date as such. The bill states that the IRS should issue the refund or credit any overpayment attributable to this provision as rapidly as possible. However, no refund or credit shall be made or allowed under this provision after December 31, 2020.

KPMG observation

The rebate is not available to any individual who is a nonresident individual, nor to any individual who can be claimed as a dependent on another's return, nor to estates and trusts. It is important to note the requirement that qualifying individuals and their children must have a social security number, although there is an exception for military spouses. The bill denies the rebate to an eligible individual with a social security number if the individual filed a joint return with a spouse who has an Individual Taxpayer Identification Number (ITIN), or filed a return with a qualifying child who has an ITIN.

Changes to charitable deduction rules for itemizers and non-itemizers

The bill provides a new "above the line" charitable contribution deduction of up to $300 to individuals who do not itemize their deductions. For individuals who do itemize their deductions, the bill permits a charitable contribution deduction of up to 100% of their adjusted gross income. Both the above the line deduction and the increased limitation require the contribution to be made in cash, in 2020, and to a public charity or private operating foundation described in section 170(b)(1)(A). Contributions made to a supporting organization or a donor-advised fund do not qualify for either the above the line deduction or the increased limits.

KPMG observation

See the observation for the modification of the charitable contribution limitation for corporations, above.

Temporary exclusion for student loan repayment benefits from employers

The bill allows an employer to provide a tax-free student loan repayment benefit to employees under section 127. The bill allows an employer to contribute up to $5,250 annually toward an employee's student loans and the payment in not included in employee income. The annual limit applies to both the student loan payment as well as other educational assistance traditionally provided under a section 127 plan. The bill disallows the employee's deduction for interest paid on the student loan. This provision would be effective for payments made after date of enactment and before January 1, 2021.

Temporary waiver of early withdrawal penalty for certain withdrawals from qualified retirement plans

The bill provides that the 10% penalty for early withdrawal from a qualified retirement account is waived for distributions up to $100,000 for coronavirus-related purposes. Further, the distribution is taxed over three years, but the taxpayer has the option to repay the amount to the retirement plan within the three year period. Distributions are coronavirus related if made to an individual:

- Who is diagnosed with COVID-19 with a test approved by the CDC,
- Whose spouse or dependent (as defined by section 152) is diagnosed with COVID-19, or

- Who experiences adverse financial consequences as a result of being quarantined, furloughed, laid, off having work hours reduced, being unable to work due to lack of child care due to COVID-19, closing or reducing hours of a business because of COVID-19, or other factors determined by Treasury.

A plan administrator may rely upon the certification of an employee that a condition was satisfied. This provision applies to distribution made on or after January 1, 2020.

The bill also provides that the limit on loans from qualified plans are increased from $50,000 to $100,000. The loan is limited to the present value of the nonforfeitable accrued benefit of the employee under the plan. The loan limit is increased for a 180-day period starting on the date of enactment.

Additionally, the bill provides that the repayment due dates with respect to certain outstanding loans from qualified plans made to qualified individuals that were otherwise due between the enactment of the bill and December 31, 2020 will be delayed for one year. Further, the bill provides that any subsequent repayments will be adjusted to reflect the delay and any interest accrued during such delay.

Temporary waiver of required minimum distribution rules for certain plans and accounts

The bill waives the required minimum distribution rules for calendar year 2020 for certain defined contribution plans and IRAs. Individual are usually required to take mandatory distributions starting at age 72, but such distributions are not required during 2020. The provision is effective for calendar years beginning after December 31, 2019.

Single-employer plan funding rules

The bill provides single employer pension companies additional time to meet funding obligations. Minimum required contributions to single employer pension plans that would otherwise be due during 2020 may be deposited before January 1, 2021—at which time contributions will become due and if would have been due earlier, will be due with applicable interest. Further, the bill provides that plan sponsors of single-employer pension plans may elect to treat the plan's adjusted funding target attainment percentage for the last plan year ending before January 1, 2020 as the adjusted funding target attainment percentage for plan years which include calendar year 2020.

KPMG observation

The bill does not appear to extend the timing of the deduction for contributions; as such, employers may want to consider if they would like to make contributions earlier to be deductible in the 2019 tax year, including filing extensions as provided in IRS guidance.

