How Best to Handle Tax & Audit Issues

During #Covid-19

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Awaiting Additional Guidance

All of the information presented is subject to change based on (additional) guidance by the Congress, SBA, IRS, Department of Treasury, Department of Labor and the various State Taxing Authorities.

Claiming COVID-19 Loss

- Losses usually deducted in year it occurs
- In Presidentially-Declared-Disaster you can **elect to deduct entire disaster loss in the year of loss (2020) or prior year (2019)**
- On an originally filed or amended 2019 tax return

Requirements

- **Loss must be attributable to the disaster (some direct causation)**
- Loss must have occurred within disaster area
- Loss must be of a type deductible under Section 165(a) for trade or business activity or transaction entered into for profit; and
- Loss must not be reimbursed by insurance or otherwise

Examples with direct causation

- Closure of store or 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 or supplies that are unsaleable or unusable**
- Termination payments for executory contracts
- Losses from sale of property

Benefit of Deducting Losses in 2019

- Losses in 2019 may generate a Net Operating Loss that can be carried back 5 years (one year earlier than losses in 2020)
- Tax savings on 2019 income so more immediate cash flow!

Employer Payroll Tax Relief

- Families First Coronavirus Response Act
  - Paid Sick Leave & Paid Family Leave
    - Payroll Tax Credit
    - Health Insurance Portion Credit
    - Employer FICA on required sick pay waived
    - Employer's Medicare tax on required sick pay waived
- CARES Act
  - Employee Retention Credit
  - Deferral of Payroll Taxes

Effective April 1, 2020 through December 31, 2020

Determining an Employee's Pay Under the Emergency Family and Medical Leave Expansion Act (EFMLEA)

Start Here

Has the employee been on payroll for at least 30 calendar days?

- **NO** → The employee is not eligible for leave under the EFMLEA.
- **YES** → Is the employee requesting leave to care for their child whose school or place of care has closed or is unavailable due to COVID-19?
  - **NO** → The employee is not eligible for leave under the EFMLEA.
  - **YES** → **The employee is entitled to 12 weeks of EFMLEA leave.** Has the employee already used Emergency Paid Sick Leave from the EPSLA?
    - **NO** → The employee can use two weeks of EPSLA leave during the first two weeks of EFMLEA leave. This is paid at 2/3 the employee's regular rate.
      - **THEN** → The following 10 weeks must be paid at 2/3 the employee's regular rate of pay.
    - **YES** → Does the employee have accrued balances of paid leaves?
      - **YES** → The employee can use their accrued paid leave during the first two weeks. This is paid at the employer's normal leave rates.
        - **THEN** → The following 10 weeks must be paid at 2/3 the employee's regular rate of pay.
      - **NO** → The first 10 days (2 weeks) of EFMLEA leave may be unpaid.
        - **THEN** → The following 10 weeks must be paid at 2/3 the employee's regular rate of pay.

Note: Payments to employees under the EFMLEA may not exceed $200 a day or $10,000 total.

Effective April 1, 2020 through December 31, 2020

FFCRA – Leave Chart for Emergency FMLA and Emergency Sick Leave

Qualifying Reasons for: Emergency Paid Sick Leave (EPSL)	Weeks 1 and 2 (80 hours)		Weeks 3 through 12 (additional 10 weeks)
1. subject to a Federal, State, or local quarantine or isolation order related to COVID-19	Paid EPSL at regular rate	No EFML	No EFML
2. has been advised by a health care provider to self-quarantine related to COVID-19	Paid EPSL at regular rate	No EFML	No EFML
3. is experiencing COVID-19 symptoms and is seeking a medical diagnosis	Paid EPSL at regular rate	No EFML	No EFML
4. is caring for an individual subject to an order described in (1) or self-quarantine as described in (2)	Paid EPSL at 2/3 regular rate	No EFML	No EFML
5. is caring for his or her child whose school or place of care is closed (or child care provider is unavailable) due to COVID-19 related reasons **This is Also the Only Qualifying Reason for Emergency Family Medical Leave (EFML)**	Paid EPSL at 2/3 regular rate	Unpaid EFML	PAID EFML at 2/3 regular rate
6. is experiencing any other substantially-similar condition specified by the U.S. Department of Health and Human Services	Paid EPSL at 2/3 regular rate	No EFML	No EFML

