CARES Act Business Tax Provisions with Significant Multistate Tax Considerations

Overview

Congress has approved and President Trump has signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act,[1] a tax-and-spending package intended to provide economic relief to help address the impact of the Novel Coronavirus (COVID-19) pandemic. The CARES Act includes several significant business tax provisions that, among other things, has:

- Given businesses and individuals the opportunity to carry back net operating losses (NOLs) arising in taxable years beginning in 2018, 2019 and 2020 to the five prior tax years;[2]
- Repealed the 80-percent of taxable income limitation added to Internal Revenue Code (IRC) section 172(a) by the 2017 Tax Act (P.L. 115-97, commonly known as the Tax Cuts and Jobs Act of 2017 or TCJA) for taxable years beginning before January 1, 2021;[3]
- Generally loosened the business interest expense limitation under section 163(j) by increasing the adjusted taxable income (ATI) threshold from 30 percent to 50 percent for taxable years beginning in 2019 and 2020 (although special partnership rules apply);[4] and
- Amended section 168 to permit 100% bonus depreciation for eligible Qualified Improvement Property (QIP) placed in service by the taxpayer after December 31, 2017 and before January 1, 2023.[5]

These CARES Act tax provisions will directly impact states that have statutory federal conformity provisions that tie them automatically to the federal changes, except where the state explicitly decouples from the IRC treatment or provides a specific modification.

This alert discusses these key business tax provisions and the multistate tax considerations of each.

Federal Changes under the CARES Act

Modification of Limitation on Business Interest under Section 163(j) (CARES Act Section 2306)

As amended by the TCJA, section 163(j) limits the deduction for business interest expense to the sum of (1) the taxpayer's business interest income; (2) 30 percent of the taxpayer's ATI; and (3) the taxpayer's floor plan financing interest expense for the taxable year. The CARES Act increases the 30 percent ATI threshold to 50 percent for taxable years beginning in 2019 and 2020. In addition, the CARES Act allows taxpayers to elect to use their 2019 ATI as their ATI in 2020 (with special rules applying for short taxable years beginning in 2020).

The CARES Act includes special rules for partnerships. The increased 50 percent ATI threshold would not apply to partnership taxable years beginning in 2019. Instead, excess business interest expense (i.e., business interest expense exceeding 30 percent of the partnership's adjusted taxable income) allocated by a partnership to a partner from a taxable year beginning in 2019 would be bifurcated. Fifty percent of that excess business interest expense would be treated as paid or accrued in 2020 and deductible by the partner without regard to the section 163(j) limitation. The remaining 50 percent of excess business interest expense would be subject to the existing rules, which generally treat excess business interest expense as paid or accrued only if the partner receives an allocation of excess taxable income or excess business interest income in a later year from the same partnership.

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[1] Coronavirus Aid, Relief, and Economic Security Act, H.R. 748, 116th Cong. (2020). A copy of the CARES Act is available here.
[2] *Id.* at Sec. 2303.
[3] *Id.*
[4] *Id.* at Sec. 2306.
[5] *Id.* at Sec. 2307.

Modification of Net Operating Losses under Section 172 (CARES Act Section 2303)

The CARES Act includes several significant amendments to the provisions of section 172. These amendments, among other things:

- Repeal the 80-percent of taxable income limitation added to section 172(a) by the TCJA (80 percent limitation) for taxable years beginning before January 1, 2021. This amendment applies to taxable years beginning after December 31, 2017, and taxable years beginning on or before December 31, 2017, to which NOLs arising in taxable years beginning after December 31, 2017, are carried; and
- Provide a five-year carryback period for NOLs arising in taxable years beginning in 2018, 2019, or 2020. This amendment applies to NOLs arising in taxable years beginning after December 31, 2017, and to taxable years beginning before, on, or after such date to which such NOLs are carried.

Significantly, the temporary repeal of the 80 percent limitation, when coupled with the new five-year NOL carryback period, affords corporations the ability (1) to utilize NOLs in taxable years beginning as early as in 2013 (for an NOL experienced in a taxable year beginning in 2018), and (2) to offset taxable income in those prior years that had been subject to tax at a 35 percent rate. Overall, these changes are intended to allow corporations to utilize NOLs and amend prior year returns, which will provide additional cash flow and liquidity.

In the case of a taxable year beginning after December 31, 2020, the 80 percent limitation is amended such that it applies before taking into account the deductions allowed under sections 199A and 250 and after taking into account the NOL deductions for NOL carryovers arising in taxable years beginning before January 1, 2018 and carried to such taxable year. As amended by the CARES Act, the 80 percent limitation applies to NOLs arising in taxable years beginning after December 31, 2017 (*e.g.*, including calendar years 2018, 2019, and 2020) that are carried forward into any such taxable year.

