

# TAX HELP IN THE CARES ACT OF 2020

# INTRODUCTION

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With U.S. corporate bankruptcies poised to hit a decade-long high as a result of the economic impact of COVID-19, we have prepared these materials that detail the key bankruptcy tax issues and guidance offered by Linda Swartz, the chair of Cadwalader's Tax Group, in old and new speeches and panels. We hope you find this presentation to be both useful and informative.

For additional information, contact [Linda Swartz](mailto:linda.swartz@cwt.com) ([linda.swartz@cwt.com](mailto:linda.swartz@cwt.com)).

## Upcoming speaking engagements:

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| <b>October 14, 2020</b> | <ul style="list-style-type: none"><li>• <b>Linda Swartz</b> will be presenting "Tax Strategies for Financially Troubled Businesses and Other Loss Companies" at PLI's <a href="#">Tax Strategies for Corporate Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations &amp; Restructurings 2020</a></li></ul> |
| <b>November 5, 2020</b> | <ul style="list-style-type: none"><li>• <b>Linda Swartz</b> will be presenting "A Cause for Distress? The Ways the Federal Income Tax Pushes Taxpayers into Bankruptcy" at <a href="#">The University of Chicago Tax Conference</a></li></ul>   |
| <b>January 25, 2021</b> | <ul style="list-style-type: none"><li>• <b>Linda Swartz</b> will be presenting "Distressed Corporations: Creditor and Shareholder Issues" at the <a href="#">2021 University of Southern California Federal Tax Institute</a></li></ul>   |
| <b>February 8, 2021</b> | <ul style="list-style-type: none"><li>• <b>Linda Swartz</b> will be presenting "Workouts and Debt Restructurings" at PLI's <a href="#">23rd Annual Real Estate Tax Forum</a></li></ul>  |

# LINDA Z. SWARTZ

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**Linda Z. Swartz**  
Chair, Tax  
New York  
(212) 504 6062  
linda.swartz@cwt.com

Linda Swartz, the longtime chair of Cadwalader's Tax Group and member of the Firm's Management Committee, focuses her practice on structuring complex restructurings, bankruptcies, mergers and acquisitions, spin-offs, joint ventures, and foreign tax planning strategies. She also regularly advises clients on fund structures, financings and derivative transactions.

Linda is consistently recognized as one of the leading tax lawyers in the country. She was recently named one of 14 "Influential Women In Tax Law" by *Law360*, noted for her role as "a key architect on billion-dollar transactions involving major multinational companies" with clients describing her tax structuring expertise as "so strong that we don't even go to the IRS to get a blessing from them. We go to Linda to get a blessing from her." She has been described by *Chambers USA* as "acclaimed for her vast reservoir of practical knowledge of the U.S. tax code" and "an expert on the law of today but cognizant of where the law might go in the future, allowing clients to make decisions which last for the next ten years." Clients quoted by *The Best Lawyers* in America have described Linda as "the foremost U.S. tax advisor on structured acquisition and divestiture deals" and "a professional force of nature" with "extraordinary technical ability, coupled with fiercest and most trenchant deal negotiation skills of any transactional tax lawyer." She was also recognized as "2017 Foreign Tax Planning Lawyer of the Year" by *Finance Monthly*, and *Dow Jones*, reporting on Procter & Gamble's Reverse Morris Trust transaction with Coty, noted that "it isn't often you see a tax adviser credited on a deal, but that's exactly what happened for Cadwalader, Wickersham & Taft in P&G's complicated \$12.5 billion unloading of its beauty business to Coty."

Linda is widely regarded as a thought leader in the industry and is a prolific speaker and writer on a wide range of transactional tax issues, with articles that include "Partnership Bankruptcy Tax issues," "Debt Exchanges," "Bankruptcy Tax Issues," and "Bankruptcy Tax 101." She also authors the chapters on Debt Exchanges in *Collier on Bankruptcy Taxation* (Matthew Bender) and Securities Lending Transactions in *Taxation of Financial Institutions* (Clark Boardman Callaghan). In addition to writing, she speaks on a broad range of topics, including each year on workout and bankruptcy tax issues at the corporate and real estate tax PLI conferences.