Application of cooperative and small employer charity pension plan rules to certain charitable employers whose primary exempt purpose is providing services with respect to mothers and children

The bill provides that small employer charity pension plans will include pension plans that as of January 1, 2000 have been maintained by an employer that is described in section 501(c)(3), has been in existence since at least 1938, that conducts medical research directly or indirectly through grant making, and whose primary exempt purpose is to provide services with respect to mothers and children. This amends and expands the definition of cooperative and small employer charity plans. This provision is effective for plan years beginning after December 31, 2018.

Excise tax changes

Aviation tax "holiday"

The bill provides an "excise tax holiday" from the taxes imposed by sections 4261 and 4271 of the Code for amounts paid for transportation by air of persons and property, including amounts paid for the right to award free or reduced rate air transportation. The bill also provides an excise tax holiday from the taxes imposed by sections 4041 and 4081 of the Code for kerosene used in commercial aviation, except the Leaking Underground Storage Tank (LUST) tax.

This provision is effective upon enactment through December 31, 2020; however, it does not apply to payments made on or before the date of enactment.

KPMG observation

The bill provides welcome relief to the airline and air cargo industries by providing an excise tax holiday from the so-called "ticket taxes" and the tax imposed on payments for transportation by air of cargo. This relief extends to payments for mileage awards and could provide a significant prospective benefit to arrangements made by air carriers and purchasers of mileage awards. The relief for transportation taxes appears to apply broadly to all payors of these taxes, including airlines, charter companies, and private and business aviation.

The term "commercial aviation" generally means any use of an aircraft in a business of transporting persons or property for compensation or hire by air. Thus, it appears the fuel tax relief applies only to companies to which the reduced $0.043 per gallon commercial aviation rate of tax on kerosene applies. The bill revises the refund mechanism for kerosene purchased at a tax-included price to allow for refunds of this tax.

The LUST tax of $0.001 per gallon continues to apply to kerosene used in commercial aviation during the excise tax holiday; however, this tax would continue to be refunded under current rules regarding nontaxable uses of kerosene.

Temporary excise tax exception related to alcohol used in hand sanitizers

The bill provides a temporary one year exception from excise tax for removals of distilled spirits for use in or contained in hand sanitizer. The hand sanitizer must be "produced and distributed in a manner consistent with any guidance issued by the Food and Drug Administration (FDA) that is related to the outbreak of virus SARS-CoV-2 or coronavirus disease 2019 (COVID-19)". Certain labeling and bulk sales requirements and penalties do not apply during the temporary exception.

This provision is effective for distilled spirits removed after December 31, 2019 and before January 1, 2021 for such specified use.

KPMG observation

The Alcohol and Tobacco Tax and Trade Bureau (TTB) has already provided guidance waiving certain permitting, bond, and formula requirements to expand the ability of the distilled spirits industry to provide hand sanitizer in connection with COVID-19; however, only denatured alcohol could be removed tax free for use in hand sanitizer. Read ***TaxNewsFlash***. The bill now allows undenatured alcohol (i.e., beverage alcohol) to be removed tax free for use in hand sanitizer.

Distilled spirits may be removed in bulk for this use without incurring a penalty and are not required to be labeled with the Surgeon General's Government Warning related to consumption of alcoholic beverages. However, other existing TTB recordkeeping requirements should be maintained. Further, FDA guidance should be consulted to ensure compliance with production and distribution requirements.

A credit or refund of tax may be available with respect to tax-paid alcohol used to produce hand sanitizer.

Health-related tax provisions

Use of health savings accounts for telehealth services

The bill provides that the status of high-deductible health plans (HDHPs) is protected even if there is no deductible for telehealth or remote health services for plan years beginning on or before December 31, 2021.

KPMG observation

This provision goes beyond Notice 2020-15 issued earlier this month, which stated that providing benefits related to testing for and treating COVID-19 without a deductible would not violate the rules pertaining to health savings accounts used with HDHPs. This provision would permit the use of telemedicine services without a deductible for HDHPs for other unspecified illnesses. In addition, the bill contains a number of non-tax provisions promoting the use of telemedicine in a variety of contexts as a result of the pandemic.

Over-the-counter products purchased with health savings account and flexible savings account funds

The bill provides that menstrual health products will be treated as qualified medical expenses for purposes of health savings accounts, health reimbursement arrangements, flexible spending accounts, and Archer medical savings accounts. This rule applies to distributions from savings accounts and reimbursements for expenses incurred after December 31, 2019.

