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Responding to income tax changes under the Coronavirus Aid, Relief, and Economic Security Act (CARES)

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The Coronavirus Aid, Relief, and Economic Security Act (CARES) will offer some taxpayers an opportunity to take immediate action to reduce their federal income tax liability as they prepare their 2019 income tax returns. However, much of the CARES tax impact will be delayed until income tax returns are filed for tax periods during the crisis, which, for most U.S. taxpayers, began in 2020. Thus, in many cases, federal income tax refunds (particularly refunds resulting from the carryback of net operating losses (NOLs)) will not become available until income tax returns for 2020 are filed in 2021. Nevertheless, some action can be taken in the short term to accelerate the ability of taxpayers to obtain income tax refunds this year, and some action can be taken during the balance of 2020 to ensure that income tax refunds will be obtained when 2020 income tax returns are filed in 2021.

The discussion that follows is a “high-level” summary ONLY. The specific facts of each taxpayer’s situation need to be considered before any decision is made or any action is taken. Additionally, the state income tax implications of any action will vary based on the laws of each state, and these considerations may have some effect on the decision-making process.

— ***C-Corporations with a fiscal tax year that made estimated tax payments***. For corporate taxpayers with lower taxable income (or potentially a loss) for a fiscal year ending in 2020, it is possible to recoup estimated tax payments for the current year as soon as the year is completed by filing IRS Form 4466 (Corporation Application for Quick Refund of Overpayment of Estimated Tax) before the corporation’s income tax return is due for the year. Significantly, even if the corporation’s income tax return for a fiscal year ending in 2020 is put on extension, the corporation can still recoup some or all of its expected refund shortly after the end of the current tax year. And while this quick refund approach is probably of little help for corporations whose fiscal years end before April 30, 2020, as the economic cost of COVID-19 continues to mount, this will become more significant for more corporate taxpayers. Note that individuals and other taxpayers do not have this quick refund procedure available to them. Finally, we note that if this

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is relevant (i.e., the substantive tax law changes that affect 2019 materially affect projected 2019 income tax liability), a Form 4466 must be filed for the calendar year 2019 by April 15, 2020. This filing deadline is an example of why taxpayers should not assume that all federal tax reporting obligations are delayed simply because the April 15 federal income tax payment and filing deadline has been extended.

- ***Estimated tax payments by all taxpayers during 2020***. Estimated income tax payments for all taxpayers that were due on April 15, 2020, have been deferred until July 15, 2020. There is no official guidance on estimated tax payments that are due on June 15, 2020. Presumably, the required estimated income tax payments for all taxpayers that are engaged in business activities for 2020 will be significantly reduced and, due to current losses, potentially eliminated.
- ***C-Corporations with any remaining alternative minimum tax (AMT) credit carryover***. Originally, the unapplied balance of AMT credits was to be refunded on corporate income tax returns for years beginning in 2021. Now, the unapplied balance will be refunded on corporate income tax returns for years beginning in 2019 (e.g., the calendar year 2019 tax returns).
- ***Substantive tax law changes that affect 2018, 2019, and 2020 income tax liabilities for all taxpayers***. For certain corporate and individual taxpayers, their 2018, 2019, and 2020 income tax liability may be reduced for the following items:
  - Elimination of the 80% limitation on NOL carryovers by C-corporations (affects 2018, 2019, and 2020 tax years)
  - Elimination of the $250,000 "cap" ($500,000 on joint returns) on the use of NOLs by non-corporate taxpayers (affects 2018, 2019, and 2020 tax years)
  - Adoption of a new five (5) year carryback of NOLs (affects NOLs arising in 2018, 2019, and 2020 tax years)
  - Increased deduction of business interest expense—from 30% of "modified EBITDA" to 50% of "modified EBITDA" (affects 2019 and 2020 tax years)
  - Correction of the "retail glitch" created by the Tax Cuts and Jobs Act (2017) (TCJA), by allowing immediate expensing of "qualified improvement property" (which not only encompasses the three pre-TCJA categories of "qualified property within tenant space—(i) qualified leasehold improvement property, (ii) qualified restaurant property, and (iii) qualified retail improvement property—but also permits immediate expensing of certain improvements to common elements of commercial rental real estate) (affects the last few months of 2017, 2018, and later years)
  - Accelerated recovery of any remaining AMT credit carryover by C-corporations (discussed above)

