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2020 Tax Planning Opportunities

CARES ACT

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FOREWORD

On March 27, 2020 the President signed The Coronavirus, Aid, Relief and Economic Security Act (CARES Act). The CARES Act includes many tax provisions that are intended to put cash flow in the hands of individuals and businesses.

The CICPAC Tax Thought Leadership Committee has compiled a summary of those changes potentially impacting our construction clients for consideration. In the interest of timing, this document only provides an overview for further consideration for planning in 2020 and beyond.

This document is a follow-up to the *2020 Tax Planning Opportunities for the Construction Industry* whitepaper that was published recently.

Many thanks to the members of the Tax Thought Leadership Committee (below) for their contribution to the CICPAC organization and their collective efforts resulting in this document. We are also grateful to Kathleen Baldwin and Michelle Class for bringing it all together.

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Because many businesses face unparalleled economic uncertainty due to COVID-19, Congress passed the Coronavirus Aid, Relief and Economic Security Act (CARES Act). The CARES Act provided relief for businesses and individuals. As we approach tax year end planning, business taxpayers should consider the following provisions:

Net Operating Losses

The passage of the Tax Cuts and Jobs Act (TCJA) in 2017 made significant changes to the treatment of net operating losses (NOL) for both corporations and individual taxpayers. Under the provisions of the TCJA, NOLs generated in tax years beginning in 2018 and later years can no longer be carried back to prior years but must be carried forward indefinitely. Additionally, losses that are carried forward can only be used to offset up to 80 percent of taxable income in carryover years. NOLs related to farming businesses maintained the possibility of a two-year carryback.

The CARES Act reinstated and expanded the ability to carry back business losses. Under the CARES Act, losses arising in 2018, 2019, and 2020 tax years can be carried back to the previous five tax years. Furthermore, the taxable income limitation has been removed for losses arising in these years. Taxpayers can by election forego the loss carryback. For losses arising in the 2018 and 2019 tax years, the irrevocable election to forego carryback to the previous five years is made by attaching an affirmative statement to a timely filed return for the first tax year ending after the enactment date of the law, March 27, 2020. Taxpayers who are impacted by the rules for inclusion of deferred foreign income under Sec. 965(a), may also elect to forego the NOL carryback to any "section 965 year." NOLs still retain an indefinite carry forward.

The IRS provided guidance extending the due date for filing Form 1045 or Form 1139 to request a refund arising from the carryback of a loss from tax year 2018 to June 30, 2020. If the taxpayer failed to file a claim for refund for the 2018 loss carryback by this deadline, they must now file amended returns in order to carryback the 2018 loss. The deadline for filing Applications for Tentative Refunds for the carryback of losses arising in tax year 2019 is December 31, 2020.

The CARES Act also contained technical corrections to the TCJA's NOL provisions. NOLs generated in a year beginning in 2017 and ending in 2018 can now be carried back to the previous two tax years. Also, for tax years beginning after December 31, 2020, the 80% of taxable income limitation is calculated by adding back deductions under Sec. 199A and Sec. 250 and subtracting any NOLs carried forward from years ending before January 1, 2018.

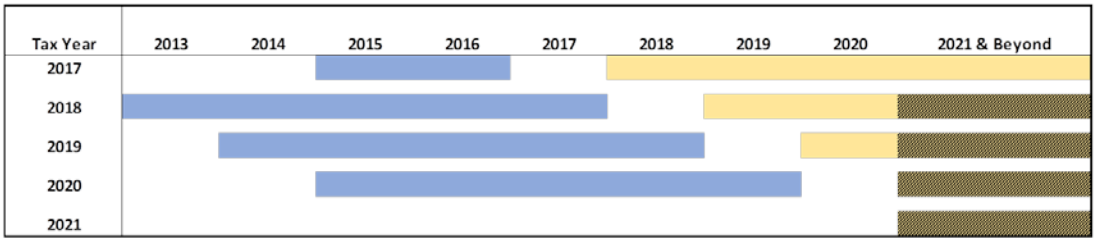
Because of reductions in tax rates included in the TCJA, there may be significant advantages to maximizing loss deductions for tax years ending prior to January 1, 2021. The rate variance is likely particularly

