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CARES ACT – PASS-THROUGH BUSINESSES

The following chart sets forth some of the provisions affecting pass-through businesses in the CARES Act. This chart highlights only some of the key issues and is not intended to address all aspects of the legislation. If you have any questions, please contact your Andersen Tax advisor.

As of March 27, 2020

PASS-THROUGH BUSINESSES		
Provision	**Description of Change**	**Comments**
Business Interest Expense Deduction Limitation - Partnerships	This CARES Act provision changed for 2019 and 2020 taxable years certain mechanics of Tax Cuts and Jobs Act's (TCJA's) limitation on business interest expense deduction. For partnerships, the limitation is applied at the partnership level with special rules at the partner level to prevent double counting of income. S corporations are treated similarly to partnerships. For all taxpayers (including partnerships and S corporations), Sec. 163(j) now allows a taxpayer to elect to substitute the adjusted taxable income (ATI) for its last taxable year beginning in 2019 for its taxable year beginning in 2020. In the case of a partnership, such election is made by the partnership. Under the CARES Act, there were two special changes for partnerships and partners for 2019 and 2020. First, a partnership may include 50% of its ATI in its limitation calculation for 2020. However, the partnership may elect to still include only 30% of ATI in its limitation calculation for 2020. A partnership must use 30% of ATI for its limitation calculation in 2019. Second, Sec. 163(j) now provides some relief to partners that received an allocation of excess business interest (i.e., Line 13K on Schedule K-1) from a partnership whose tax year began in 2019. Unless the partner elects out, 50% of the excess business interest from 2019 shall be treated as business interest paid or accrued by the partner in the partner's first taxable year beginning in 2020. Additionally, this portion of business interest may be deducted without limitations for the partner's first tax year beginning in 2020 and will not be subject to the Sec. 163(j) limitation rules. The residual 50% of the excess business interest allocated from 2019 would still be subject to the general carryforward rules of Sec. 163(j). Unlike partnerships, the CARES Act changes did not provide any exceptions or special rules specific to S corporations and their shareholders.	For partnerships and partners, there will be NO impact to the 2019 returns. The calculation of a partnership's Sec. 163(j) limitation generally should not change for taxable year 2019. There will be changes in 2020 at both the partnership and partner level, including a special 2020 rule aimed at providing relief for partners for excess business interest arising from the 2019 tax year. Remember that excess business interest allocated to a partner in a partnership is effectively isolated and treated as a separate attribute of the partner. The partner may only treat the interest as being paid or accrued in a subsequent tax year in which the partner is allocated excess taxable income or excess business interest income (together, "excess income items"), from the same partnership. Once treated as paid or accrued by the partner, the interest may be subject to Sec. 163(j) at the partner level. The CARES Act allows 50% of any excess business interest from 2019 to be deducted by the taxpayer in 2020 without limitation, notwithstanding the general rules related to excess income items in 2020 and separate application of Sec. 163(j) to the partner. The special partnership rule may have been intended to provide Sec. 163(j) relief to partners of partnerships without requiring partnerships to issue amended information reporting for 2019 and to avoid complexities in doing so for partnerships subject to the BBA partnership audit rules.

PASS-THROUGH BUSINESSES (CONT.)		
Provision	**Description of Change**	**Comments**
Qualified Improvement Property (QIP) and Eligibility for Bonus Deprecation	As a technical correction to the Tax Cuts and Jobs Act (TCJA), qualified improvement property (QIP) is assigned a 15-year recovery period, rather than a 39-year recovery period. This correction also allows such property to also qualify for bonus depreciation under Sec. 168(k). A second technical correction was also made to the definition of QIP to clarify that QIP only includes those improvements made by the taxpayer, thus used or other property acquired by the taxpayer is not QIP. A third technical correction assigned a 20-year recovery period to QIP for purposes of the alternative depreciation system (ADS). All corrections are effective as if they were included in the TCJA (i.e., properly placed in service after December 31, 2017).	The technical correction to provide a 15-year recovery period is generally helpful as it allows QIP to qualify for bonus depreciation. The change applies retroactively to properly placed in service after December 31, 2017. Taxpayers may generally implement the correction by amending prior year returns or by filing an automatic method change for either the 2019 or 2020 tax year. However, for partnerships subject to the BBA partnership audit rules, an administrative adjustment request (AAR) is required instead of filing an amended return. The tax effects of the AAR would generally be reflected in a post 2019 taxable year return by the partnership's partners for the taxable year in which the QIP was placed in service (i.e., 2018 and 2019 partners). For these partners, it may be advisable to file a Form 3115 for 2019 or 2020 instead of an AAR. This change may change the economics for taxpayers that made a real property trade or business election for purposes of Sec. 163(j), which is currently irrevocable, based on the assumption that QIP was no longer eligible for bonus depreciation. It is not currently known when, or if, IRS may provide relief allowing such elections to be revoked.

