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2020 Year in Review

CARES Act, COVID-19 and an Election

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Agenda

- CARES Act
- SALT Issues Related to the Pandemic
- What’s Next: Tax Consequences of the Election
- Other Multistate SALT Issues to Have on Your Radar in 2021

CARES Act

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What is the CARES Act?

- The Coronavirus Aid, Relief, and Economic Security Act (CARES Act)
  - Signed into law on March 27, 2020
  - Largest stimulus package in United States history:
    - Provides direct financial assistance to distressed businesses;
    - Significantly expands unemployment assistance; and
    - Provides rebates directly to taxpayers (also called stimulus checks, with eligible taxpayers receiving up to $1,200 ($2,400 if married) and an additional $500 per child)

Why is this Relevant?

- The CARES Act also includes several taxpayer-favorable changes to core federal tax provisions that were enacted or revised by the Tax Cuts and Jobs Act (TCJA)
- The CARES Act:
  - Establishes a new employee retention payroll tax credit,
  - Permits employers to defer the payment of payroll taxes,
  - Modifies:
    - **Net operating loss (NOL) provisions under IRC § 172**
    - **Business interest limitation provisions of IRC § 163(j)**
    - Bonus depreciation provisions of section IRC § 168(k)
    - Excess business loss limitation provisions under IRC § 461(l), and
    - Corporate alternative minimum tax (AMT) provisions under IRC § 53(e)

The CARES Act’s Changes to NOLs (IRC § 172)

– Elimination of the 80% Limitation
  - “The Temporary Repeal of Taxable Income Limitation”
  - Applicable to taxable years beginning before January 1, 2021
  - NOLs from taxable years beginning after December 31, 2017 that are carried forward to taxable years beginning after December 31, 2020 will be subject to the 80% limitation that was enacted as part of TCJA

– Reinstatement of NOL Carrybacks
  - 5-year carryback period for NOLs arising in 2018, 2019, and 2020 (taxable years beginning after December 31, 2017 and before January 1, 2021)

The CARES Act’s Changes to IRC § 163(j)

- New IRC § 163(j)(10)
  - In the case of any taxable year beginning in 2019 or 2020, the business interest expense limitation amount is increased from 30% of ATI to 50% of ATI
  - Taxpayers may elect not to have IRC § 163(j)(10) apply, retaining the application of the 30% ATI limitation
  - Permits taxpayers to elect to use 2019 ATI for taxable years beginning in 2020

CARES Act Impact on Federal Tax Provisions

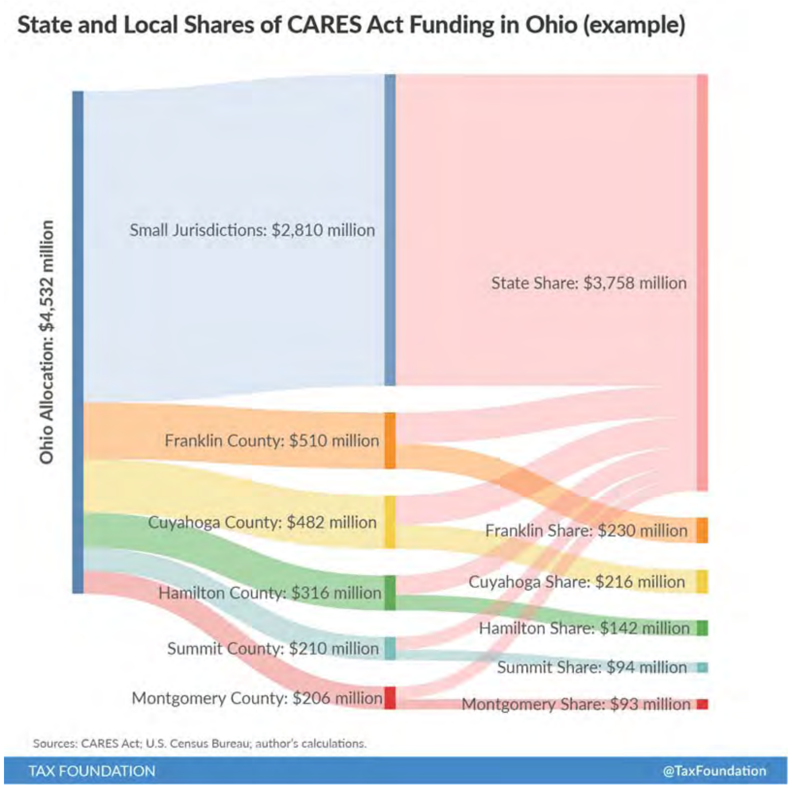
Tax Provision	Operation under the TCJA	CARES Act Impact
Net Operating Losses (§172)	No carryback for post-2017 NOLs; could only be carried forward	2018-2020 NOLs can be carried back up to 5 years
	Limits NOL deduction to 80% of taxable income	Deduction limitation repealed for 2018-2020 NOLs
Business Interest Expense Deduction (§163(j))	Business interest expense deduction limited to business interest income plus 30% of adjusted taxable income	2019-2020 adjusted taxable income (ATI) limitation loosened to 50% of adjusted taxable income
		May elect out of loosened limitation; may also elect to use 2019 ATI for taxable years beginning in 2020
Qualified Improvement Property – Bonus Depreciation (§168(k))	Failed to qualify for bonus depreciation under §168(k)	Includes QIP as 15-year property eligible for bonus depreciation retroactively to September 27, 2017
AMT Credits (§53(e))	Repealed corporate AMT post-2017; any earlier unused AMT credits only carried forward and allowed portions in 2018-2021	Accelerates refunds of credits to either 2018 or 2019
		Provides election to take entire refundable credit in 2018