Technical Amendments Regarding Qualified Improvement Property under Section 168 (CARES Act Section 2307)

The CARES Act includes a technical correction that corrects the 2017 Tax Act to permit 100% bonus depreciation for eligible QIP placed in service by the taxpayer after December 31, 2017 and before January 1, 2023. This technical correction is made to section 168 and may provide a significant opportunity for taxpayers that placed eligible QIP in service during 2018 and 2019 to claim 100% bonus depreciation. The technical correction also provides for a 15-year regular modified accelerated cost recovery system (MACRS) depreciation recovery period and a 20-year alternative depreciation system (ADS) depreciation recovery period.

This could be significant for many taxpayers, including REITs and manufacturers, that own certain types of nonresidential real estate improvements on leased land and did not claim 100% bonus depreciation previously. This can also provide immediate current cash flow benefits and relief to taxpayers, especially those in the retail, restaurant, and hospitality industries. Taxpayers that placed QIP into service in 2019 can claim 100% bonus depreciation on their 2019 return. They may also consider filing Form 4466 to recover overpayments of 2019 estimated taxes. Taxpayers that placed QIP in service in 2018 and that filed their 2018 federal income tax return treating the assets as bonus-ineligible 39-year property should consider amending that return to treat such assets as eligible for bonus depreciation.

Alternatively, in lieu of amending the 2018 return, taxpayers may file an automatic Form 3115, Application for Change in Accounting Method, with the 2019 return to correct their method of accounting and claim the missed depreciation as a favorable section 481(a) adjustment.

Multistate Tax Considerations under the CARES Act

Conformity to the CARES Act

Many state corporate income tax regimes are affected by federal tax law and regulatory changes because they conform to the IRC for purposes of administrative ease by either incorporating the IRC in whole or in part, or by using federal taxable income as the starting point. When considering the state tax impact of a federal tax law or regulatory change, taxpayers should be mindful of the particular state’s level of conformity.

Approximately half the states, so-called rolling conformity states, have provisions that tie to the federal system in such a way that they automatically pick up certain changes as they occur. Other states that tie to the federal system as of a specified date, so-called static conformity states, may pick up CARES Act changes when those states' legislatures update their conformity provisions. However, even in states that follow the version of the IRC that includes the CARES Act provisions, federal and state differences may remain as states may decouple from or modify the federal treatment for state income tax purposes.

To determine how the amendments to the CARES Act apply for state income tax purposes, taxpayers should consider the varying levels of conformity, along with any specific decoupling provisions, in their relevant states as these provisions may lead to significant differences between the federal and state income tax treatment.

Section 163(j) Interest Expense Limits

For federal income tax purposes, the CARES Act temporarily loosens the business interest limitation under section 163(j) increasing it from 30 percent to 50 percent of ATI for taxable years beginning in 2019 and 2020.

As explained above, many states conform to the federal system on a rolling basis. Absent a specific decoupling provision, these states automatically pick up the CARES Act changes easing limits on the deductibility of interest expense by increasing the section 163(j) 30 percent limit to 50 percent. Since the enactment of the TCJA in 2017, which imposed the 30 percent limitation under section 163(j), states have been slow to decouple from the business interest limitation provisions. As a result, almost half the states now follow the new 50 limitation business interest limitation. These states include: Alabama, Alaska, Colorado, Delaware, the District of Columbia, Illinois, Iowa (for tax years beginning on or after January 1, 2020), Kansas, Louisiana, Maryland, Michigan (at the taxpayer's option), Montana, Nebraska, New Jersey, New Mexico, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee (for tax years beginning prior to January 1, 2020), and Utah. Of the remaining states, many states will continue to follow the 30 percent limitation enacted as part of the TCJA, absent any specific decoupling or modification provisions. A few states, such as California and Texas, do not follow section 163(j) due to a lagging conformity date that pre-dates the TCJA and the CARES Act.

While it is too soon to determine how states may react to the increased section 163(j) limitation, the recent passage of the New York FY 2020-2021 Budget Act (New York Budget Act) may provide a preview of what is on the horizon. In the New York Budget Act, New York specifically decoupled from the CARES Act amendment that increased the section 163(j) limitation to 50 percent and requires taxpayers to add back the difference.

In addition to increasing the section 163(j) limit to 50 percent, the CARES Act provides taxpayers with the ability to elect to use their 2019 ATI as their ATI in 2020. When businesses are considering whether to respond to the CARES Act election to use 2019 ATI to calculate a 2020 section 163(j) limit, they should consider the impact of the election on their state income taxes. Like the CARES Act increase to the section 163(j) limit, the CARES Act election to use 2019 ATI will only be available in rolling conformity states that tie automatically to the change or in static conformity states that update their conformity statute.