State and local tax implications

General state tax conformity overview

Nearly every state corporate and personal income tax base conforms in some manner to the federal Code. In doing so, states generally follow one of two methodologies. Rolling or current conformity states tie to the Code for the tax year in question; these states adopt and incorporate all changes to the Code as passed by Congress unless the state passes legislation to decouple from specific provisions. Static or fixed-date conformity states tie to the Code as of a particular date (e.g., January 1, 2020), meaning the state legislature must act to incorporate subsequent federal changes into the state tax code. Most static conformity states update their reference date annually; California is an exception and updates far less frequently. States are about evenly divided between rolling and static conformity.

KPMG observation

It is important to note that, if federal provisions are enacted retroactively to a date prior to the state's conformity date, a static conformity state may adopt the federal Code *as it existed* on the specified conformity date and therefore the provisions that are *applied* retroactively for federal tax purposes may not apply at the state level.

Many static conformity states have already enacted conformity date changes during their 2020 legislative session and would need to enact new legislation to include the provisions in the bill. At this time, 17 state legislatures have adjourned the regular session for 2020 *sine die* or were not scheduled to meet this year. Another 26 legislatures have adjourned temporarily or suspended operations in light of the COVID-19 emergency. When the legislatures are physically able to reconvene in regular or special session, it seems likely their attention will be focused dealing with the health and medical outcomes of the emergency as well as dealing with what is anticipated to be a severe impact on state revenues and finances overall. Whether they would take up conforming to the federal changes is unknown.

State nonconformity to portions of the bill that revise provisions of the TCJA could prove problematic from an ongoing compliance perspective. For example, most states conform to the interest expense limitation in Code section 163(j), but a number of them will pick up the provisions prior to the effective date of the bill. The same is true for those states that conform to the TCJA net operating loss provisions. Likewise most states had decoupled from the "bonus" depreciation in Code section 168(k) which may affect whether a state adopts the changes made by the bill to

the treatment of "qualified improvement property." To the extent that states have differing provisions from the new federal law, the federal and state differences may require taxpayers to implement additional procedures for state-by-state tracking of carryovers and limitations that are based on nonconforming provisions.

Finally, in assessing the impact of the federal changes at the state level, it will be important to examine the exact language of the state and federal provisions carefully. If federal provisions are enacted retroactively to a date prior to the state's conformity date, a static conformity state may adopt the federal Code *as it existed* on the specified conformity date and therefore the provisions that are *applied* retroactively for federal tax purposes may not apply at the state level. This could well be the case with the changes in the bill with respect to qualified improvement property.

State tax filing and payment extensions

The bill does not deal with an extension of the filing and payment deadlines for the federal income tax as that was addressed administratively by the IRS.

KPMG observation

A number of states conform by law to the federal due date for return filing; fewer states tie their income tax payment date to the federal. In addition, many states have acted to extend the filing and payment dates and to offer various forms of relief for a wide range of taxes independently of the federal government. As a result nearly every state has taken some action with respect to providing temporary filing or payment relief for one or more taxes. A summary of these actions is available through KPMG ***TaxNewsFlash***. Importantly, the extensions generally address only the initial due date of the returns; the extended due dates generally remain unchanged at this time.

Interest expense limitations under Code section 163(j)

The bill makes certain business tax changes that will have implications for state taxpayers. Currently, the deduction for net interest expense is limited to the extent it exceeds 30% of a taxpayer's adjusted taxable income (ATI). Under the bill, taxpayers would be able to deduct interest expense up to 50% of ATI for the 2019 and 2020 tax years only. An election would be allowed to not apply the increased limitation. The bill would also allow a taxpayer to elect for tax years beginning in 2020 to use its 2019 ATI to compute the Code section 163(j) limitation amount.

KPMG observation

For the 2019 tax year, there are certain states that do not conform to Code section 163(j), either because they have specifically decoupled (CT, GA, IN, MO, SC, WI), or because the state has unique conformity and does not adopt many sections of the Code (e.g., CA). In these states, this change would have no effect. So-called "rolling conformity" states that conform the Code on a moving or rolling basis and currently conform to Code section 163(j) would generally adopt the temporary increase, as well as the elections to not apply the 50% limitation and to use 2019 ATI in 2020. The states that have fixed-date conformity in adopting Code section 163(j) would not adopt these changes unless and until the legislature takes some further action. Adopting legislation this

year to allow the increased interest deduction on 2019 returns may be a challenge given that a number of state legislatures have adjourned *sine die* for the 2020 year and others are suspended due to COVID-19.