CARES and Federal Aid to States

- **<u>Emergency Supplemental Funding</u>: $274 billion**
  - Disaster Relief Fund: $45 billion
  - Education Stabilization Fund: $30 billion
  - Transit Infrastructure Grants: $25 billion
  - Airport Improvement: $10 billion
  - Community Development Grants: $5 billion
  - Homeless Assistance Grants: $4 billion
  - Economic Development: $1.5 billion
  - Preparedness Grants: $1.5 billion
- **<u>Stafford Act Declaration</u>: $50 billion**
- **<u>Coronavirus Relief Fund</u>: $150 billion**
- **<u>Borrowing Authority</u>: $954 billion**
  - Exchange Stabilization Fund: $454 billion (shared with private sector)
  - Municipal Liquidity Facility: $500 billion
- **<u>FMAP Increase</u>: $50 billion** *(pre-CARES)*

CARES and Federal Aid to States

- In Idaho, Coronavirus Relief Act Funding is simple; the state is the only recipient ($1.25 billion)
- Limitations on use: must be in service of an economic or public health response to the pandemic
- Treasury guidance provides some flexibility in applying it to salaries of existing government employees who are responding to the pandemic in public health or safety roles



SALT Issues Related to the Pandemic

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Pandemic implications on federal and state tax policy

The **first phase** of the crisis, not surprisingly has been dominated by the federal government provision of **fiscal and tax stimulus**

- To date, the federal government has provided over $3 trillion of fiscal aid and tax stimulus with additional federal aid under consideration in the U.S. Congress

At some point, however, as the health and economic crisis abates, government policies will likely switch to the **second phase: tax increases and budget cuts to offset significant federal and state revenue shortfalls**

Growing state revenue shortfalls and debt

Before COVID-19

- Rainy day fund balances were at highest levels since before the "Great Recession"
  - California: Governor's proposed FY21 budget operating surplus was over $5B
- Rising corporate tax receipts, including those resulting from federal Tax Cuts & Jobs Act (TCJA) base broadeners
- Additional sales tax revenues from remote sellers and marketplaces

During COVID-19

- No state insulated: Pandemic affects almost every source of state and local revenue
- The largest states (CA; NY; TX; PA; IL) have projected revenues declines of $72B for FY2020-21
- Estimates of **state and local government shortfalls** range from $200B for FY2020-21 (TF & TPC) to $500B for FY2020-22 (CBPP)

