Top Tax Topics Impacting Businesses During COVID-19

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Learning Objectives

- Review, at a high level, the latest updates on federal and state regulations
- Discover key opportunities for discussions around NOLs, compensation, international tax and more
- Identify when you should contact an expert on COVID-19 tax matters

Expert Biography

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David has 30 years of public accounting experience and leads Armanino's tax practice. He also leads the National Tax Office Provision (ASC 740) team. David specializes in compliance and consulting for complex tax and business issues facing venture capital funded private businesses, organizations planning for an IPO, well as publicly traded companies in the technology space. He has experience assisting clients with accounting for income taxes, mergers and acquisitions, accounting periods and methods, R&D tax credits, tax audits and state and local taxation.

Prior to joining the firm, he spent 18 years with a Big Four Firm, where he served many prominent semiconductor, software and internet clients. David is a member of the American Institute of Certified Public Accountants and the California Society of Certified Public Accountants. He earned his Bachelor of Science degree from Santa Clara University.

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David has over a decade of public accounting experience, including several with a Big Four firm in the San Francisco Bay Area and Omaha, NE. David has extensive tax experience in the technology, hospitality, and consumer product goods industries, having provided tax services to a variety of companies both publicly and privately held.

He specializes in corporate taxation with a focus on ASC 740 income tax accounting and theory. He is also a subject matter expert for the Tax Cuts and Jobs Act of 2017. He is a licensed CPA in the State of California, is a member of the American Institute of Certified Public Accountants, and California Society of Certified Public Accountants.

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Matt has over two decades of experience providing tax expertise to technology and life sciences clients, including tax accounting of public companies, venture-funded corporations and startup entities. He specializes in corporate deferred tax accounting and tax reserve analyses, acquisition accounting and tax attribute analyses, tax internal controls, domestic compliance and consulting.

Prior to joining Armanino, Matt was a managing director at Alvarez and Marsal and the co-lead partner at Clifton Douglas. He also has prior experience at Deloitte and PwC, where he worked on large multinational companies and newly formed public corporations and was the office lead for expat/inpat tax services, completing various tours overseas.

Agenda

- Federal & State Update
- Impact to Provision (ASC 740)
- Business Opportunities
  - Section 382
  - 409A
  - Transfer Pricing
  - 165(i)
- Government Aid Update

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Federal & State Update

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Overview – H.R. 6201 and CARES Act

Families First Coronavirus Response Act (H.R. 6201)

- Intent was to stabilize federal and state agencies financially
- Expanded Emergency Paid Sick and Emergency Family and Medical Leave Acts of 1993
- Offered tax credits as offsets for Emergency Paid Sick and Family Medical Leave
- Supported unemployment insurance funds

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

- A much broader brush stroke was made to encompass both businesses and individuals
- Economic relief to the U.S. for those “impacted” by the COVID-19 virus
- Myriad of provisions, Corporate and Individual taxation and Government grans and loans
- Our focus will be on Corporate tax impacts and Government grants.

NOL Carryback Provision

- **Can now carryback NOLs from 2018 2019 & 2020**
- **Tax-year 2017 FYE2018 taxpayers can carryback that loss 2 years**
  - TCJA fix for “straddle years”
- **Scenario planning due to elections, ordering rules, past positions**
  - Planning around carryback to years where future benefits are more valuable – taking 21% vs. 35% rates into account and all other tax attributes (planning)
  - Need to consider indirect impact of carrybacks - §199, §250, §163(j), Credits, etc.

NOL Year	Carryback Period	Carryforward Period	Taxable Income Offset
On or before 12/31/2017	Two Years	20 years	100%
After 12/31/2017 and before 1/1/2021	Five Years	Indefinite	100% prior to 2021 80% after 2020
On or after 1/1/2021	None	Indefinite	80%

Other Pertinent Corporate Provisions

Other opportunities based on loss year…

- **Change to interest expense limitation** in 2019 and 2020 from 30% to 50%
- **Change to business expensing of assets not covered in the original TCJA** which will allow companies to generate larger NOLs to potentially carryback
  - Amendments to the 2018 return for enhanced deduction allowed
  - May be able to file an automatic Form 3115 method change to "catch up" the 2019 return
- **Immediate write-off of costs to improve facilities vs. having to depreciate improvements**
- **Current refunds of prior AMT this year vs. spread over future years**
  - If taxpayer filed a refund claim on its 2018, can file a corporate application for tentative refund by 12/31/2020 to claim remaining AMT refund.
  - Alternatively, taxpayer can file its 2019 return or superseded 2019 return claiming remaining AMT refund.