Interaction

- If you received PPP Loan –
  - Can take FFCRA tax credits but not on the same wages
  - Cannot claim the Employee Retention Credit on any wages
  - If any of your PPP was forgiven, you cannot defer payroll taxes on any wages past the date of loan forgiveness
- If you didn't receive PPP Loan-
  - Can claim both FFCRA and ERC credits but not on the same wages

Loan Programs Update

- SBA 7(b) – Economic Injury Disaster Loan (EIDL)
  - Early applicants are seeing grants of up to $10k ($1k/employee with cap of $10k) funded.
  - Phase I (50% of prior year gross profit up to $500k) – status of program unclear, no funding that we know of to date; talks of cap at $15k.
  - Phase II based on actual losses / need, up to total for all Phases of $2m – status also unclear, no funding to date.
  - SBA lacks manpower to process (burden is on SBA to administer, rather than individual banks / lenders).

- SBA 7(a) – Paycheck Protection Program (PPP)
  - Original budget of $349bn exhausted; Senate has approved $310bn of additional funds with $30bn earmarked for banks <$10bn in assets, $30bn 10-50bn in assets, remaining $250bn available for all lenders to distribute. Pending House approval.
  - Many businesses have received funds and are now navigating the forgiveness guidance which lacks clarity
  - Advice for self-employed individuals and smaller businesses seeking loans

Loan Programs Update

- PPP - Documentation of Need
- Deductibility of Expenses

Loan Programs Update

- Main Street Lending Program
  - New loan facilities up to lesser of $25m or 4x Adjusted 2019 EBITDA
  - Expanded loan facilities up to lesser of $200m or 6x 2019 EBITDA
  - Rate: LIBOR + 300 basis points
  - 4 year term, various priorities
  - Restrictions on distributions, dividends, executive and highly-compensated individual pay.
  - Banks are awaiting guidance;
  - Banks will retain a 5% - 15% exposure and are underwriting as such.

Financial Modeling

- Business leaders should be continuously updating budgets and projections within their operating models to understand near-term financial position and potential funding shortfalls

- Connecting financial models to various funding programs:
  - EIDL – Phase II (when available), an updated model showing spend needed for operations will support receiving max loan amount of up to $2m.
  - PPP – Understanding required spend during the covered period (8 weeks from date of funding) and strategic application of funding to maximize forgiveness.
  - Main Street Lending Program – vetting and quantification of potential adjustments to reported EBITDA may allow for additional funding that is more representative of the leverage ratio the business can support (as is governed by 4x or 6x EBITDA for new and existing loans, respectively).

Net Operating Losses

- TCJA - No carryback of losses - Carryforward indefinitely and only 80%
- Cares Act - 5 year carryback beginning 12/31/17 and before 1//1/21 and at 100%
- Losses in 2018, 2019 and 2020
- Higher rates dating back to 2013
- Utilize the Disaster area provisions

Add’l Provisions That May Create Losses

- Business Interest limitation relaxed to 50% - 2019 and 2020
- Use of 2019 Income for 2020 computation
- Bonus Depreciation - QIP
- Excess Business Losses (250/500)

State Income Tax Relief

- **Most States Extended the Corporate and Personal Income Tax Filing and Payment Deadline to 7/15 including 1st Quarter Estimate to 7/15)**
- **Growing Number of States are extending 2nd Quarter Estimate to 7/15 as well**
- States offering generous relief include:
  - Alabama, California, Colorado, Connecticut, Georgia, Kentucky, Maryland, Missouri, Nebraska, New Mexico, North Dakota, South Carolina, West Virginia, Wisconsin

When is my Florida Corporate Income Tax Return Due?