significant for corporate taxpayers where corporate marginal rates for years prior to 2018 as high as 35 percent were replaced by a flat 21 percent rate. Taxpayers may want to consider aggressive use of bonus depreciation, accounting method changes such as converting to the completed contract method of accounting, or a cash method where allowable, and other acceleration of deductions to create larger losses for carryback. Both the TCJA and the CARES Act have many taxpayer friendly provisions that will facilitate this planning.

There may also be negative consequences for NOL carrybacks and planning considerations should include:

- Alternative Minimum Tax generated in a prior year by an NOL carryback may reduce the benefit of the refund. The TCJA repealed the AMT for corporate taxpayers and significantly limited its application for individual taxpayers, however the pre-TCJA AMT rules will still apply to prior years when losses are carried back.
- NOL carrybacks to pre-TCJA years could result in permanent loss of tax credits, incentives, and other deductions including the Sec. 199 Domestic Manufacturing Deduction.
- Most states do not conform to the federal carryback/carryforward provisions and guidance to date has been very limited. The use of a carryback at the federal level may result in a permanent loss of NOL carryforward deductions at the state level.
- The impact of NOL carrybacks on the taxation of foreign income such as GILTI and FDII, and Sec. 965(a) income should be modeled.
- NOL carrybacks can open statutes for closed years allowing the IRS a second opportunity for audit or adjustment. Amended returns claiming large refunds are likely to be reviewed prior to the issuance of the refund.
- The impacts of NOL carrybacks on financial statement reporting, and contractual agreements arising from mergers or other acquisitions should also be thoroughly investigated.

CARES ACT - NOL CARRYBACKS AND CARRYFOWARDS



NOL Year	Carryback Period	Carryover Period	Carryforward Limitation 2018-2020	Carryforward Limitation > 2020
Pre-2018 NOLs	2 years	20 years	None	None
2018-2020 NOLs	5 years	Indefinite	None	80%
Post 2020 NOLs	No carryback	Indefinite	N\A	80%

Excess Business Loss Limitations

The TCJA includes provisions that limit how individuals can use business losses to offset nonbusiness income. Under provisions of the TCJA individual taxpayers are only allowed to deduct $250,000 of net business losses ($500,000 for joint filers) against other nonbusiness income. Excess losses are treated as net operating loss carryovers in subsequent tax years. The CARES Act repeals the limitation of excess business losses for tax years beginning before January 1, 2021. There is no provision allowing for elective application of the repeal. As such, taxpayers reporting excess losses for the 2018 or 2019 tax year must file amended returns to claim the full loss, even if the results are unfavorable.

The CARES Act also includes a number of technical corrections regarding the calculation of excess business losses. These changes will be applicable when the limitations are put back into effect for tax years beginning after December 31, 2020. These technical corrections include:

- Any gross income, deductions, or gains attributable to the trade or business of performing services as an employee will no longer be used in the determination of excess business losses. This means that beginning in the 2021 tax year, W-2 wages will no longer be included in calculating excess business losses.
- Net Operating Loss deductions under Sec. 172 and the Qualified Business Income Deduction under Sec. 199A are not considered in determining the taxpayer's business deductions for the purposes of Sec 461(l).
- Net capital gains attributable to a trade or business, limited to the taxpayer's overall capital gain net income, are considered in the determination of excess business losses. However, net capital losses attributable to a trade or business are not included in the calculation.

Significant complications regarding the application of these provisions may arise at the state level, depending on how the state conforms to the federal law. At present, many states do not conform with the provisions of the Cares Act, and there has been little guidance to date regarding how to apply the ongoing limitations and the potential interactions with NOL carryovers at the state level. It likely will be necessary to prepare pro forma excess loss limitation calculations and adjust state income accordingly.

