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The background of the slide features a photograph of several business professionals in a meeting. They are gathered around a table, looking at documents and a laptop. The image is overlaid with a semi-transparent blue filter. The text is centered on this blue overlay.

2020 Tax Update for Manufacturers

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Circular 230

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... Coronavirus Aid, Relief and Economic Security Act (CARES Act)

On March 27, 2020, the CARES Act was signed into law. The CARES Act provided the largest aid package in history, with roughly \$2.2 trillion of relief for emergency assistance being provided due to the COVID-19 Pandemic.

Business Provisions

Paycheck Protection Program (PPP)

PPP Loans

- Eligible recipients were able to obtain forgivable SBA backed loans from lenders of up to \$10 million.
 - Eligible recipients were generally employers with 500 or fewer employees.
- The first loan application period was February 15, 2020 and was originally scheduled to end on June 30, 2020, which was later extended to August 8, 2020.
- Loan amounts were generally 2.5 times the “total monthly payroll costs” incurred during the one-year period prior to the loan date (up to a maximum of \$10,000,000).

Paycheck Protection Program (PPP)

Summary of PPP Approved Lending

- The SBA published a summary of the program's approved lending through August 8, 2020:
 - Total Loans 5,212,128
 - Net Dollars \$525,012,201,124
 - Total Lenders 5,460

Paycheck Protection Program (PPP)

Summary of PPP Approved Lending (Continued)

- The SBA also published the specific loan size and other statistics under the PPP loan program (as a % of loan count):
 - \$50K and Under 68.6%
 - \$50K - \$100K 13.1%
 - \$100K - \$150K 5.7%
 - \$150K - \$350K 7.2%
 - \$350K - \$1M 3.8%
 - Over \$1M 1.6%
- Average loan size = \$101,000.

Paycheck Protection Program (PPP)

Impact on 2020 Taxable Income (Loss)

- The CARES Act specifically provided that the debt discharge (forgiveness) is excluded from gross income of the recipient.
- On April 30, 2020, Internal Revenue Service Notice 2020-32 was issued, which contradicts the language in the CARES Act (or at least the intent of legislation).
 - The IRS Notice provides that the amount forgiven creates a “class of exempt income.”
 - The IRS then concluded that the expenses that were paid with tax-exempt income will not be allowed a deduction.
 - The Notice effectively deems the PPP forgiveness as taxable income (by virtue of disallowing the deductions for wages, etc.).

... Employee Retention Credit for Employers

The CARES Act provides a refundable payroll tax credit for 50% of wages paid by eligible employers to certain employees during the Pandemic.

- *Eligible employers.* The 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. When the employer's gross receipts exceed 80% of the comparable quarter in 2019, the employer no longer qualifies for the credit at the end of that quarter.

... Employee Retention Credit for Employers

- Wages for the refundable credit are capped at the first \$10,000 in wages paid to an eligible employee.
- The credit applies to wages paid after March 12, 2020 and before January 1, 2021.
- The credit is **not** available to employers receiving a Paycheck Protection Program (PPP) loan or to self-employed individuals.

... Deferral of Employer Payroll Taxes

- CARES Act allows employers to defer payment of employer portion of Social Security (and RRTA taxes) through 2020.
 - Medicare portion is not eligible for deferral.
- The deferral period began March 27, 2020 and ends December 31, 2020.
- 50% of the deferral is payable December 31, 2021, and the 50% remaining deferral is payable December 31, 2022.
- This was originally not available to taxpayers that have Paycheck Protection Program indebtedness forgiveness, but this provision was removed with the Paycheck Protection Program Flexibility Act of 2020.

... Modifications for Net Operating Losses

- The Tax Cuts and Jobs Act (TCJA) changed the rules for NOL's by:
 - Repealing the NOL carryback provisions for losses incurred in tax years ended after December 31, 2017; and
 - For losses in tax years beginning after December 31, 2017, the NOL deduction was limited to 80% of taxable income.
- The NOL's generated in tax years ended after December 31, 2017, were allowed to be carried forward indefinitely to future tax years, subject to the taxable income limitation (80%) in each subsequent year.