PASS-THROUGH BUSINESSES (CONT.)		
Provision	**Description of Change**	**Comments**
Net Operating Loss (NOL) Deduction – Pass-Through Businesses	This provision modifies certain net operating loss (NOL) rules enacted as part of Tax Cuts and Jobs Act (TCJA). TCJA had (i) limited NOL carryovers to 80% of taxable income before NOLs, and (ii) generally repealed all carrybacks of NOLs. For taxable years beginning before January 1, 2021, the CARES Act repealed the 80% taxable income limitation (i.e., net operating loss (NOL) deductions taken in all taxable years prior to 2021 are allowed up to 100% of taxable income). For taxable years beginning in 2021, the NOL deduction is the sum of (A) the pre-2018 NOL carryovers plus (B) the lesser of (1) the post-2017 NOL carryovers or (2) 80% of the excess of taxable income for the year over the pre-2018 NOL carryovers. In addition, the CARES Act provides an NOL carryback rule up to five taxable years for NOLs arising in 2018, 2019, and 2020. The NOL rules are not applied at the partnership or the S corporation level; rather, the partner or S corporation shareholder take them into account in determining such person's taxable income. NOL carryforwards and carrybacks are permitted for individuals, trusts and estates as it pertains to trade or business deductions from a pass-through business or sole proprietorship. While not specifically classified as technical corrections within the bill, the CARES Act made additional modifications to the NOL rules enacted as part of TCJA. First, the CARES Act addressed the stacking issue arising from having a mix of NOL carryovers, where only the pre-TCJA NOL carryovers are expiring and where the post-TCJA NOL carryover deductions were limited to 80% of taxable income. Beginning with 2021 taxable years, the CARES Act clarifies that taxable income is first reduced by pre-TCJA NOL carryovers (that expire but are not subject to a taxable income limitation) before being reduced by the post-TCJA NOL carryovers with no expiration that are subject to the 80% taxable income limitation. Second, the CARES Act also addresses a stacking issue arising from having multiple Code sections subject to a taxable income limitation. Beginning with 2021 taxable years, the CARES Act clarifies that taxable income is first reduced by any NOL deduction under Sec. 172 before being reduced by any deductions under Sec. 199A or Sec. 250. If an NOL is carried to a Sec. 965 inclusion year, the taxpayer is treated as having made the election in Sec. 965(n), which provides that the income inclusion under Sec. 965 does not need to be taken into account to determine either the NOL deduction for that year or the amount of taxable income eligible for reduction by an NOL carryover or carryback to that year. However, taxpayers can elect to exclude any Sec. 965 inclusion year from the five-year carryback period. The CARES Act also made a technical correction with respect to the effective date in TCJA to ensure that NOLs for 2017 fiscal years remain subject to pre-TCJA law (carrybacks allowed, no taxable income limitation), consistent with taxpayers with a 2017 calendar tax year.	This change provides the opportunity to carry back 2018, 2019 and 2020 losses for five years and to offset 100% of income of such prior taxable years (instead of the 80%). In particular, the creation of a five-year carryback for these NOLs creates an opportunity to carry such losses back to a pre-TCJA taxable year when higher individual income tax rates were in effect, thus increasing the amount of potential refund available. Affected individuals, trusts and estates should evaluate the availability and benefit of filing NOL carryback refund claims. Individuals should consider interaction with the alternative minimum tax (AMT) rules as NOLs may only offset 90% of taxable income, rather than 100%, for AMT purposes.

