Key Considerations and Opportunities: Cash and Liquidity Impacts of the TCJA on Losses

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Questions?

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Agenda

- Overview
- Impacts of the TCJA
  - Amendments to NOL carryover rules
  - Changes to the international rules
  - Bank regulatory changes
- Policy issues
- Planning approaches
- Q&A

Impacts of the TCJA

Changes to the NOL Rules

Pre-TCJA	Post-TCJA	Effect
2-year carryback	No carryback	Taxpayers cannot use NOL carryback to get an immediate tax refund
No limit on use of NOL carryover to offset taxable income	NOL offset in any year limited to 80% of taxable income	Taxpayers may be delayed in using NOL carryforwards
20-year carryforward	Unlimited carryforward	NOLs are not lost if limited by the above rules, only delayed

Interest Limitation Under Section 163(j)

- Under new section 163(j), deductions for interest in a taxable year are generally limited to 30% of a corporation's EBITDA
  - Thus, either an increase in interest expense or a reduction in earnings can cause companies to hit the limit
  - Both conditions are more likely in time of economic upheaval
- Deductions in excess of this amount are not disallowed, but instead carried forward indefinitely

Base Erosion and Anti-Abuse Tax

- BEAT eliminates deductions for certain related party payments
- This increases the base on which tax is assessed, albeit at a lower rate
- Thus, a taxpayer can owe tax under BEAT even if the taxpayer has no U.S. taxable income

U.S. Taxable Income: (100)
Regular Tax Liability: 0
Base Erosion Tax Benefits: 250

Modified U.S. Taxable Income: (100) + 250 = 150

BEAT Liability: (150 x 10%) − 0 = **15**

- Additionally, to the extent that a taxpayer has an NOL in a given year, the portion of that NOL that the BEAT rules consider related to these disallowed related party deductions can give rise to additional tax liability under the BEAT in years following the initial loss

GILTI and FDII

Losses by foreign subsidiaries

- Losses in a single CFC can eliminate certain tax attributes (including QBAI and tested foreign taxes) that can increase tax liability for GILTI
- Overall tested losses and any associated tested foreign taxes are not carried forward

Losses by domestic subsidiaries

- The section 250 deduction is subject to a taxable income-based limit; thus, losses by domestic subsidiaries can result in full 21% tax on GILTI and FDII
- If there is no section 904 limitation, any deemed paid taxes associated with GILTI will be eliminated and not carried forward

Repatriation of Cash

- TCJA was intended to move towards a territorial system that would simplify the repatriation of cash from foreign operations
  - Because of the operation of the transition tax and GILTI, however, most offshore earnings are PTEP rather than untaxed earnings eligible for the dividends received deduction
- In theory, PTEP is distributable to the United States on a tax-free basis
  - In reality, distributions of PTEP are subject to a set of complicated rules for which there is little final guidance
  - 10 different types of PTEP, each which can have different rates, foreign tax, and FX consequences
  - If there is insufficient basis in the chain, a distribution of PTEP could trigger tax
- At the same time, Treasury issued regulations that turn off the application of section 956 when earnings, if distributed, would otherwise qualify for the dividend received deduction

Bank Regulatory Changes

- Regulatory Capital Impact
  - Elimination of NOL carrybacks – larger peak-to-trough declines in capital ratios in stress tests for banking organizations that are profitable leading up to tests
  - Limits on NOL carryforwards – slows projected recovery of capital ratios over stress test horizons, as carryforwards do not boost regulatory capital in profitable years following an unprofitable year
  - Stress capital buffer – TCJA may cause projected CET1 ratios to decline more substantially under the stress test, making it more likely the bank's SCB exceeds the 2.5% floor and leading to greater capital requirements
- Current Expected Credit Loss (CECL) model
  - CECL allowance calculations in Q1 and Q2 2020 may significantly impact capital ratios
  - FDIC Chairman Jelena McWilliams' letter to FASB requesting delay of CECL implementation

Policy Issues

Legislative Solutions

COVID 1.0	• No tax provisions
COVID 2.0	• Tax credits for small businesses that provide emergency paid leave
COVID 3.0	• Currently in negotiations
COVID 4.0	• Potentially in May

COVID 3.0 and COVID 4.0

- COVID 3.0
  - Payroll tax deferral
  - ~~Deferral of corporate estimated tax payments~~
  - ~~Delay in filing deadline~~
  - NOL carrybacks and carryforwards
  - Section 163(j)
  - Tech corrections re QIP, NOLs, d~~ownward attribution, section 965 overpayments~~
- COVID 4.0
  - Will provisions dropped from COVID 3.0 be back on the table?