... Modifications for Net Operating Losses

- The CARES Act modified the NOL rules by:
 - Temporarily removing the taxable income limitation (80%) for tax years beginning before 2021.
 - This allows for an NOL equal to up to 100% of taxable income for tax years 2018 through 2020.
 - For tax years beginning on or after January 1, 2021, the TCJA NOL rules will return (the 80% taxable income limitation for NOL's arising after 2017).

... Modifications for Net Operating Losses

- The CARES Act modified the NOL Carryback rules by:
 - NOL's arising in tax years beginning after December 31, 2017 and before January 1, 2021, can be carried back to each of the **five** tax years preceding the tax year of the loss (NOL).
- **Special Note:** The NOL carryback provisions are mandatory under the tax law, unless the taxpayer elects to waive the carryback period. Failure to comply with the mandatory carryback provision with no election to waive the carryback period could result in a disallowance of the loss in a future year.
- Revenue Procedure 2020-24 was issued to address some of these issues, including special rules for 2018 and 2019 NOL's.

... Losses for Noncorporate Taxpayers

- The TCJA added a provision for “excess business losses” and the amount of allowable losses that can be utilized in a tax year (for non-C-corporation businesses).
- The TCJA limited the allowable loss to the sum of aggregate business income plus \$250,000 (\$500,000 for married filing joint).
- Excess business losses would convert to a net operating loss, which would be subject to the 80% taxable income limitation under the same TCJA NOL rules.

... Losses for Noncorporate Taxpayers

- The CARES Act **retroactively** removed the “Excess Business Loss” limitation under Section 461 for business losses arising in 2018, 2019, and 2020.
 - The Excess Business Loss rules will return for tax years beginning after December 31, 2020 and before January 1, 2026.
- For tax returns filed for 2018 and 2019, action may need to be taken to amend and recalculate the tax returns to account for the retroactive law change. Failure to do so may result in a disallowance of losses claimed in future years.

... Interest Expense – Section 163(j)

- The TCJA added limitations to the amount of business interest allowed to be deducted by certain taxpayers beginning with the 2018 tax year.
- The TCJA provision limited the business interest deduction to 30% of adjusted taxable income for the year.
- Any disallowed business interest would carry forward to future tax years, subject to the same 30% adjusted taxable income limitation.
- **Note:** The Section 163(j) limitation exempts some small businesses (typically with annual average gross receipts of no more than \$25 million in 2018, and \$26 million in 2019).

... Interest Expense – Section 163(j)

- The CARES Act temporarily and retroactively increases the limitation of deductible business interest from 30% of adjusted taxable income to 50% of adjusted taxable income.
- The CARES Act change only applies to tax years beginning in 2019 and 2020 (does not retroactively apply to 2018).
 - Partners in a partnership subject to Section 163(j) provisions will only see the 50% limitation for 2020 (not for 2018 or 2019).
- The CARES Act also allows taxpayers to elect to calculate the 2020 interest limitation using 2019 adjusted taxable income.

... CARES Act Changes to Depreciation

- **TCJA Law Change:** Allows 100% expensing for qualified property (generally, depreciable assets other than buildings) that are acquired and **placed in service after September 27, 2017** and before 2023 (before 2024 for “longer production period” property and certain aircraft).

... CARES Act Changes to Depreciation

- Prior to the TCJA, certain “qualified improvement property” was included in qualified property for purposes of claiming 100% additional first-year depreciation (bonus depreciation).
- The TCJA failed to classify “qualified improvement property” as expected, thus fell into the 39-year recovery period for nonresidential real property, not eligible for bonus depreciation.

... CARES Act Changes to Depreciation

- The CARES Act provides for a technical correction to the TCJA (not a law change) with respect to “Qualified Improvement Property” (QIP).
- The CARES Act specifically designates QIP as 15-year property, eligible for 100% bonus depreciation, for property placed in service after December 31, 2017.

... Qualified Improvement Property (QIP)

- What is Qualified Improvement Property?
 - QIP is any improvement to an interior portion of a building that is nonresidential real property, if the improvement is made by the taxpayer and placed in service after the date the building was first placed in service.
 - QIP does not include an improvement for which the expenditure is attributable to:
 - (1) Enlargement of the building;
 - (2) Any elevator or escalator; or
 - (3) The internal structural framework of the building.

Outlook on Interest Charge Domestic International Sales Corporations (IC-DISC)

... Manufacturing and IC-DISC's

What is an IC-DISC?