To the extent a state conforms to Code section 163(j), but does not pick up the changes in the bill, this will add an additional layer of complexity to what is already a significant compliance burden for corporate filers. Many states already require taxpayers to compute a state-specific 163(j) limitation based on the state's filing method (e.g., separate filing or combined group) which, in turn, requires taxpayers to track differences between state and federal limitations and carryovers on a state-by-state, entity-by-entity basis. The addition of a new temporary federal interest limitation to which not all states will conform creates another state-federal difference to be tracked and managed.

For a state that does conform to the TCJA changes extending Code section 163(j) to partnerships but that does not update its "static conformity" for changes in this bill, a partnership and its partners will be required to undertake state-specific limitation computations and tracking.

Net operating losses

The bill allows NOLs arising in a tax year beginning in 2018, 2019 or 2020 to be carried back five years. The bill would also temporarily suspend the 80% limitation on the use of NOLs.

KPMG observation

Most states have their own provisions addressing NOL carrybacks and carryforwards, and there is significant variation among the states. Thus, in certain rolling conformity states that will adopt the bill provisions automatically, NOL carrybacks may not be allowed for state purposes because of a specific state law to the contrary. Certain states conform to the 80% limitation and (depending on the state's particular type of conformity) would likely pick up the suspension of the 80% limitation for the 2018-2020 tax years.

Allowing a 5-year carryback for NOLs generated in 2018, 2019, and 2020is intended to permit taxpayers to amend prior year returns and claim refunds as part of an effort to assist taxpayers in generating cash relatively quickly in response to the COVID-19 emergency. States generally require amended state returns when a federal amended return is filed. As a result, the filing of federal amended returns to claim NOL carrybacks may trigger numerous state amended filings (perhaps even in cases where the federal change has no effect on state taxable income). Failure to file these state amended returns may extend the state statute of limitations for those returns, or possibly cause the statute of limitation to stop running if there is an opportunity for a state refund.

To the extent partnerships file federal administrative adjustment requests under the new federal partnership audit rules, the related state reporting, including associated forms and procedures will likely be complicated due to a majority of states not yet enacting rules in response to the new federal audit rules.

KPMG observation

Income Tax Nexus - The significant expansion of remote workers in response to the COVID-19

pandemic creates the potential for new nexus risks for corporations and pass-through entities. The most material state income tax effect of newly remote workers as a result of COVID-19 is likely the potential for triggering tax and filing responsibilities for taxpayers that have historically taken P.L. 86-272 positions (a federal statute limiting states' authority to impose net income taxes) in states in which they have significant sales, but no activities that go beyond the solicitation activities protected under P.L. 86-272. States have historically take a position that the presence of remote workers could trigger nexus and affect the applicability of P.L. 86-272. It is not at all clear whether they will continue this position in the context of a global pandemic causing many state and local governments to mandate shelter-in-place or other limitations on residents leaving their homes. For businesses anticipating being in a taxable loss situation in 2020, however, establishing nexus and exceeding the protections of P.L. 86-272 in 2020 could result in the creation of new state NOLs rather than a significant new tax exposure.

Income Tax Apportionment Sourcing - All states with an income tax apportion taxable income or loss based at least in part on a sales factor, consisting of a ratio of a taxpayer's sales in the taxing state over its sales everywhere. For sales of services, the determination of whether a sale is attributed to the state and included in the numerator of this ratio may be based (at least in part) on where the person performing that service is located. This ultimately affects the amount of income apportioned and taxed by states. Service business with large numbers of newly remote employees could see shifts in where there services are sourced for sales factor purposes if working remotely becomes a long-term reality.

Impact of the bill on accounting for income taxes

Among other provisions, the bill provides relief to corporate taxpayers through temporary adjustments to net operating loss rules, changes to limitations on interest expense deductibility, and the acceleration of available refunds for minimum tax credit carryforwards.

KPMG observation

The tax effects of retroactive changes in tax laws or rates on income taxes receivable (payable) for a prior year are recognized in income tax expense (benefit) from continuing operations as of the date of enactment. To the extent a retroactive change impacts income taxes receivable (payable) of the current year, such impacts are recognized in the estimated annual effective tax rate beginning in the interim period which includes the enactment date.