Technical Amendment/Correction to QIP - §168

- **Treats Qualified Improvement Property (QIP) as 15-Year MACRS Property**
  - Eligible for 100% bonus depreciation under current law
- **Coordination with §163(j)**
  - If a Taxpayer has made an Electing Real Property Trade or Business election under §163(j)(7), the Taxpayer must use the Alternative Depreciation System (ADS) (under §168(g)) to depreciate QIP
    - ADS does not allow for Bonus Depreciation
    - ADS requires straight line depreciation over class life (20 years for QIP).
- **Under current law, QIP is treated as non-residential real property**
  - MACRS 39-year, straight line, or
  - 40-year straight line for ADS.

State & Local Landscape

- **States likely not to conform to all federal provisions**
- **Need to plan this year** to maximize the value of this year's losses and COVID-19 expenses:
  - Apportionment analysis with focus on maximizing NOLs
  - Expense allocation analysis could also significantly increase losses in any state
- **State and Local Tax cash preservation opportunities**:
  - **Extended filing and payment deadlines** – generally automatic
  - **Refund Reviews** – Review of all material state and local tax returns for refund opportunities
  - **Business Activity Tax Extensions on Filing and Payment due dates** (CA)
  - **Sales Tax Collected but not yet remitted deferrals**
    - By request (CA and TX), and includes several other taxes administered by the CDTFA in CA
  - **State Payroll Taxes and Reports due date extensions**

Impact to Provision (ASC 740)

Impact to ASC 740

Interim Periods – Estimated Annual Effective Tax Rate (EAETR) ASC 740-270

- The determination of the EAETR requires an estimate of forecasted income or losses for the year
- COVID-19 pandemic can create challenges in preparing a reliable forecast
  - e.g., suspended operations, closures, reduction in demand, etc.
- If a Company is unable to reliably estimate its AETR, the actual ETR for the YTD period may be the best estimate of the AETR.
  - This may be the case when a small change in estimated ordinary income would result in a large change in the EAETR
  - e.g., when a company is estimating that its operating results will be at or about break even, or when permanent differences are significant as compared to estimated income.

Impact to ASC 740 (Continued)

- **Interim Period Losses**
  - Companies that are experiencing losses in light of COVID-19 may need to adjust their EAETR, limit YTD tax benefits, or both, if those losses exceed the ordinary losses expected for the full fiscal year
  - Additional jurisdictions may need to be excluded from the EAETR – ordinary losses for which a tax benefit cannot be realized
- **Material changes to state apportionment** – could impact EAETR and discrete deferred remeasurement
- **Need to consider "rate" EAETR vs. discrete impacts of COVID-19 and CARES Act**
  - e.g. – 2020 loss carryback benefit part of EAETR. 2018 – 2019 carryback benefit out-of-period recognized discretely

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Impact to ASC 740

CARES Act – March 27, 2020

- Companies should recognize the effect of the change in tax law on existing DTAs and DTLs in income from continuing ops in the interim period that includes March 27
  - Global companies need to consider other jurisdictions around the world that have enacted or are contemplating changes in tax laws or rates
- Any **deferred tax remeasurement** is recognized discretely
- Any **retroactive impacts of the new legislation** require income taxes payable or receivable for a prior annual period to be adjusted in the interim period of enactment
- **For now, no SAB 118 type relief,** but the SEC has provided general 10Q and 10K delayed filing date relief

