DOWNTURN TAX PLANNING

CASE FOR LOSSES: INTEREST AND DEPRECIATION EXPENSES

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The recent CARES Act enacted on March 27, 2020 creates opportunities to create and use losses. In particular, the CARES Act increases deductions for depreciation and interest expense for some taxpayers. Those items, in turn, may reduce taxable income in 2018, 2019 and 2020 or add to losses than can be carried back or forward to other years to generate refunds.

2017 tax reform legislation, 2017 TCJA, roughly speaking limits business interest expense deductions for any taxpayer (for an entity and individual) in any year to 30% of taxable income with adjustments. To implement the limitation, the IRS and Treasury came out with over 400 pages of proposed regulations in November 2018. Those regulations treat many items as interest expense, propose a highly complex allocation scheme for partnerships and cover a variety of other issues, some more controversial than others. The IRS and Treasury may have intended to issue final regulations in the near future – but along comes Covid-19. The CARES Act modifies the business interest expense limitation. Specifically, that the CARES Act raises the limit on deductible business interest expense to 50% of adjusted taxable income for 2019 and 2020. The rules for partnerships for 2019 follow a different set of rules. Taxpayers generally may make elections to retain the 30% limit or use 2019 adjusted taxable income in computing the limit for 2020. In April 2020, the IRS issued Rev. Proc. 2020-22 to provide rules regarding making and withdrawing elections related to business interest expense.

The CARES Act also made a long-awaited technical correction to provide that qualified improvement property (QIP) has a useful life of 15 years, rather than 39 years, retroactive to December 2017. In April 2020, the IRS issued Rev. Proc. 2020-25 to address issues raised by the change in useful life. The change has created headaches for partnerships that must determine how best to report and conform to the change. For example, an article in the May 6, 2020 issue of Tax Notes Today points out that taking the adjustments into account through the administrative adjustment request (AAR) process in 2020 could deprive partners of the tax benefits of the change. The IRS provided some relief to partnerships in Rev. Proc. 2020-23 by enabling them to file amended tax returns and issue amended K-1s for 2018 and 2019. The Rev. Procs. referenced above contain filing deadlines and other detailed requirements.

Making QIP 15-year property enables taxpayers to write-off 100% of the cost under the bonus depreciation rules. That change should help taxpayers in retail and restaurant businesses hit hard by the Covid-19 pandemic to reduce their tax liabilities and potentially receive refunds.

The preceding discussion is not and should not be construed as legal or tax advice or representation on specific legal matters for any client or jurisdiction, but rather as a general commentary. The information provided should not be acted upon without specific legal advice based on particular situations.

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