Note that tax losses and benefits reported on partnership returns also need to be considered. There are many exceptions and complexities that will not be addressed here, but here is the general rule: If the partnership has already filed its 2019 return, and it did not reserve the right to amend by filing an extension request, any changes to its 2019 return will not be available to its partners until they file their income tax returns for 2020 under the complicated rules that apply to amended partnership income tax returns. Similarly, if a partnership amends its 2018 return (e.g., based on the retail glitch), the benefit of this change will not be available to its partners until they file their 2020 income tax returns (assuming that the partnership promptly files an amended 2018 tax return).

- ***Carryback of 2018, 2019, and 2020 net operating losses by all taxpayers***. The TCJA denied taxpayers the ability to carry back NOLs from 2018 and later years to reduce the income reported in 2017 and prior years in order to generate tax refunds based on income taxes paid in the carryback year(s). Prior to TCJA, the carryback period was two (2) years (e.g., a 2017 NOL could be carried back to 2015 and 2016). Subject to exceptions that we won't address here, CARES now permits taxpayers to carry back NOLs arising from years beginning on or after January 1, 2018, and before January 1, 2021 (e.g., calendar years 2018, 2019, and 2020), for five (5) years. Note that, particularly for C-corporations, the maximum tax rate for 2017 and prior years was higher than for 2018 and later years (i.e., the top rate before 2018 was 35% as opposed to the current 21%). So, the savings created by a carryback of current losses could be significant. In lieu of simply filing an amended return to carryback an NOL to recover taxes in prior years, accelerated refunds can be obtained by filing a "quickie refund claim" using IRS Form 1139 for corporations and Form 1045 for individuals. Generally, quickie refund claims must be filed not later than twelve (12) months from the last day of the loss year, and the IRS is required to process the request within ninety (90) days of receipt. If an amended income tax return is filed to claim an NOL carryback, the time for processing such returns is generally much longer than ninety (90) days. Special considerations apply to each of the three impacted years listed above.
    - ***NOLs sustained and already reported (i.e., 2018 NOLs)***. CARES allows for "quickie refund claims" for prior year NOLs, but those claims must be filed within one hundred twenty (120) days of CARES's enactment on March 27, 2020 (the "enactment date"). Even if a quickie refund claim is not filed (i.e., the NOL carryback will be claimed on an amended tax return), a special election apparently will be required to be filed within one hundred twenty (120) days of the enactment date. Presumably, the IRS will issue some guidance on these procedures since the normal rule would require a quickie refund claim for 2018 to be filed before December 31, 2019. Past experience with similar situations suggests that an IRS notice or revenue procedure will be forthcoming to address these procedural issues.
    - ***NOLs sustained in 2019 (and which may have already been reported)***. As noted above, it is unlikely that income tax law changes in CARES will materially impact the calculation of a taxpayer's NOL sustained in 2019. Instead, in most cases, the issue will be making certain that all the required paperwork—(i) the election to carryback NOLs, (ii) the 2019 income tax return, and (iii) the "quickie refund claim"—is timely filed.
    - ***NOLs sustained in 2020.*** The disruption occasioned by COVID-19 will likely cause many businesses to sustain substantial losses in 2020 that, in turn, will trigger an NOL carryback that cannot be monetized until tax returns are filed in 2021. One critical issue that may apply to some taxpayers who report income and losses from partnerships (e.g., in real estate) is to make certain that any required amendments to partnership tax returns filed for 2018 (and in some cases 2019) are filed during 2020 so that the reduction in income from that year can be claimed on the taxpayer's 2020 income tax return.

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