Impact to ASC 740

- **Valuation allowance** – Companies experiencing losses may need to analyze whether current market conditions result in the inability to realize deferred tax assets. Especially, DTAs that expire in the near term or that are capital in nature
  - Scheduling of reversal may become necessary as Companies are unable to support realizability of its DTAs solely based on forecasts of future taxable income
  - Alternatively, carryback years is one of the four sources of taxable income to support realization of DTAs
- **APB 23 (ASC 740-30)** – Indefinite Reinvestment of Foreign Earnings
- **FIN 48 impacts**
- **Goodwill Impairment**
- **AMT** – consider reclassing DTA or long-term receivable to current receivable if refund expected within 12 months
- **Rate change** – existing temporary differences at the 21% rate that are expected to reverse during the year and become part of a loss that's carried back to a 35% year should be remeasured to 35% discretely in the period of enactment

Business Opportunities

Cash, Valuations, and Section 382

- **Funding and ownership**
  - The need for funding and with valuations, perhaps a down round
  - Current low interest rates that post-ownership change annual limits are based
  - Proposed regulations eliminate Notice 2003-65 (“deemed recognized built-in gains”)

- **What do we do today**
  - Analyze current ownership and cumulative change; understand “Section 382 “
  - Change triggers. Work to have changes in earlier periods when valuation higher
  - Create change before proposed regulations are final and use built-in gain provisions
  - Implement “poison pill” provisions to deter triggering an ownership change
  - For public companies, consider control premiums
  - Understand CARES, and develop a road map for attribute utilization

Section 382 – Problems We're Currently Seeing

- A combination of a decline in company values with the need to raise money can create Section 382 "change in ownership" problems.
- **Further compounding the issue are:**
  1. Current low interest rates that post-ownership change annual limits are based on (the Sec. 382 applicable federal rate; 1.09% in April and dropping fast), and
  2. Newly enacted proposed regulations (issued January 2020) that, once issued as final, will eliminate the benefit of Notice 2003-65 (utilization of "deemed recognized built-in gains").
- Both factors will have a significant effect on the annual utilization of tax attributes following a Section 382 "change in ownership."

Section 382 – Our Recommendation

- All companies should **assess the impact** that an additional funding round, or other share activity, might have towards incurring a potential change in ownership and the resultant loss of tax attributes.
- **For those companies with the potential of experiencing a change in ownership:**
  - Plan to avoid the impact of the newly issued proposed regulations; some of our clients are planning to trigger a change in ownership sooner, before final regulations are issued, rather than later.
  - If a change in ownership occurs, assess the existence of built-in gains on an asset-by-asset basis. Appreciated inventory or other appreciated “for sale” assets would result in actual recognized built-in gain upon sale, increasing the annual limit dollar for dollar.
  - Also, consider a “closing of the books” election which would shift more income to pre-change periods allowing unlimited use of tax attributes.

Valuations

- Valuations of private and public companies dramatically altered by Corona
- Reliance of valuation
  - Public valuations are set by market
  - Public impacts could be intangible assets and goodwill; impairments
  - 409A valuations and relevance to current conditions
  - Equity grants and value for taxation upon exercise or vesting

- Is this 2008-2010 great recession
  - Valuation methodologies need to assessed, market multiple, discounted CF, forecast
  - Stock repricings as a solution
  - Equity exchanges and accounting charge

§165(i) “Disaster Losses”

- **Section 165(i) permits companies to claim losses attributable to presidentially declared disasters on the prior year’s return.**
- The President made the required declaration on March 13, 2020, declaring the entire nation to be a federally declared disaster area by reason of COVID-19.
- **Examples of “disaster losses” include, but are not limited to:**
  - Closure of store and facility locations
  - Abandonment of leasehold improvements
  - Permanent retirement of fixed assets
  - Abandonment of pending business deals for which costs have been capitalized
  - Disposal of inventory, supplies and other property that has become unsaleable
  - In certain circumstances, termination payments for executory supply or customer contracts, leases, or licenses
  - Worthless securities (but not business bad debts)
  - Impaired securities if the taxpayer uses the mark-to market method, and
  - Loss from a sale or exchange of property.

§165(i) "Disaster Losses" (continued)

- **File claim on Form 4466**
  - **This is an extremely time sensitive opportunity**
  - Although the IRS extended the 2019 tax return due date to July 15, 2020, the notice did not postpone the Form 4466 due date.
  - Form 4466 must be filed by April 15, 2020, for a 2019 calendar year company.
- **Could increase 2019 NOL to be carried back to an earlier taxable year** (via the CARES Act).
- **Must have robust causation documentation** along with identifying, quantifying, and meeting the procedural requirements for claiming the losses using the one-year carryback election.