PASS-THROUGH BUSINESSES (CONT.)		
Provision	**Description of Change**	**Comments**
Limitation on Business Losses for Taxpayers Other than C-Corporations	The excess business loss limitation rule of Sec. 461(l), which was enacted as part of TCJA, has been suspended for 2018, 2019, and 2020. The loss limitation rule will come back in play in taxable years beginning in 2021 and expire for taxable years beginning after December 31, 2025. In addition, taxpayers engaged in a farming business are also not subject to the loss limitation rule of Sec. 461(j) for 2018, 2019 and 2020. Under TCJA, after the application of the passive loss limitation regime under Sec. 469, excess business losses of a taxpayer (other than a C corporation) are deferred and carried forward as a part of the taxpayer's NOL carryforward. For trades or businesses that are partnerships or S corporations, the limitation applies at the partner or shareholder level, and excess business loss is determined by looking at the partner's allocable share or shareholder's pro rata share of items from the partnership(s) or S corporation(s), combined with any other trade or business gross income and deductions of the taxpayer. The CARES Act also made technical corrections to TCJA that a taxpayer's excess business loss is computed without regard to any Sec. 172 or 199A deductions and without regard to income from being an employee for taxable years beginning after December 31, 2017. The CARES Act also clarified that an excess business loss does not include deductions for capital losses from the sale or exchange of a capital asset. In addition, the CARES Act also clarified that capital gain from the sale or exchange of a capital asset is only included in computing the excess business loss by including the lesser of the net capital gain attributable to a trade or business or the capital gain net income.	This change provides that the excess business loss limitation rule is inapplicable for three years (2018, 2019, and 2020). Affected non-corporate taxpayers subject to an excess business loss limitation in 2018 or 2019 should consider whether to amend tax returns to claim a refund based on this change and the other changes to the NOL rules. Although the instructions to Form 1065 and Form 1120S have not yet been revised, partnerships and S corporations should no longer need to report Sec. 461(l) information for Schedule K-1s to be filed for 2019 or 2020. Affected taxpayers will no longer have to file Form 461 for these years.
Limitation on Excess Farm Losses for Taxpayers Other than C-Corporations	For taxable years beginning after December 31, 2017 and before January 1, 2026, the limitation on excess farm losses for non- C corporate taxpayers do not apply. However, starting with taxable years beginning after January 1, 2021, the limitation on excess business losses under Sec. 461(l) does apply.	This change, along with the repeal of Sec. 461(l) for 2018, 2019, and 2020 allows partners and S corporation shareholders to take excess farm losses into account for those taxable years. Because the excess farm loss rule is now inapplicable for 2018 and 2019, partners and S corporation shareholders should consider whether to amend 2018 and 2019 tax returns based on this change.
Charitable Contributions – Pass-Through Entities	A partnership or S corporation can make charitable contributions which flow-through to its partners or shareholders. The partner or shareholder then makes the ultimate determination of the amount of the charitable deduction, considering limitations that apply at the taxpayer level.	As contributions made by a partnership or S corporation may reduce the owner's Sec. 199A deduction according to the draft Form 8995, partners and S corporation shareholders should consider making charitable contributions at the owner level from personal funds, rather than at the entity level, to the extent possible.

PASS-THROUGH BUSINESSES (CONT.)		
Provision	**Description of Change**	**Comments**
Food Inventory Contribution	For all taxpayers (which includes partners in a partnerships and shareholders in S corporations), there is an enhanced deduction for charitable contributions of food inventory for the benefit of the ill, needy or children. The limitation on the deduction was increased from the existing 15% of aggregate net income to 25% of aggregate net income of the taxpayer. If the partnership or S corporation makes the food inventory contributions, such contribution flows-through to its partners or shareholders. The partner or shareholder then makes the ultimate determination of the amount of the charitable deduction.	This provides a charitable deduction opportunity to the partners in partnerships and shareholders in S corporations that contribute food inventory to the ill, needy or children. However, taxpayers should keep in mind that such contributions by a partnership or S corporation may reduce the owner's Sec. 199A deduction.

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