Employee Retention Credit

For many businesses during 2020, operations been fully or partially suspended due to a government order limiting commerce, travel or group meetings. Companies have experienced significant decline in quarterly revenues. In these cases, a refundable payroll tax credit for up to 50% of wages paid might be available. The Employee Retention Credit is available to employers, including non-profits, whose operations have been fully or partially suspended as a result of a government order limiting commerce, travel, or group

meetings. The credit is also provided to employers who have experienced a greater than 50% reduction in quarterly receipts, measured on a year-over-year basis.

The Employee Retention Credit is equal to 50% of qualified wages paid to employees after March 12, 2020 and before January 1, 2021. Qualified wages depends on the number of employees.

EMPLOYEE RETENTION CREDIT IS EQUAL TO 50% OF QUALIFIED WAGES PAID TO EMPLOYEES.

For employers who had an average number of full-time employees in 2019 of 100 or fewer, all employee wages are eligible, regardless of whether the employee is furloughed. For employers who had a larger average number of full-time employees in 2019, only the wages of employees who are furloughed or face reduced hours as a result of their employers' closure or reduced gross receipts are eligible for the credit.
The term "wages" includes health benefits and is capped at the first $10,000 in wages paid by the employer to an eligible employee.

An eligible employer's ability to claim the Employee Retention Credit is impacted by other credit and relief provisions as follows:

- If an employer receives a Small Business Interruption Loan under the Paycheck Protection Program, authorized under the CARES Act, then the employer is not eligible for the Employee Retention Credit.
- Wages for this credit do not include wages for which the employer received a tax credit for paid sick and family leave under the Families First Coronavirus Response Act.
- Wages counted for this credit can't be counted for the credit for paid family and medical leave under section 45S of the Internal Revenue Code.
- Employees are not counted for this credit if the employer is allowed a Work Opportunity Tax Credit under section 51 of the Internal Revenue Code for the employee.

In order to claim the new employee retention credit, eligible employers will report their total qualified wages and the related health insurance costs for each quarter on their quarterly employment tax returns, which will be Form 941 for most employers, beginning with the second quarter. The credit is taken against the employer's share of social security tax but the excess is refundable under normal procedures.
The window is closing for companies to take advantage of the Employee Retention Credit. Taxpayers should review the credit qualifications and their wages paid during the required period to determine if the credit is available.

Delay of Payment of Employer Social Security Taxes

Beginning 3/27/2020 until 12/31/2020, employers can delay paying their employer share of all social security taxes due between 3/27/2020 and 12/31/2020. Please note that the delay does not apply to the employee or employer Medicare taxes or the employee portion of social security taxes. Those will need to be paid as normal.

Employers will eventually have to pay these payroll taxes; 50% due by 12/31/2021 and the remaining 50% due 12/31/2022.

Qualified Improvement Property

A technical glitch in the 2017 Tax Cuts and Jobs Act prevented taxpayers from applying 100% bonus depreciation to Qualified Improvement Property. Qualified Improvement Property (QIP) is defined as any improvement made to the interior portion of nonresidential real property after the date the building was first place in service. Any enlargement of the building, any elevator or escalator or improvement to the internal structural framework of the building does not qualify as QIP. The QIP was originally intended to be 15-year property and subject to bonus depreciation, but it was excluded due to a drafting error.

The CARES Act fixed this "retail glitch" by including QIP in the definition of 15-year property. The change allows taxpayers to claim 100% bonus depreciation on QIP retroactively to January 1, 2018.