Transfer Pricing

How can companies streamline and identify cost-effective solutions to manage their transfer pricing risks and compliance?

- Transfer pricing policies for routine entities that receive “guaranteed profits”
  - Assess the legal framework and third-party behavior (e.g., force majeure doctrine and termination options)
  - Consider adjusting the transfer pricing to lower guaranteed returns to limited risk distributors, contract manufacturers, and service providers
    - what costs should be included in the compensation formula
    - whether and how much of a mark-up should be applied
    - Limited risk entities operate at break even
  - Charging out service fees for COVID-19 related expenses

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Government Aid Update

SBA Loan Programs

1. CARES/Paycheck Protection Program (PPP)
2. Economic Injury Disaster Loans (EIDLs)
3. Emergency Economic Injury Gra

CARES/Paycheck Protection Program (PPP)

- Maximum loan is $10,000,000 or 250% of the average monthly payroll expenses for the preceding one-year period, whichever is less
- Loans are made by lenders delegated authority under the SBA 7(a) guarantee program
- Interest rates – 4% maximum
- Term – up to 10 years
- Loan payment deferment relief of up to one year
- Loan forgiveness is available subject to certain limitations

SBA Disaster Loans

- **Economic Injury Disaster Loans (EIDLs)**
  - Maximum loan is $2,000,000 and maximum unsecured loan amount is $25,000. (EIDL)
  - Loan funds come directly from the U.S. Treasury.
  - Borrower collateral – business assets and other collateral of 20% plus owners
  - Personal guarantees – on loans in excess of $200,000, all 20% plus owners must provide personal guarantees
  - Interest rates:

- **Title IV Loans** for larger corporations (500-10,000 Employees)
  - Six-month deferral of payments, 2% interest rate

Where are we today?

- **Timing**: The SBA issued clear guidance to the banks about those underwriting and secondary market processes very late this afternoon. It is reasonable to expect that the bankers will be adjusting their processes to meet these guidelines overnight and into tomorrow.
- **Affiliates:** The SBA’s affiliation rules are broader than what we typically see in the affiliation concept. The SBA’s affiliation rules will play a role in determining the eligibility for an SBA loan. As many of us have noted, this could have a significant negative impact on venture capital-backed companies if they “affiliate” otherwise unrelated business and their employees against the 500 EE criteria.

Where are we today? (Continued)

- **Venture Funds:** There are two scenarios that could impact many VC backed companies. If a venture fund (and some or all of its portfolio companies) are affiliated with the applicant by way of ownership or control, the “employee” count for a company may include employees of the venture fund and employees of some or all of its portfolio companies. The rules rest at 50% or more of the company and certain control elements. If less than 50%, there needs to be an analysis of both positive and negative evidence to decide if control exists to where it would disqualify the company. We expect more details on this in the coming days.
- **Payroll Tax & PPP:** Neither section 1102 (PPP) nor section 1106 mention the section 2302 or the payroll deferral. Today, no debt has been forgiven. Therefore, a reasonable position to currently defer payroll taxes under section 2302. Once the forgiveness of a PPP loan has occurred, the statute appears to preclude a taxpayer from deferring the payroll taxes under the provision. At no time should a taxpayer include federal payroll tax deferral amounts in the Paycheck Protection Loan that may be forgiven (state and local employment taxes paid may be included as part of “payroll costs”).

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What are the main differences between the loans?

	PPP	EIDL	EEIG
Maximum Loan	$10 million	$2 million	$10,000
Forgiveness	Yes (Partial to Full)	No	Yes
Collateral Required	No	Yes	No
Funded By	Local Bank	SBA	SBA
Application Requirement	Simple	Complex	Simple
Compliance Requirement	Complex	Simple	NA
Time to Funding	4-6 weeks (expected)	3-4 weeks (estimated)	3 days
Personal Guarantee	No	Yes	No
Appropriate For	Capital to cover the cost of retaining employees, paying rent and utilities, plus any interest on debt	Payroll and other operating expenses that could have been met had the disaster not occurred	An emergency infusion of cash to cover you right now; an advance against EIDL

Questions?

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