Many unknowns impact post-pandemic federal and state tax policy

Duration of the Pandemic

Depth and Length of the 2020-21 Recession

Level of Public Support for Additional Government Spending

- Safety net programs, climate change, and infrastructure investment

Evolving Public Attitudes Toward Deficits, Debt, and Additional Taxes

What's Next
The SALT Impact of the Election

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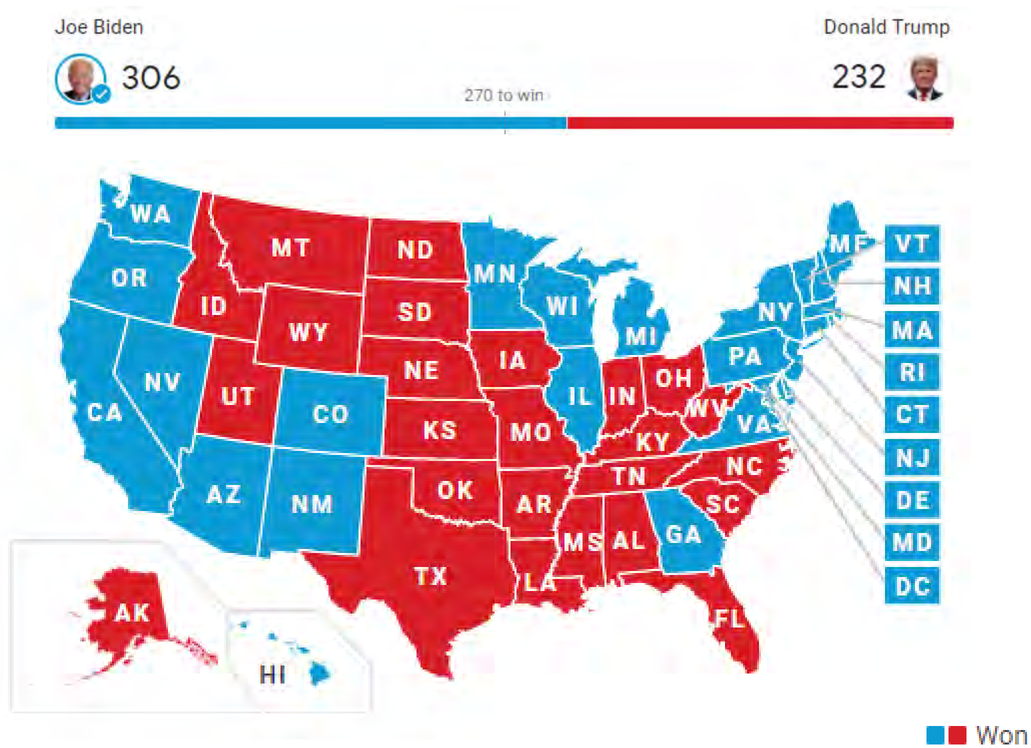
Presidential election



Source: Associated Press

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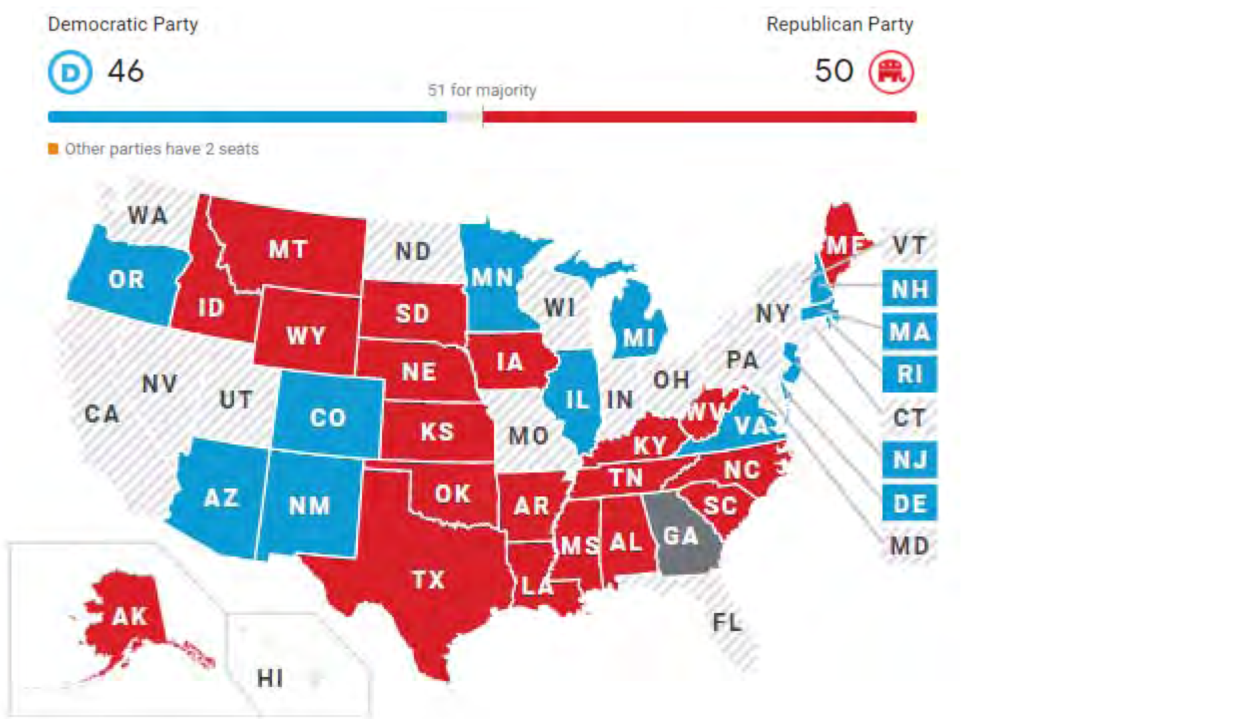
Senate election