Linda is a member of the Executive Committee of the New York State Bar Association Tax Section and has chaired its Tax-Free Reorganizations; Corporations; Bankruptcy; Consolidated Returns; Real Property; and Tax Accounting and Basis Committees.

Linda received her J.D. from University of Pennsylvania Law School, and her B.A. from Bucknell University, where she graduated *magna cum laude* and was elected to Phi Beta Kappa.

# CARES ACT: BUSINESS TAX PROVISIONS

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The Coronavirus Aid, Relief, and Economic Security (CARES) Act, P.L. 116-136, included several provisions that provide business tax relief:

- Temporarily increased business interest deduction limitation under section 163(j);
- Temporarily reduced NOL limitations;
- Precluded government investment from causing a section 382 ownership change;
- Accelerated corporate AMT credit recovery; and
- Fixed the “retail glitch”, allowing immediate expensing of Qualified Improvement Property.

# CARES ACT: INCREASED INTEREST DEDUCTION CAP

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The CARES Act increased the 2017 Tax Act taxpayer interest deduction cap of 30% of Adjusted Taxable Income (ATI).

- Pre-CARES Act, ATI generally equaled EBITDA. For taxable years beginning in 2022, ATI will generally equal EBIT.
- The CARES Act increases this cap on deductions:
  - Raises the 30% ATI threshold to 50% for taxable years beginning in 2019 and 2020 (unless the taxpayer elects out); and
  - Allows taxpayers to elect to calculate the interest limitation for taxable years beginning in 2020 based on the taxpayer's ATI for its last taxable year beginning in 2019.
  - Special rules apply to partnerships. Section 163(j)(10)(A)(ii).

# PROCEDURES FOR INTEREST DEDUCTION AND REAL PROPERTY ELECTIONS

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Revenue Procedure 2020-22 provides mechanics for interest deduction elections.

- Describes the election process:
  - to retain the 30 percent, rather than 50 percent, of ATI limitation on interest deduction for tax years beginning in 2019 and 2020;
  - to use the taxpayer's ATI for the last tax year beginning in 2019 to calculate the taxpayer's section 163(j) limitation in 2020; and
  - to subject all, rather than 50 percent, of a partner's allocable excess business interest expense from a partnership to the section 163(j) limitation for tax years beginning in 2020.
- Revenue Procedure 2020-22 also allows certain taxpayers to make a late election – or to withdraw a prior election – to be an electing real property trade or business (section 163(j)(7)(B)) or an electing farming business (section 163(j)(7)(C)) for 2018, 2019 and/or 2020 taxable years.
  - Businesses making these elections are exempted from the 163(j) interest deduction limitation at the expense of a slower depreciation schedule.

# FINAL SECTION 163(J) REGULATIONS

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## Regulations refine interest definition and ATI calculations

- Permits ATI increase for depreciation, amortization, and depletion amounts capitalized under section 263A for taxable years beginning before 2022.
- Narrower interest definition:
  - In response to broad criticism, several items including commitment fees, debt issuance costs, hedging transactions, and guaranteed payments were removed from the definition of interest.
  - The narrow scope of the new definition is undercut by the addition of an anti-abuse rule that may apply to recast any transaction that has a principal purpose of artificially reducing net business interest expense.
    - Further, the IRS is continuing to study the treatment of debt issuance costs.

# CARES ACT: EXPANDED NOL CARRYOVERS

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The 2017 Tax Act prohibited most taxpayers from carrying back NOLs to prior taxable years and limited new NOLs to offsetting only 80% of taxable income in any carryover taxable year.

- The CARES Act temporarily rescinds these restrictions, permitting taxpayers to:
  - carry back NOLs arising in taxable years beginning in 2018, 2019, and 2020 up to five taxable years, and
  - offset 100% of their taxable income with NOL deductions in taxable years beginning before 2021.
- The CARES Act appears to preclude taxpayers from carrying back NOLs to offset lower-taxed section 965 inclusions via an automatic section 965(n) election.
  - Taxpayers may waive carrybacks to taxable years with section 965 inclusions, or alternatively, waive the entire 5-year carryback period.
- Special rules apply to REITs and life insurance companies.