- **The Florida Department of Revenue issues Emergency Order Extending Corporate Income Tax Filing and Payment deadlines due to COVID-19, however it is important note that filing and payment dates are NOT the same.**
- Highlights of the Order include the following:
  - Entities with a 12/31/202019 year end: 1. Filing of Corporate Income/Franchise Tax RETURNS: due date is now 8/3/2020 2) Corporate Income/Franchise tax PAYMENTS: due date is now 6/1/2020; 3) Request for extension of time to file the return and make any tentative payments is extended to 6/1/2020. Request for extension filed on or before 6/1 may be granted extended due date of 11/2/2020.
  - 1/31/2020 Fiscal year end, due date for filing return is 8/3/2020, however due date for PAYMENTS and extension requests remains 6/1/2020; Request for extension filed on or before 6/1 may be granted extended due date of 12/1/2020.
  - 2/29/2020 Fiscal year end, due date for filing returns is 8/3/2020, however, PAYMENTS and extension requests remains 7/1/2020. Request for extension filed on or before 7/1 may be granted extended due date of 1/1/2021
- (See FL DOR, Order of Emergency No. 20-52-DOR-003, 04/27/20].

Additional States with Limited Relief - Corporate

- Arkansas - Due Date Remains 4/15 and Franchise Tax remains due 5/1
- Idaho –Due Date Extended to 6/15 including 2020 Q1 Estimate
- Minnesota – due date 4/15 (but check for automatic extension)
- Montana- Due date Remains unchanged at 5/15
- 2020 Estimates
  - Q1 and Q2 – Conditional Penalty Relief in a number of states and a number of states have not granted any extension for estimates

Does the State CARE – Conformity to IRC Section 163(j) and NOLS

- 163(j)
  - How will the States React to CARES ACT provision under Section 163(j) which temporarily relaxes limits on business interest payment deductions? Will states follow federal or decouple from the Federal Law like NYS/NYC
  - Section 163(j) enacted under The Tax Cuts and Jobs Act of 2017 provides that certain companies' allowable deduction for interest expense is generally limited to the sum of 30% of "adjusted taxable income" plus business interest income (excess may be carried forward to future years).
  - **For tax years beginning in 2019 or 2020, the CARES Act temporarily increases the threshold from 30% to 50%. Since many states starting point for computing state income tax is its federal taxable income, those states should adopt the CARES Act temporary benefit to companies under 163(j).**
- NOLs
  - Since the enactment of the Tax Cuts and Jobs Act of 2017 (TCJA), NOLs generally could not be carried back but could be carried forward indefinitely. Further, the TCJA limited NOL absorption to 80% of taxable income.
  - **Under the CARES Act, NOLs arising in tax years beginning after December 31, 2017, and before January 1, 2021 (e.g., NOLs incurred in 2018, 2019, or 2020 by a calendar-year taxpayer) may be carried back to each of the five tax years preceding the tax year of such loss**.

States following CARES 163(j) and NOL Carrybacks or not…

- **163 (j) - Almost half the states now follow the new 5O% 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, 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.
- **NOL CarryBacks - Most states generally decouple from the federal NOL carry-back provisions**
  - Even in conforming states, the states may limit the annual amount of NOLs eligible to be carried back.
  - Still other states may have state-specific carry-back provisions including
    - the amount of the carry-back; and
    - the timing of when it may be claimed.
  - Thus, only a few states allow for NOL carry-backs such that they will pick up the CARES Act carry-back provision.
- **What about Florida?**

Florida

- Florida
  - No (CARES Act) Yes (TCJA). Florida currently conforms to the IRC as amended and in effect on January 1, 2019 and does not conform to the amendments to IRC § 163(j), as enacted by the federal Coronavirus Aid, Relief and Security (CARES) Act.
    - Thus, no temporary increase from 30% to 50% as of now…
  - No Carryback allowed
  - PPP Loan Forgiveness – Since Florida does not currently conform to the CARES Act, Florida may treat PPP loan forgiveness as taxable income.

California and New York

- California has provided some preliminary information on conformity/ nonconformity to the CARES ACT
  - CA does not conform to some of the changes made by the CARES Act including those related to:
    - loan forgiveness related to the paycheck protection program;
    - net operating loss (NOL) carrybacks;
    - business interest limitations;
- New York
  - Corporate Income
    - New York has decoupled from the 163(j) federal stimulus package and will require businesses to continue to limit the business interest expense to 30% on both the New York State and New York City returns.
    - New York does not follow the 5-year carryback provision in the CARES Act.
  - Personal Income
    - New York does not adopt the 5-year carryback provision of the CARES Act as it decoupled from those provisions in Budget Bill S7508.