Source: Associated Press

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House election

Source: Associated Press

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Election developments

What happens next?

- Campaign promises vs. implementation
  - Biden’s transition website is very light on tax policy
  - Prioritization of tax changes vs. COVID-19 relief
  - Will some items be negotiated away?
  - Push-back from interested parties, taxpayers, GOP
- Phased approach to implementation
  - Campaign hinted that some policies may not take effect until 2022

Biden tax plan

Businesses

- Raising the corporate tax rate to 28 percent
- Imposing a 21 percent minimum tax “on all foreign earnings of U.S. companies located overseas”
  - Double the current 10.5 percent GILTI rate
  - Compute GILTI tax (and related foreign tax credits) on a county-by-country basis rather than a worldwide average*
- Instituting a “tax penalty” on “corporations that ship jobs overseas in order to sell products back to America”
- Imposing a 15 percent minimum tax on book income
- Eliminating Section 1031 exchanges and the ability to offset real estate losses against other income under the passive activity loss rules*

** Reported in media but not present on official campaign website on Election Day.*

Biden tax plan

Individuals

- Raise the top individual income rate back to 39.6 percent
  - Income over $400,000 would also be subject to Social Security Tax*
  - Restored Pease limitation, 28% overall cap on deductions
- Equalizing the wage and investment income rates for individuals making over $1M
- Child tax credit expansion
  - $3,000 - $3,600 per child; fully refundable
- Health premium tax credits
  - Caps spending on healthcare to 8.5 percent of income
- First-time homeowner tax credit (Up to $15,000)
- "Equalizing the tax benefits of requirement plans"

** Reported in media but not present on official campaign website on Election Day.*

SALT Considerations

1. Gating question: conformity
2. State and local politics
   - Economic inequality
   - Competition among states and localities
   - Mobility of industries and workforce
3. Budget concerns
   - Feds to the rescue?
   - 2021 legislative priorities

Other Multistate SALT Issues to Have on Your Radar in 2021

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State responses to COVID-19

Working from home

- Millions of U.S. workers have shifted to remote work arrangements due to the pandemic
- Potential long-term impact: employers rethinking the need for expensive office spaces and shifting to a partially or fully remote workforce
- The shift towards remote work can have significant tax implications for companies

State responses to COVID-19

SALT consequences of working from home

Income tax filing requirements	Sales tax registration and collection obligations	Gross receipts taxes
Local taxes	Employment taxes	Interest and penalties

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Possible state legislative revenue raiser proposals

CIT Rate Increases

- Excess profits taxes; minimum taxes
- E.g., New York's 5% excess profits tax

CIT Base Expansion to Include Foreign Source Income

- Renewed state efforts to tax GILTI
- Mandatory worldwide combined reporting

Digital Services Taxes

City Payroll Taxes

- E.g. Portland, San Francisco and Seattle
- E.g., CEO pay ratio taxes (California, New York, Washington)

More state legislative revenue raiser proposals

Wealth Taxes

- E.g., New York's "Billionaire Mark-to-Market Tax Act" targets New York State resident billionaires and create a mark-to-market requirement to pay tax on all unrealized gains annually
- E.g. California's .4% tax on net worth above $30M

New Jersey Stock Transfer Tax

Elimination or Postponement of Certain Corporate Tax Credits

- E.g., California's NOL deduction suspension and $5M tax credit limitation for 2020-2022

Increases in Excise Taxes

- E.g. marijuana, cigarettes, gasoline

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