# PROCEDURES TO CARRY BACK NOLs

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## Revenue Procedure 2020-24

- Explains the procedures for taxpayers to:
  - waive carryback of NOLs arising in taxable years beginning in 2018, 2019, and 2020, or exclude taxable years with section 965 inclusions from the elective carryback period, and
  - make tentative carryback adjustments and NOL carryover elections with respect to NOLs arising in taxable years straddling, and not ending on, December 31, 2017.
- Clarified that the deemed Section 965(n) election applies only to NOLs carried back under the CARES Act.

## Notice 2020-26

- Grants taxpayers a six month extension to apply for tentative carryback adjustments for NOLs that arose in tax years beginning in 2018 and ending on or before June 30, 2019.

## Temporary Section 1502 Regulations

- Allow consolidated taxpayers more flexibility to waive carrybacks to pre-consolidation periods for CNOLs attributable to an acquired member's 2018 to 2020 taxable years.

# CARES ACT: ACCELERATED RECOVERY OF CORPORATE AMT CREDITS

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Before its repeal in 2017, the corporate alternative minimum tax (AMT) generated minimum tax credits that could be used to offset the corporation's regular tax in future years.

- The 2017 Tax Act repealed the corporate AMT and provided that any then unused AMT credits would be refundable over several years, with any remaining AMT credits refundable in taxable years beginning in 2021.
- The CARES Act accelerated this recovery by making the remaining AMT credits fully refundable in taxable years beginning in 2019.
- IRS posted Q&As to their website on May 27 clarifying how to calculate the impact of NOL carrybacks to pre-2017 tax years when AMT applied, which would otherwise trigger complex recalculations of AMT and AMT credits.
  - However, taxpayers cannot rely on the Q&As, which may conflict with the Code in some cases.

# CARES ACT GOVERNMENT INVESTMENTS WILL NOT TRIGGER OWNERSHIP CHANGES

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Section 382 strictly limits the amount of net operating losses and other tax attributes a corporation can use after it undergoes an ownership change.

- The CARES Act allows Treasury to invest in corporations, and requires Treasury to provide guidance to the effect that the government's investment "does not result in an ownership change for purposes of section 382," which is reminiscent of the guidance issued by the IRS in the wake of the 2008 credit crisis.
  - However, until Treasury issues the required guidance it will not be clear which types of transactions will be exempted.

# CARES ACT: BONUS DEPRECIATION FOR QUALIFIED IMPROVEMENT PROPERTY

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The 2017 Tax Act allows taxpayers to claim 100% bonus depreciation deductions for certain investments.

- However, due to a drafting error, certain improvements to the interior of nonresidential buildings known as Qualified Improvement Property (QIP) were not eligible for bonus depreciation.
- The CARES Act fixed this glitch so that QIP improvements made by a taxpayer after September 27, 2017, and placed in service by the taxpayer after December 31, 2017, are eligible for bonus depreciation, assuming all other requirements under section 168 are satisfied.

# PROCEDURE FOR ELECTING BONUS DEPRECIATION FOR QIP

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## Revenue Procedure 2020-25

- Permits a taxpayer to change the depreciation method for QIP placed in service after 2017 and in a taxable year ending in 2018, 2019 or 2020 by filing;
  - an application to change its accounting method,
  - an amended tax return, or
  - for partnerships, an administrative adjustment request.
- Also provides that a taxpayer can make a late election, or revoke or withdraw certain depreciation elections with respect to depreciable property placed into service during taxable years ending in 2018, 2019 or 2020.
  - Late and revoked elections made within the time specified will be treated as accounting method changes, reducing the administrative burden on taxpayers.

# SPECIAL PARTNERSHIP PROCEDURES

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## Revenue Procedure 2020-23

- Allows a larger partnership and its partners to quickly obtain the benefits of the CARES Act by amending returns for taxable years beginning in 2018 or 2019 that were filed before the revenue procedure was issued on April 8, 2020.
  - This process obviates the need to file an Administrative Adjustment Request, which would not benefit its partners until their current taxable year returns are filed, diminishing the immediate tax benefit the CARES Act was intended to provide.