- An IC-DISC is a tax-exempt corporation (pays no Federal income tax), which generates commission income from a “related producer,” or the manufacturing entity.
- The IC-DISC generates commission income from the related producer’s sale of “qualified export property,” which is deductible to the related manufacturer.

... Manufacturing and IC-DISC's

Transactions with the IC-DISC

- The IC-DISC generates commission income from the related manufacturer on qualified export sales equal to the greater of:
 - 50% of the net profit on the export sales; or
 - 4% of the total export sales (limited to net profit).
- The IC-DISC generates commission income, while the related producer deducts the commission expense, reducing taxable income of the manufacturer.

... Manufacturing and IC-DISC's

Benefits of the IC-DISC

- The related manufacturer is able to deduct commission payments against taxable income:
 - 21% (2019) for C-Corporations; and
 - Up to 37% (2019) for S-Corporation/Partnership.
- The IC-DISC pays no Federal income tax on the commission income (no state tax in New York) on undistributed profits.

... Manufacturing and IC-DISC's

Benefits of the IC-DISC (continued)

- The commission income is not taxed until a taxable dividend is paid from the IC-DISC to its shareholders.
 - Taxed at “qualified dividend” rates (15-20%), and subject to net investment income tax rules (3.8%).
- IC-DISC's can defer tax on up to \$10 million in export gross receipts per year, and deferral is indefinite (until dividends are paid to its shareholders).

... Manufacturing and IC-DISC's

Benefits of the IC-DISC (continued)

- Undistributed profits are subject to an annual interest charge on the amount of income tax deferred.
 - 2019 interest rate was 2.347% (base period T-bill rate).
 - The projected 2020 interest rate will be significantly lower than 2019, making the cost of deferring tax even less.

... Manufacturing and IC-DISC's

Additional Considerations and Planning Opportunities

- Profits may be deferred (indefinitely) without the imposition of income tax.
- To defer income, cash must be paid from manufacturer (producer) to the IC-DISC and cannot be distributed to IC-DISC shareholders (taxable dividend).
- IC-DISC shareholders defer tax on undistributed IC-DISC profits at the cost of the “interest charge” on the deferred tax.

... Manufacturing and IC-DISC's

Future Considerations and Outlook of IC-DISC

2019 Tax Rates

- Manufacturer tax rate = 21% to 37%.
- Shareholder tax rate (dividend) = 15% to 23.6%.
- Rate differential = 6% to 13.4% (without state tax impact).

Potential Increase under Biden Administration

- Proposed manufacturer tax rate of **28% to 39.6%**.
- Proposed ordinary income rates (up to 39.6%) on capital gains and qualified dividends for taxpayers with income over \$1 million.

Individual Provisions

... Special Rules for Use of Retirement Funds

(Act Section 2202)

- **No 10% Additional Tax for Coronavirus-related Retirement Plan Distributions.**
 - 10% additional tax (IRC Section 72(t)) does not apply to any coronavirus-related distribution of up to \$100,000 made to a qualified individual.
 - A qualified individual is an individual who:
 - Is diagnosed with the virus SARS-CoV-2 or with coronavirus disease 2019 (COVID-19) by a test approved by the Centers for Disease Control and Prevention (CDC);
 - Whose spouse or dependent is diagnosed with such virus or disease by such a test; or
 - Who experiences adverse financial consequences as a result of being quarantined, being furloughed or laid-off or having work hours reduced due to such virus or disease, being unable to work due to lack of childcare due to such virus or disease, closing or reducing hours of a business owned or operated by the individual due to such virus or disease, or other factors as determined by the Secretary of the Treasury.

... Special Rules for Use of Retirement Funds

(Act Section 2202)

- *Recontribution:*
 - Any individual who receives a coronavirus-related distribution may, at any time during the 3-year period beginning on the day after the date on which such distribution was received, make one or more contribution in an aggregate amount not to exceed the amount of such distribution to an eligible retirement plan of which such individual is a beneficiary and to which a rollover contribution of such distribution could be made.

... Special Rules for Use of Retirement Funds

(Act Section 2202)

- *Inclusion in income over three years:*
 - Unless the taxpayer elects not to, any amount required to be included in gross income for such tax year will be so included ratably over the 3-tax year period beginning with such tax year.
- Coronavirus-related distributions are not treated as eligible rollover distributions.
- The administrator of an eligible retirement plan may rely on an employee's certification that the employee satisfies the conditions of subparagraph (A)(ii) in determining whether any distribution is a coronavirus-related distribution.
- Applies to distributions made on or after January 1, 2020, and before December 31, 2020.