Taxpayers can take advantage of this correction in the CARES Act by reviewing improvements to existing buildings in 2020 to determine if the property qualifies as QIP allowing them to claim 100% bonus depreciation on the improvements. Cost segregation tools can assist with maximizing the amount eligible for Qualified Improvement Property. Taxpayers should also consider if electing out of bonus depreciation for QIP would be more advantageous in cases where there are limitations to consider such as passive activities, at-risk or basis limitations. In these considerations, taxpayers should be aware that many states have de-coupled from the federal bonus depreciation deductions which can potentially create another level of complexity in tracking basis and future asset sales as well as disparity in state taxable income on an ongoing basis.

Business Interest Expense

The 2017 Tax Cuts and Jobs Act established IRC Section 163(j) which limits business interest expense to 30% of Adjusted Taxable Income (ATI) for taxpayers with annual gross receipts of $25 million dollars or

more. The CARES Act increases the business interest deduction limit to 50% of ATI for 2019 and 2020 for taxpayers. The taxpayer may elect out of the increased business expense limitation.

Partnerships must apply the 30% ATI limit for 2019 but will apply the 50% limit in 2020. Partners that are allocated 2019 excess business interest expense (EBIE) will treat 50% of the EBIE as paid or incurred in 2020 and will not be subject to the business interest limitation. Partners will treat the remaining 50% EBIE carried over from 2019 as subject to the limitations.

CARES ACT INCREASES THE BUSINESS INTEREST DEDUCTION LIMIT TO 50% OF ATI, FOR 2019 AND 2020.

In addition to the loosened limitations, a taxpayer may elect to use the 2019 ATI when computing the business expense limitation in 2020. This provision assumes 2019 will have higher ATI than 2020 so the election potentially allows a larger business interest expense.

Taxpayers with annual gross receipts over $25 million (subject to aggregation rules) should evaluate their 2020 ATI and determine if any business interest expenses elections should be made that may increase the deductible amount.

Paycheck Protection Program (PPP)

The construction industry was the leading recipient of U.S. Small Business Administration (SBA) Paycheck Protection Program (PPP) funding when implemented this past spring at the onset of the coronavirus pandemic.

For Federal purposes under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, PPP loan forgiveness was originally noted as excluded from gross income. However, the IRS issued Notice 2020-32 in April 2020, indicating that expenses associated with tax-free income are nondeductible. This is consistent with prior IRS positions and results in the net effect of reversing any tax-free benefit of the exclusion of loan forgiveness under the PPP. While members of Congress have stated disagreement with this position, no fixes have been formally implemented.

The IRS recently published Revenue Ruling 2020-27, which makes clear taxpayer's with reasonable expectations for loan forgiveness cannot deduct the qualified expenses paid with loan proceeds, regardless of the year the taxpayer applies for forgiveness or the year legal forgiveness occurs. Therefore, it is expected qualifying expenses for most taxpayers will not be deductible in 2020.

The program creates a range of impact in various financial and tax areas to consider, such as state taxability, financial reporting, bonding/surety communication, and the application and allocation of nondeductible expenses that may impact work-in-progress calculations and certain tax credits.

Families First Coronavirus Response Act (FFCRA):

- **Emergency Paid Sick Leave Act** – Employers with fewer than 500 employees and government employers must provide two weeks of paid sick leave to employees, regardless of how long they have worked, affected by the coronavirus until December 31, 2020.
    - Employees who are quarantined, isolated, or seeking a diagnosis or preventative care for coronavirus will be paid at their regular rate for those two weeks with a cap of $511 per day.
    - Employees who are caring for family members with the same requirements listed in the bullet above or are caring for children who are affected by school closures or unavailable childcare will be paid at two-thirds their regular rate for those two weeks with a cap of $200 per day.
    - Full-time employees are entitled to two weeks (80 hours) and part-time employees are entitled to the typical number of hours they work in a two-week period.
    - Employers cannot require the employees to find someone to do their jobs while they are out.
    - Employers of healthcare providers or emergency responders may elect to exclude these employees from application of paid sick leave.
    - Employers with fewer than 50 employees may request exemption from the Secretary of Labor.