Takeaway on State Income Tax Relief

- Review of State Conformity to CARES Act provisions
  - The CARES Act will add another layer of complexity to state income tax compliance, which was already complicated by the TCJA.
- Review state specific rules to avoid unwanted income tax assessments as well as interest and/or penalties
- Beware of Localities administering their own income/gross receipts type taxes.
- Localities are not necessarily following State extension relief (e.g., NYS extended due date and Q1 estimates to 7/15 and NYC due date of 4/15 not extended although penalty waivers considered)
- **Contact State Taxing Authorities if Payment cannot be made and…**
  - **Confirm Relief – go to state website – charts not always up to date**
  - **Contact States and/or Localities to Request Payment Plans**

Sales Tax - What Relief is being offered by the States?

- **Sales Taxes are Trust Fund Taxes which are collected at time of transaction, and thus most States DID NOT extend deadlines.**
  - **Seller does not “own” funds as seller is “Trustee” for the Jurisdiction**
- States offering some sort of Sales Tax Relief (many are conditional) include the following States.
  - Alabama, California, Colorado, Connecticut, District of Columbia, Illinois (very limited), Louisiana, Maryland, Massachusetts, Michigan, Minnesota (very limited), North Carolina (interest still accrues), Vermont (limited), Virginia by request, Washington and Wisconsin (limited)

When are my Florida Sales Tax Returns Due?

- February - no penalties or interest were imposed if return filed and taxes paid by 3/31/2020
- March Returns and payments extended to 4/30/2020 if the taxpayer has been *adversely affected* by the COVID-19 outbreak.
- What does Adversely affected mean? Shouldn't all businesses be eligible for relief?
- April Returns and payment (if any) due May 20, 2020 – FL DOR reminded taxpayers that they must file a tax return even if they don't owe tax.

"Adversely Affected" Defined by FL DOR as...

- Any of the following four conditions:
  - 1) The business closed in March 2020 in compliance with a state or local government order issued in response to the COVID-19 outbreak and following the closure had no taxable transactions for the taxes listed above; OR
  - 2) The business experienced sales tax collections in March 2020 that are less than 75% of March 2019 sales tax collections; OR
  - 3) The business was established after March 2019; OR
  - 4) The business is registered with the Department to file quarterly.

Nexus For Remote Workers

- **How will remote workers create nexus for Businesses due to COVID19 (stay at home orders)**
- **What is nexus?**
  - **The connection business has with a state/locality that creates a filing requirement for income and/or sales taxes**
- Example: Ashley is head of sales for PetRetail Co. in FL. She lives in GA and normally commutes to NYC as the company does not permit telecommuting. She and colleagues are working remoting in NJ or CT (and states not near NYC to be with family/friends) due to stay at home order in NYC.
- Will nexus be created in States where Company X has remote workers?

When is nexus created?

- Pre-Covid19 - Income tax (and sales tax) nexus is generally created when an employee (or 1099) works from home for a business.
  - Physical Presence via employees and/or 1099s
- During Covid19 – Several States have issued guidance that remote workers will not impact nexus determinations during the duration of pandemic.
  - Physical presence will be ignored temporarily
  - District of Columbia, Indiana, Maryland (case by case), Minnesota, Mississippi, New Jersey and Pennsylvania
- Post Covid19 – When will states look to assert nexus over remote workers based upon a physical presence argument? 30 days after stay at home orders lifted? 60 days? What about employees that prefer to work from home indefinitely?