Deferred tax assets (liabilities) are remeasured to reflect the effects of enacted changes in tax laws as of the date of enactment. The impact of the remeasurement, if any, is reflected entirely within the interim period that includes the enactment date and allocated directly to income tax expense (benefit) from continuing operations. We believe the portion of the deferred tax remeasurement to be recognized discretely may be based on balances either at the date of enactment or the beginning of the year. The approach selected represents an accounting policy choice that should be consistently applied.

The discussion below highlights selected areas of the bill that may have accounting for income taxes considerations, but it is not all inclusive.

Net operating losses

The bill permits a five year carryback of net operating losses (NOLs) arising in tax years beginning after December 31, 2017 and before January 1, 2021. The bill further relaxes the 80% taxable income limitation imposed under current US federal tax law to permit a full deduction for the carryback of those losses.

Companies carrying back losses from the 2018 to 2020 tax years will need to consider the impact of tax rates in the carryback year to which the losses are applied. For example, a NOL from 2018 that previously created a deferred tax asset measured at 21%, under the bill may be carried back to offset taxable income from 2013 that would have been taxed at a 35% federal income tax rate. As such, the refund receivable recognized may be measured at the 35% rate applicable to the carryback year, while the deferred tax asset that is derecognized may have been measured at a 21% rate. For a 2020 loss expected to be carried back to a pre-2018 year, this may result in a benefit in the estimated annual effective tax rate at the 35% rate.

KPMG observation

Companies may need to update the scheduling of the reversal of temporary differences in determining the total amount of deferred tax assets supported by reversing taxable temporary differences. An entity may have less carryforwards after the bill and the reversal of existing temporary differences may result in a change in the amount of valuation allowance required. Additionally, certain entities with a non-calendar year-end may be able to rely on carryback availability to support the recognition of a portion of the deferred tax assets for temporary differences expected to reverse in a tax year beginning before January 1, 2021.

Relaxation of limits on interest deductibility

Under current US federal tax law, interest expense is generally deductible to the extent it does not exceed 30% of adjusted taxable income for the respective tax year. The bill temporarily relaxes the section 163(j) limitation on deductible interest and increases the limit from 30% of adjusted taxable income to 50% of adjusted taxable income for tax years beginning in 2019 and 2020.

Increasing the limitation on the deductibility of interest expense may provide an immediate tax impact for entities, either through increasing a net operating loss in the 2019 or 2020 tax years (which can be carried back up to five years) or reducing the tax liability for these years.

KPMG observation

The increase in the limitation on the deductibility of interest expense may reduce interest carryforwards generated in these tax years and the related deferred tax assets. Consequently, existing valuation allowance judgments should be reassessed to determine the realizability of the remaining deferred tax assets. Similar to the changes in net operating losses, companies may need to revise the scheduling of the reversal of temporary differences to appropriately determine the amount of interest character deferred tax assets that are supported by reversing taxable temporary differences.

Alternative minimum tax

The TCJA repealed the corporate alternative minimum tax (AMT) effective for tax years beginning after December 31, 2017. In addition, for tax years beginning in 2018, 2019, and 2020, to the extent that AMT credit carryovers exceed regular tax liability (as reduced by certain other credits), 50% of the excess AMT credit carryovers were refundable. Any remaining AMT credits were generally fully refundable in 2021. The bill allows for any remaining AMT credits to be fully refundable in 2019.

Entities generally reflect any remaining AMT credits as either an income tax receivable or as a deferred tax asset. As remaining minimum tax credit carryforwards will be realized either as a reduction of income taxes payable or as a refundable amount, existing deferred tax assets related to minimum tax credit carryforwards may be reversed and an income taxes receivable recognized.

KPMG observation

Any income taxes receivable recognized is presented as a current receivable as the expected timing of receipt would be anticipated to be within 12 months or the operating cycle. If an entity previously recognized a noncurrent receivable for the portion of the AMT credit expected to be refunded in 2021, a reclassification should be made from noncurrent to current.

Summary

Many of the adjustments arising from the bill will result in income tax refunds associated with prior tax years with a corresponding reduction in deferred tax assets; however, given the potential for different tax rates to apply in the respective periods or changes in valuation allowances to occur, an overall net income tax benefit may exist, and may generally be expected, as a result of the bill.