- **Emergency Family and Medical Leave Expansion Act** – Employees of employers of fewer than 500 employees and government employees who have been on the job for at least 30 days will have the right to take up 12 weeks of job-protected leave to be used to care for a child of an employee if the child's school or place of care has been closed, or the childcare provider is unavailable, due to a coronavirus.
    - These individuals will receive two-thirds of their pay capped at $200 a day and $10,000 in the aggregate.
    - The first 10 days of leave may consist of unpaid leave; however, employees may elect to substitute any accrued vacation leave, personal leave, or medical or sick leave for the first 10 days.
    - The Secretary of Labor has the authority to exclude certain healthcare providers and emergency responders from eligibility of paid leave.

  - The Secretary of Labor also has the authority to exempt employers of fewer than 50 employees from requirements of paid leave if the imposition of such requirements jeopardize the viability of the employer as a going concern.

- **Payroll Credit for Required Paid Sick Leave** – The bill provides a refundable tax credit equal to 100% of qualified paid sick leave wages paid by an employer for each calendar quarter. The tax credit is allowed against the tax imposed by section 3111(a) (the employer portion of Social Security taxes). Qualified sick leave wages are wages required to be paid by the Emergency Paid Sick Leave Act and the following limits will apply:
  - For amounts paid to employees directly affected by the coronavirus as referenced above, the amount of qualified sick leave wages taken into account for each employee is capped at $511 per day.
  - For amounts paid to employees caring for a family member or for a child whose school or place of care has been closed, the amount of qualified sick leave wages taken into account for each employee is capped at $200 per day.
  - The aggregate number of days taken into account per employee may not exceed the excess of 10 over the aggregate number of days taken into account for all preceding calendar quarters.
  - If the credit exceeds the employer's total liability under section 3111(a) for all employees for any calendar quarter, the excess credit is refundable to the employer.

- **Payroll Credit for Required Paid Family Leave** – The tax credit is allowed against the tax imposed by section 3111(a) (the employer portion of Social Security taxes). Qualified family leave wages are wages required to be paid by the Emergency Family and Medical Leave Expansion Act.
  - A refundable tax credit equal to 100 percent of qualified family leave wages paid by an employer for each calendar quarter is available.
  - The amount of qualified family leave wages taken into account for each employee is capped at $200 per day and $10,000 for all calendar quarters.
  - If the credit exceeds the employer's total liability under section 3111(a) for all employees for any calendar quarter, the excess credit is refundable to the employer.

Section 139: Tax Free Reimbursements for COVID-19 Expenses

In response to the ongoing pandemic, on March 13, 2020, President Trump declared the coronavirus or COVID-19, a national disaster under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. This declaration put into play a little-known *existing* provision of the tax law –Section 139 of the Internal Revenue Code.

Section 139, however, provides that any amount received as a "qualified disaster relief payment" cannot be taxed to the employee as income. These payments are not subject to any federal withholding obligations and do not need to be reported on a Form W-2 or 1099. Significantly, any amounts paid as a "qualified disaster relief payment" are also deductible by the employer.

ANY AMOUNT RECEIVED AS "QUALIFIED DISASTER RELIEF PAYMENT" CANNOT BE TAXED TO EMPLOYEE AS INCOME.

A "qualified disaster relief payment" under Section 139 includes payments by an employer, not compensated for by insurance or otherwise, paid to or for the benefit for its employees to:

- reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster; and
- reimburse or pay reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster.

The IRS has not issued any guidance specific to COVID-19 and thus it is not entirely clear what types of expenses during this time will be considered "qualified disaster relief payments."