... Special Rules for Use of Retirement Funds

(Act Section 2202)

- Increase in limit on loans not treated as a distribution.
 - Plan loan limit increased from \$50,000 to \$100,000.
 - Due date extension for repayments for any loans with a due date falling between date of enactment (March 27, 2020) and December 31, 2020.
 - Due date is extended one year.

... Temporary Waiver of Required Minimum Distribution Rules for Certain Retirement Plans and Accounts

(Act Section 2203, IRC Section 401(a)(9) Amended)

- CARES Act provides that the RMD requirements do not apply for calendar year 2020 to:
 - Defined contribution plan (i.e., Pension/401k);
 - An eligible deferred compensation plan described in Code Section 457(b), but only if such plan is maintained by an employer described in Code Section 457(e)(1)(A); and
 - An IRA.

... Allowance of Partial Above the Line Deduction for Charitable Contributions

(Act Section 2204, IRC Section 62(a) Amended)

- Adds a deduction to the calculation of gross income, in the case of tax years beginning in 2020, for the amount (not to exceed \$300) of qualified charitable contributions made by an eligible individual (non-itemizer) during the tax year.
- Qualified contributions:
 - Paid in cash during calendar year 2020 to 501(c)(3) and certain other charitable organizations;
 - Taxpayer elects to apply this provision with respect to the contribution; and
 - Applicable for tax year beginning after December 31, 2019.

... Modification of Limitations on Charitable Contributions During 2020

(Act Section 2205)

- Individuals: Temporary suspension of limitations on certain cash contributions.
 - 60% adjusted gross income (AGI) limit disregarded for qualified contributions.
 - To the extent the qualified contributions exceed the taxpayer's base (100% of AGI), excess treated as a carryover under normal 5-year carryover rules.

... Modification of Limitations on Charitable Contributions During 2020

(Act Section 2205)

- Corporations: Qualified contributions shall be allowed as a deduction only to the extent that the aggregate of such contributions do not exceed the excess of 25%.
 - Nonqualified contributions and carryovers are still subject to the 10% limitation.
- Qualified Contributions.
 - Paid in cash during calendar year 2020 to 501(c)(3) and certain other charitable organizations; and
 - Taxpayer has elected the application of this section with respect to such contribution.

... Modification of Limitations on Charitable Contributions During 2020

(Act Section 2205)

- Exceptions: Qualified contribution shall not include a contribution by a donor if the contribution is:
 - Made to an organization described in Section 509(a)(3):
 - Private Foundation.
 - Made for or the establishment of a new, or maintenance of an existing, donor advised fund.
- Increased limits on contributions of food inventory from 15% to 25%.
- Applicable to taxable years ended after December 31, 2019.

... Exclusion for Certain Employer Payments of Student Loans

(Act Section 2206, IRC Section 127(c) Amended)

- Eligible student loan payments are now included in the overall \$5,250 per employee limit for all educational payments.
 - Eligible student loan repayments are payments by the employer, whether paid to the employee or a lender, of principle or interest on any qualified higher education loan as defined in Code Section 221(d)(1) for the education of the employee (*but not of a spouse or dependent*).
- To prevent a double benefit, student loan repayments for which the exclusion is allowable can't be deducted under Code Section 221 (which allows the deduction of student loan interest subject to a dollar limit and a phase-out above specified taxpayer income levels).
- Applies to payments made after the date of the enactment (March 27, 2020).

... CARES Act & New York State Taxes

- For taxable years beginning in 2019 and 2020, New York State's budget bill decouples from the CARES Act and will not include any changes made to the Internal Revenue Code after March 1, 2020 for taxable years beginning before 2022.
- As a result, the following significant Federal changes made to the IRC by the CARES Act that we've previously discussed are not allowed for New York State tax purposes:
 - Net Operating Losses: Elimination of 80% limit and 5-year carryback.
 - Excess Business Losses: Limitation on Excess business losses still exists for New York State taxpayers.
 - Interest Expense Limitation under Section 163(j): New York State limit remains at 30% of adjusted taxable income.



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... Questions