The chart below identifies which states are tied to the CARES Act's increase in the ATI threshold to 50 percent, which states are still tied to the ATI threshold of 30 percent, and which states decouple from the interest expense deduction limitation.[6]

States[7]	Follows the 50% ATI threshold under the CARES Act	Follows the 30% of ATI threshold under the TCJA	Decouples from the limitation under IRC § 163(j)
Alabama	X		
Alaska	X		
Arizona		X	
Arkansas			X
California			X
Colorado	X		

[6] The chart reflects state laws in effect as of April 3, 2020.
[7] Nevada, Ohio, South Dakota, Washington, and Wyoming are not included within this table as these states do not impose a corporate income or franchise tax.

Connecticut			X
Delaware	X		
District of Columbia	X		
Florida		X	
Georgia			X
Hawaii		X	
Idaho		X	
Illinois	X		
Indiana			X
Iowa	X (2020)	X (2019)	
Kansas	X		
Kentucky		X	
Louisiana	X		
Maine		X	
Maryland	X		
Massachusetts	X		
Michigan	X (at taxpayer's option)		
Minnesota		X	
Mississippi			X
Missouri			X
Montana	X		
Nebraska	X		
New Hampshire		X (2020)	X (2019)
New Jersey	X		
New Mexico	X		
New York		X	
New York City[8]		X	
North Carolina		X	
North Dakota	X		
Oklahoma	X		
Oregon	X		
Pennsylvania	X		
Rhode Island	X		
South Carolina			X
Tennessee	X (2019)		X (2020)
Texas			X
Utah	X		
Vermont		X	
Virginia		X	
West Virginia		X	
Wisconsin			X

Net Operating Losses

On the federal front, the CARES Act also amended the NOL provisions under section 172. The amendments, among other things, eliminated the 80 percent taxable income limitation and provided a five-year carry-back for NOLs arising in taxable years beginning after December 31, 2017, and before January 1, 2021.

While states have been slow to decouple from the business interest limitation provisions under section 163(j), states commonly decouple from or specifically modify the NOL provisions under section 172, leading to differences in federal and state NOL balances. Some states are tied to the federal NOL provisions and will continue to follow the 80 percent taxable income limitation enacted as part of the TCJA, absent state legislation that updates the fixed conformity date to a version of

[8] Reflects treatment for Business Corporation Tax, General Corporation Tax, and Unincorporated Business Tax purposes.

IRC on or after the enactment of the CARES Act. A few states, such as Connecticut, provide their own state-specific taxable income limitation.

Significant differences also arise between federal and state carry-back provisions. Most states tend to decouple from the federal NOL carry-back provisions, and even in conforming states, the states may limit the annual amount of NOLs eligible to be carried back. Other states may have state-specific carry-back provisions which are subject to several nuances, including the amount of the carry-back and the timing of when it may be claimed. Therefore, only a small number of states allow for NOL carry-backs such that they will pick up the CARES Act carry-back reinstatement. The chart below identifies the states tied to the CARES Act NOL changes and describes other state-specific treatments.[9]

States[10]	Follows the elimination of the 80% limitation under the CARES Act	Follows the 80% limitation under the TCJA	Follows 5 yr carry-back under the CARES Act	State specific NOL carry-back	NOL carry-forward
Alabama				Disallowed	15 yr
Alaska	X		X		Indefinite
Arizona				Disallowed	20 yr
Arkansas				Disallowed	5 yr (2019 & prior); 8 yr (2020); 10 yr (2021 & forward)
California				Disallowed	20 yr
Colorado	X			Disallowed	Indefinite
Connecticut				Disallowed	20 yr
Delaware	X		X ($30,000 limit on carry-backs)		Indefinite
District of Columbia	X			Disallowed	Indefinite
Florida		X		Disallowed	Indefinite
Georgia		X	X (if conformity legislation enacted)		Indefinite
Hawaii		X	X (if conformity legislation enacted)		Indefinite
Idaho				2 yr ($100,000 limit)	20 yr
Illinois				Disallowed	12 yr
Indiana		X		Disallowed	20 yr
Iowa				Disallowed	20 yr
Kansas	X			3 yr[11]	10 yr

[9] The chart reflects state laws in effect as of April 3, 2020.
[10] Nevada, Ohio, South Dakota, Washington, and Wyoming are not included within this table as these states do not impose a corporate income or franchise tax.
[11] Prior to carrying back any NOL, the 10-year carryforward period must first be exhausted. If any NOL remains after the expiration of the 10-year carryforward period, the taxpayer may then carryback the NOL up to three years immediately prior to the year of the loss. Kan. Stat. Ann. §§ 79-32,143(a);(d).