Nevertheless, legislative history and a reasonable interpretation of the statutory text provides that the following payments or reimbursements from employer to employee should qualify under Section 139 provided the expenses are reasonable and necessary, relate to the COVID-19 pandemic, and are not otherwise compensated by insurance:

- Medical expenses of the employee not covered by insurance or otherwise (i.e. copays incurred for COVID-19 treatment);
- Health-related expenses other than medical expenses (i.e. over-the-counter medications used to treat COVID-19);
- Dependent care expenses, such as child care or tutoring expenses for an employee's dependent due to school closures; remote learning or home-schooling expenses, such as home internet,

computer for use by a dependent, educational materials, subscriptions to online educational resources, etc.;

- Expenses associated with working from home, including home office set-up costs, computer, internet, printer, and cell phone costs, and even increased utility costs on account of the home office;
- Transportation expenses due to work relocation including costs associated with taking a taxi or ride-sharing app service from home due to mass public transport closures;
- Critical care and funeral expenses of an employee or a member of the employee's family, who dies from a COVID-19 infection; and
- Other living expenses due to an employee's know exposure to COVID-19 such as hand sanitizers and home disinfectant supplies.

"Qualified disaster relief payments" do not include nonessential, luxury, or decorative items or services. Additionally, Section 139 does NOT cover payments that are wage replacement payments such as sick pay, family medical leave pay, or any other type of salary or leave pay). As such, wage replacement payments will still be taxable wages and will remain subject to income and payroll tax withholding and reporting.

Section 139 does not impose limits on the amount of "qualified disaster relief payments" that employers can make to employees (either individually or in the aggregate). Moreover, Section 139 does not require that employees reach a certain period of employment in order to receive tax-free payments.

2020 Election Considerations for Year-End Tax Planning

While we are still waiting to finalize the 2020 election result, former VP Joe Biden has won the presidency and the Democrats kept the House. However, the Senate race is still open and without control of the Senate, Biden might not be able pass a sweeping tax reform bill. Below is a summary of tax changes President-elect Biden publicized on the campaign trail.

- Taxpayers with income over $400,000 would see taxes increase as top rates will increase from 37% to 39.6%
- Increase to capital gain rates

INCOME (MFJ)	CURRENT RATES	BIDEN RATES
$0 - $78,749	0%	0%
$78,750 - $488,850	15%	15%
$488,851 - $999,999	20%	20%
> $ 1 million	20%	39.6%

- Corporate tax would increase from 21% to 28%. Additionally, a 15% alternative minimum tax has been discussed for corporations with book income over $100 million
- 199A Deduction – phase out all deductions for those with income over $400,000 and end special qualifying rules, including those for real estate investors / industry
- Limit itemized deduction at 28% for those with income over $400,000, but remove the state tax deduction cap
- Increase to estate tax

	CURRENT*	BIDEN
Exemption	$11.58 million	$3.5 million *(likely)*
Tax Rate	40%	*Not available*

*Current exemption amount sunsets on 12/31/2025 back to $5,000,000

- Social security - Maintain current social security wage base, but then social security tax would start again on incomes greater than $400,000

Given a likely increase in tax rates for both corporations and high earning individuals, year-end tax planning is a crucial endeavor and could result in permanent tax savings. Here are some items to consider:

- Accelerate income into 2020
    - Businesses should consider accelerating income or deferring deductions in 2020. Year over year, this could result in real tax savings. This will also maximize the QBI deduction while it is at its current levels. To preserve deductions at higher tax rates, defer equipment purchases and consider not taking bonus or section 179 if you place assets in service in 2020.
    - Individuals should consider converting any traditional IRA to Roth IRA to take advantages of lower rates.

- Take advantage of capital gains rates in 2020
    - Consider selling appreciated capital assets and equities to take advantage of preferential rates. Please consult with your investment advisor as there may be other non-tax strategies associated with stocks and bond investments.
    - S Corporations should consider paying out any remaining C corporation Earning & Profits as a dividend in 2020.
    - C corporations should consider paying dividends while both the C corporation taxes are lower and the individual taxes are lower.

- If you have management team making over $400,000 a year, consider a deferred compensation package. This will both push deductions into future years and help avoid the social security donut tax.

- Consider increased gifting and trust strategies to take advantage of the current high estate tax exemption.

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