As noted above, this discussion highlights selective common areas of accounting for income taxes that may be impacted by the new laws included in the bill, but it is not all inclusive. An entity's specific facts and circumstances should be assessed in determining the accounting for income taxes impact of the bill.

KPMG contacts

Passthroughs	Deborah Fields	dafields@kpmg.com	+1 202-533-4580
Global mobility services	Martha Klasing Joan Smyth	mklasing@kpmg.com jsmyth@kpmg.com	+1 202-533-4206 +1 202-533-4404
Corporate	Mark Hoffenberg Rob Liquerman Maury Passman	mhoffenberg@kpmg.com rliquerman@kpmg.com mpassman@kpmg.com	+1 202-533-4058 +1 202-533-3054 +1 202-533-3775
Compensation and benefits	Robert Delgado Terri Stecher	rdelgado@kpmg.com tstecher@kpmg.com	+1 858-750-7133 +1 202-533-4830

Estates, gifts, and trusts	Tracy Stone Scott Hamm	ttstone@kpmg.com scotthamm@kpmg.com	+1 202-533-4186 +1 202-533-3095
Insurance	Frederick Campbell-Mohn Sheryl Flum	fcampbellmohn@kpmg.com sflum@kpmg.com	+1 212-954-8316 +1 202-533-3394
Regulated investment companies	Deanna Flores	djflores@kpmg.com	+1 858-342-7661
Banking	Elizabeth L'Hommedieu Matthew Mosby	elhommedieu@kpmg.com mmosby@kpmg.com	+1 614-249-1849 +1 704-371-5265
Other financial products & debt	Jon Zelnik	jzelnik@kpmg.com	+1 202-533-4193
Exempt organizations	Ruth Madrigal Preston Quesenberry	ruthmadrigal@kpmg.com pquesenberry@kpmg.com	+1 202-533-8817 +1 202-533-3985
International	Seth Green Danielle Rolfes	sethgreen@kpmg.com drolfes@kpmg.com	+1 202-533-3022 +1 202-533-3378
Mergers & acquisitions	Thomas Wessel Gordon Warnke	twessel@kpmg.com gwarnke@kpmg.com	+1 202-533-5700 +1 212-954-2458
Income tax accounting	Eric Lucas	ejlucas@kpmg.com	+1 202-533-3023
Economic & valuation services	Stephen Blough Brian Cody	sblough@kpmg.com bcody@kpmg.com	+1 202-533-3108 +1 214-840-2080
Energy	Rich Blumenreich Robert Swiech	rblumenreich@kpmg.com rswiech@kpmg.com	+1 202-533-3032 +1 713-319-3257
Financial institutions and products	Mark Price	mhprice@kpmg.com	+1 202-533-4364
Accounting for income taxes	Ashby Corum Jenna Summer	acorum@kpmg.com jsummer@kpmg.com	+1 313-230-3361 +1 202-533-3614
State and local tax	Harley Duncan Sarah McGahan	hduncan@kpmg.com smcgahan@kpmg.com	+1 202-533-3254 +1 713-449-9748
Excise and credits	Taylor Cortright	tcortright@kpmg.com	+1 202-533-6188
REITs	David Lee Stephen Giordano	dwlee@kpmg.com stephengiordano@kpmg.com	+1 202-533-4071 +1 202-533-3535
Practice, procedure and administration	Mike Dolan	mpdolan@kpmg.com	+1 202-533-6150

Healthcare	Monica Coakley	mcoakley@kpmg.com	+1 615-248-5639
	Lori Robbins	lorirobbins@kpmg.com	+1 202-533-3491

Contact us

For questions on legislative matters, contact a professional in the Federal Legislative and Regulatory Services group of KPMG's Washington National Tax:

John Gimigliano
T: +1 (202) 533-4022
E: jgimigliano@kpmg.com

Jennifer Acuña
T: +1 (202) 533-7064
E: jenniferacuna@kpmg.com

Carol Kulish
T: +1 (202) 533-5829
E: ckulish@kpmg.com

Jennifer Bonar Gray
T: +1 (202) 533-3489
E: jennifergray@kpmg.com

Tom Stout
T: +1 (202) 533-4148
E: tstoutjr@kpmg.com

www.kpmg.com

kpmg.com/socialmedia