Practical Advice

- Businesses should be very careful to ensure nexus was not created before employees were required to work from home as states will not disregard tele-workers for state income tax purposes if a business had pre-existing nexus.
  - Physical presence is created by employees, 1099s, property, inventory etc…
- It is unclear if this temporary waiver of nexus created by tele-workers will apply to all taxes (income, sales and use, franchise, other taxes), particularly Sales Taxes
- Businesses may face additional withholding requirements that could differ based upon state rules and state reciprocity agreements

Sales Tax Economic Nexus – Wayfair Enforcement – Post Covid19

- Wayfair decision (June 2018) enabled states to collect sales tax from remote sellers based solely upon economic presence (abandoning) the decades old “traditional” physical presence requirement.
- 2019 – All but two States (Florida and Missouri) implemented laws to tax businesses based upon volume of sales in a state.
- 2020 –Year of economic nexus enforcement, and once this health crisis passes, we will certainly see states step up compliance efforts.
- When will Florida implement an economic sales tax nexus provision?

Practically Speaking…

- Although a few States have extended tax filing and payment deadlines, and waived interest and penalties during this crisis, States will be sure to ramp up sales tax audit activity.
  - States are already looking to hire additional examiners to compel sales tax compliance and collect revenue
  - Lookback period – depends upon state

- As online sales continue to dominate the retail industry, especially during Covid19, businesses selling in a multi-state environment should:
  - Review state and local economic sales tax filing requirements
  - Come into compliance as soon as practicable.
  - Even International Companies need to be wary of Wayfair

PPP Loan Accounting Treatment

- No formal guidance issued as of yet from AICPA
- We are advising clients to account for PPP loan as follows:
  - At time that PPP Loan cash is received:
    - Db Cash XXX
      - Cr PPP Loan XXX

- The journal entry or entries to remove the PPP loan from the Company's books depends on when the SBA forgiveness letter is received due to matching principal

PPP Loan Accounting Treatment, ctd.

- If SBA loan forgiveness is received during 2020 (i.e. same year as funds received):
  - Db PPP Loan XXX
    - Cr Exp (P/R, rent, etc) XXX

- If SBA loan forgiveness is received after 2020 (i.e. after year as funds received):
  - Db PPP Loan XXX
    - Cr Other income XXX

Subsequent event disclosures

- The impact of the coronavirus will, of course, vary from company to company.
- Following are some of the accounting and financial reporting topics that should be taken into account when evaluating the current and potential effects:
  - The use of fair value measurements
  - Collectibility of receivables
  - Impairment of: investments, long-lived tangible assets, goodwill
  - The lower of cost or net realizable value of inventories

Subsequent events, ctd.

- While ultimate outcomes of the foregoing issues are, at this time, necessarily subject to high degrees of speculation and conjecture, they represent issues that should be considered on a continuing basis
- Disclosure could nevertheless be required in response to FASB ASC 855, Subsequent Events
- We are advising clients to include subsequent event wording regarding as follows:

Subsequent events, ctd.

Note 9 – Subsequent Events

On January 30, 2020, the World Health Organization ("WHO") announced a global health emergency because of a new strain of coronavirus originating in Wuhan, China (the "COVID-19 outbreak") and the risks to the international community as the virus spreads globally beyond the point of origin. On March 20, 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally.

The full impact of the COVID-19 outbreak continues to evolve as of the date of these financial statements. As such, it is uncertain as to the full magnitude that the pandemic will have on the Company's financial condition, liquidity, and future results of operations. Management is actively monitoring the impact of the global situation on its financial condition, liquidity, operations, suppliers, industry, and workforce. Given the daily evolution of the COVID-19 outbreak and the global responses to curb its spread, the Company is not able to estimate the effects of the COVID-19 outbreak on its results of operations, financial condition, or liquidity for fiscal year 2020.

Bank covenant waivers and deadline extensions

- Waivers and deadlines are not universally governed
- Depends on the bank/lender and is on a case-by-case basis
- What we are seeing in general:
  - Banks are open to issuing FY2019 covenant waivers but are much more focused on revised forecasts for 2020
  - Banks have not relaxed covenant requirements for companies to obtain audits/reviews
  - Deadline extensions are minimal at best (i.e. 15-30 day range)

Coronavirus Resources

- https://dbllp.com/coronavirus-resource-center/
  - Extensions and Penalty Relief – State Income and Sales Taxes
  - Social Media Updates on Covid-19

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