Regulatory Responses

- Non-legislative responses are already taking place
  - Delay of tax payment and filing deadlines
  - Coverage costs under high deductible plans
- Following the 2008 financial crisis there were several administrative measures taken
  - Section 956
  - REIT rules
  - Section 382 changes
- Different crisis, and a different tax law, but administrative responses may still be helpful to address the situation
  - Industry specific rules in areas like aviation and financial services
  - Delay of effective dates for regulations

Planning Approaches

Planning Responses

- Many of the planning responses mirror the general planning approaches taxpayers were in the process of implementing to shift to the TCJA
  - Developing information reporting processes to assess the company's status across several margins – losses, BEAT, etc.
  - Identification of approaches that can be utilized to address the increased importance of the annual accounting period
  - Assessing the ability to repatriate cash given existing ownership structure and possible adjustments thereto
- Reassess tax position in light of the recent legislation, most notably, the ability to carryback losses to prior periods
  - Allows immediate refund
  - Only applies if overall loss this year, with the resulting impact, for example, on GILTI FTCs
- Dynamic situation
  - Over nine months remaining in 2020
  - Profitability has never been so difficult to predict
  - Policy actions by other countries may have significant impact on the performance of foreign subsidiaries

Acceleration of Income/Deceleration of Deductions or Losses

- Importance of the annual accounting period can be addressed through practical responses
- Preserves use of current-year tax attributes
  - Foreign taxes on GILTI income
  - Overall tested loss from a US multinationals foreign operations
- Mitigate negative effects of losses by
  - Accelerating future income into the current year
  - Decelerating expenses and shifting them into next year (or thereafter)
- Possibility of converting tested losses to qualified deficits for subpart F purposes
- Practical steps are equally important to implementing these approaches
  - Monitoring separate businesses and entities to assess location and size of potential losses well in advance of the end of the taxable year
  - Identification of permissible approaches for accelerating income and decelerating expenses

Location of Losses

- As discussed above, the location of losses within a group can produce different tax effects
- Value of losses depends on the tax rate of income from similar operations
  - 21% for U.S., branch and subpart F losses
  - 10.5% for GILTI losses
- But U.S. losses may have significant negative effects
  - Overall domestic loss can reduce taxable income and thus reduce the availability of the section 250 deduction for GILTI and FDII (resulting in taxation at 21%)
- Offshore losses present different but significant concerns
  - Losses in branch basket can be spread against other basket under the separate loss limitation rules
  - Tested loss companies lose foreign tax credits and QBAI
- Possible FX gain and losses due to differential impact of the crisis across different countries

Location of Losses – Planning Responses

- "Spreading of income" may be important—i.e., avoiding losses in one company and income in another
  - Adjusting intercompany items
    - Debt: interest accrues ratably so need to assess and move well before the end of the year
    - Similar issue for other intercompany payments, though these are more complicated as they typically are in exchange for value (e.g., IP royalties, management fees)
  - Transfer pricing approaches
    - Change in underlying assumptions
- Restructuring of entities to avoid tested loss companies

Repatriation Planning

- Post-TCJA, repatriation has been more complicated than anticipated
  - Idiosyncratic problem as PTEP is found in most or all of a multinational's subsidiaries
  - Many of these are not located in income tax treaty jurisdictions
- Necessity of minimizing or eliminating local withholding taxes
  - Immediate cash tax cost that may be deadweight if in an excess credit position (because GILTI is capped, or U.S. losses, etc.)
- Consider whether money could come back to the United States via a loan rather than as a distribution, which also would avoid issues related to PTEP distributions
  - Does not require tax basis as would a distribution of PTEP
  - May also have attendant benefits for the effect of expense allocation on GILTI
- Consider liquidations or other transactions that might aid in repatriating PTEP without triggering gain under section 961(b)
  - Entity simplification may also be useful for longer term planning post-TCJA given a number of consideration in the operation of the rules and the importance of current year information to plan, which is simplified if there are less legal entities
- Consideration of section 304 transactions
  - Risk of section 1059 applying to these transaction seems unlikely given recent statements from the government

Q&A

Questions or Comments?

Michael Caballero
mjcaballero@cov.com
+1 202 662 5610

Lindsay Kitzinger
lkitzinger@cov.com
+1 202 662 5630

Daniel Luchsinger
dluchsinger@cov.com
+1 202 662 5175

Ed McClellan
emcclellan@cov.com
+1 202 662 5313

Michael Nonaka
mnonaka@cov.com
+1 202 662 5727

Appendix – International Responses

Country	Relief Offered
China	❑ Delayed tax deadline ❑ Tax and fee incentives for small and medium-sized businesses
Canada	❑ Temporary tax deferrals ❑ Direct support for businesses and individuals
France	❑ Reduce direct taxes on businesses on a case-by-case basis.
Germany	❑ Plan to provide liquidity for businesses and to increase annual federal investments
Hong Kong	❑ Proposed one-time waivers of personal and corporate income taxes
Italy	❑ Plans to introduce tax cuts and credits ❑ Suspension of tax payments for a period of time
Japan	❑ Interest-free loans for small businesses and subsidies for freelancers ❑ Considering reducing the sales tax or direct outlays of cash for citizens
Netherlands	❑ Deferred payments of corporate taxes for affected companies
New Zealand	❑ Unspecified tax relief for small businesses