Kentucky		X		Disallowed	Indefinite
Louisiana				Disallowed	20 yr
Maine				Disallowed	Indefinite
Maryland	X		X		Indefinite
Massachusetts				Disallowed	20 yr
Michigan				Disallowed	10 yr
Minnesota		X (state specific 80% limitation)		Disallowed	15 yr
Mississippi				2 yr	20 yr
Missouri	X			2 yr	20 yr
Montana				3 yr ($500,000 limit)	10 yr
Nebraska	X			Disallowed	20 yr
New Hampshire				Disallowed	10 yr
New Jersey				Disallowed	20 yr
New Mexico	X (2020)			Disallowed	20 yr (2019 & prior) Indefinite (2020)
New York				3 yr	20 yr
New York City				3 yr	20 yr
North Carolina				Disallowed	15 yr
North Dakota				Disallowed	Indefinite
Oklahoma	X		X		Indefinite
Oregon				Disallowed	15 yr
Pennsylvania				Disallowed	20 yr
Rhode Island	X			Disallowed	5 yr
South Carolina		X		Disallowed	Indefinite
Tennessee				Disallowed	15 yr
Texas				N/A	N/A
Utah		X (state specific 80% limitation)		Disallowed	Indefinite
Vermont				Disallowed	10 yr
Virginia		X	X (if conformity legislation enacted)		Indefinite
West Virginia		X	X (if conformity legislation enacted $300,000 limit on carry-backs)		Indefinite
Wisconsin				Disallowed	20 yr

Based on a review of the relevant state NOL provisions, only Alaska, Delaware ($30,000 limit), Maryland and Oklahoma now follow the elimination the 80 percent taxable income limitation and provide a five-year carry-back for NOLs arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, as provided under the CARES Act.

Qualified Improvement Property

The headline CARES Act QIP change is to permit 100% bonus depreciation for eligible QIP placed in service by the taxpayer after December 31, 2017 and before January 1, 2023. This change may be significant for certain businesses and will flow through to a small group of states that are automatically tied to the federal bonus depreciation provisions.

However, most states have enacted legislation to fully decouple from the bonus depreciation provisions of section 168(k). Of the minority of states that do conform to section 168(k), some require the bonus depreciation to be deferred and recovered over a period of years set by statute, while others conform to section 168(k) with no modification.

Accordingly, taxpayers should be aware that when filing the corresponding 2018 amended state tax returns (as applicable) or reporting the accounting method change to the states for the above-mentioned retroactive application of bonus depreciation to QIP, the tax impact of this deduction must be analyzed and adjusted to conform with applicable state tax requirements.

Certain taxpayers may consider amending their 2018 federal return to claim 100% bonus depreciation. The amended federal return will trigger a requirement to file amended returns in most states, even in those which have decoupled from the bonus depreciation provisions of section 168(k).

CARES Act QIP changes go beyond the provisions of section 168(k). The CARES Act makes changes to the MACRS and ADS class life of QIP, retroactively amending sections 168(e)(3)(E) and 168(g)(3) to reduce the recovery period of QIP for MACRS and ADS to 15 and 20 years, respectively. As mentioned above, most states have decoupled from the section 168(k) bonus deprecation provisions. However, very few states have decoupled from the MACRS and ADS class life recovery periods in section 168. Accordingly, the CARES Act changes to substantially shorten recovery periods for QIP will likely be reflected in the state depreciation computations without regard to the state's conformity to bonus depreciation. As with the other CARES Act provisions, some states will pick up these QIP class life changes automatically while many other states will only pick up the changes when they update their conformity statutes.

Considerations

The CARES Act contains numerous significant provisions that may have an indirect impact on multistate business taxes. It makes significant changes in areas including federal individual income tax, retirement plans, employment tax and employee benefits. The Cares Act also provides financial assistance to state and local governments which fund tax agency budgets.

The CARES Act did not address federal tax payment or filing due dates. Taxpayers should look to IRS Notices 2020-18 and 2020-23 for federal due date guidance and then to individual state guidance to understand what payment or filing due date relief has been granted in reaction to COVID-19.

Contacts:

If you have questions regarding multistate tax considerations of the CARES Act, please contact any of the following Deloitte professionals:

Valerie Dickerson
Partner
Deloitte Tax LLP, Washington, DC
+1 202.220.2693
vdickerson@deloitte.com

Joe Garrett
Managing Director
Deloitte Tax LLP, Birmingham
+1 205.321.6062
jogarrett@deloitte.com

Snowden Rives
Senior Manager
Deloitte Tax LLP, Washington, DC
+1 202.220.2753
srives@deloitte.com

Amber Rutherford
Senior Manager
Deloitte Tax LLP, Nashville
+1 615.259.1830
amberrutherford@deloitte.com

Shaheen Bakaya
Manager
Deloitte Tax LLP, New York
+1 212.436.2594
sbakaya@deloitte.com

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