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Big Tax Refunds for Restaurants

Impact of the CARES Act on Depreciation and Related Carryback Claims

Your Presenters

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- Firm Tax Committee Member

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Which Taxpayers Benefit?

- The primary beneficiaries of this aspect of the CARES Act are restaurant owners that opened new locations, completed remodels, or made other significant capital expenditures during 2018 or 2019

- By deducting these big-ticket items fully in 2019, owners are likely to either pay less tax with their 2019 return, or potentially find themselves in a net operating loss situation, now eligible for carryback

* Information provided is subject to change based on legislative updates and is current as of 6/23/20

QIP – What is it?

- Qualified Improvement Property
  - Various categories of property condensed into one by the 2018 Tax Cuts & Jobs Act (TCJA)
  - Includes restaurant buildouts, remodels, and leasehold improvements
- The QIP "glitch"
  - QIP intended to be subject to 15-year depreciable life, and eligible for 100% bonus depreciation
  - Flawed wording in the TCJA caused QIP to be subject to 39-year depreciable life, and thus ineligible for bonus depreciation

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Polling Question #1

True/False

39-year property is eligible for bonus depreciation?

Impact of the CARES Act on QIP

- Fixes the “glitch” caused by the TCJA, and allows for QIP to be depreciated over 15 years, as well as eligible for bonus depreciation

- Depreciation for QIP placed in service in 2018 can be “caught-up” on 2019 return, without requiring an amended 2018 return

- Allows net operating losses (NOLs) generated by 2018 and 2019 returns to be carried back five tax years from the year of loss, with refunds issued for taxes paid

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Polling Question #2

True/False

You need to file an amended 2018 return to correct the QIP glitch?

Mechanics of 2018 Corrections

- Form 3115 (Change in Accounting Method) must be filed with the 2019 business tax return
  - Determines the exact catch-up amount for 2018 depreciation, known as a negative 481(a) adjustment
  - Detailed supporting schedules and calculations must be attached to the return

- Once the negative 481(a) adjustment is calculated, it is deducted on the 2019 return as additional depreciation, along with any other applicable depreciation for the tax year

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Example of QIP Correction

- Assume your restaurant placed in service a new buildout costing exactly $1 million in early 2018
  - Based on a 39-year life, $25,641 of related depreciation was deducted on the 2018 tax return
- Preparation of Form 3115 determines the negative 481(a) adjustment to be $974,359
  - Total cost of $1,000,000, less $25,641 of depreciation already deducted equals remaining balance of $974,359, the "catch-up" amount
  - This figure is deducted as part of current year depreciation on the 2019 tax return

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Net Operating Losses (NOL)

- When losses allocated from business activities exceed a taxpayer's income for the year, a net operating loss is created
  - Under the CARES Act, NOLs generated in 2018 or 2019 can be carried back to tax years 2013 – 2017 for refunds of taxes paid
  - Note: carryback claims for 2018 NOLs must be filed by June 30, 2020
- Form 1045
  - Calculates difference in tax liability between carryback year before and after application of an NOL
  - Required to be processed by the IRS within 90 days of filing
  - Currently being accepted via dedicated fax line, despite reduced capacity at IRS

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Further NOL Considerations

- NOL carrybacks also permitted for C-corporations
  - Form 1139 filed for C-corp carryback claims
  - Note that 2019 carryback claims involve interaction with other tax provisions and the effective rate
    - Carryback from a 21 percent federal rate NOL back to a 35 percent federal rate year (pre-2018)
    - DPAD (repealed for 2018 and later) limited to taxable income, potentially reduced by carryback
- Special temporary filing procedure:
  - Fax Form 1139 claims to: 844-249-6236
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Polling Question #3

True/False

NOL carrybacks filed with Form 1045 must be processed by the IRS within 90 days of filing?

Basic Example of NOL Carryback

- Assume QIP changes result in NOL of $500,000 for tax year 2019
  - NOL must first be carried back to 2014, with any unused amount then carried to 2015 – 2018, in order

- 2014 taxable income of $400,000, with total tax liability of $140,000 (35% tax bracket)
  - $400,000 of NOL used in 2014 for a refund of $140,000
  - Remaining NOL of $100,000 carried to 2015, for a refund of $35,000 (assuming 35% tax bracket and sufficient taxable income to absorb the NOL)

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Potential Complications

- Self-employment tax
  - SE tax cannot be offset by an NOL carryback, therefore there are no refunds for any SE tax paid
- General business credits
  - FICA tip credit, WOTC, etc.
  - Credits claimed for a carryback year may no longer be needed due to the NOL carryback; these now unused credits can be carried back one year from the carryback year, or if still not needed, forward to the years following the carryback, until fully absorbed (up to 20 years)
- IRS scrutiny
  - Large refunds generated by NOL carrybacks are likely to be scrutinized by the IRS, and require specific and voluminous attachments in order to be successfully processed

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In Conclusion

- Restaurateurs with new locations or significant improvements made in 2018 or 2019 should be sure to consult their tax advisors to ensure they are taking full advantage of the CARES Act provisions

- Carryback claims are especially valuable in these uncertain times; don't put off determining if you may have opportunity for real money in your pocket

- Forms 3115 and 1045 are highly complex areas of tax law and preparation – not a good DIY project!

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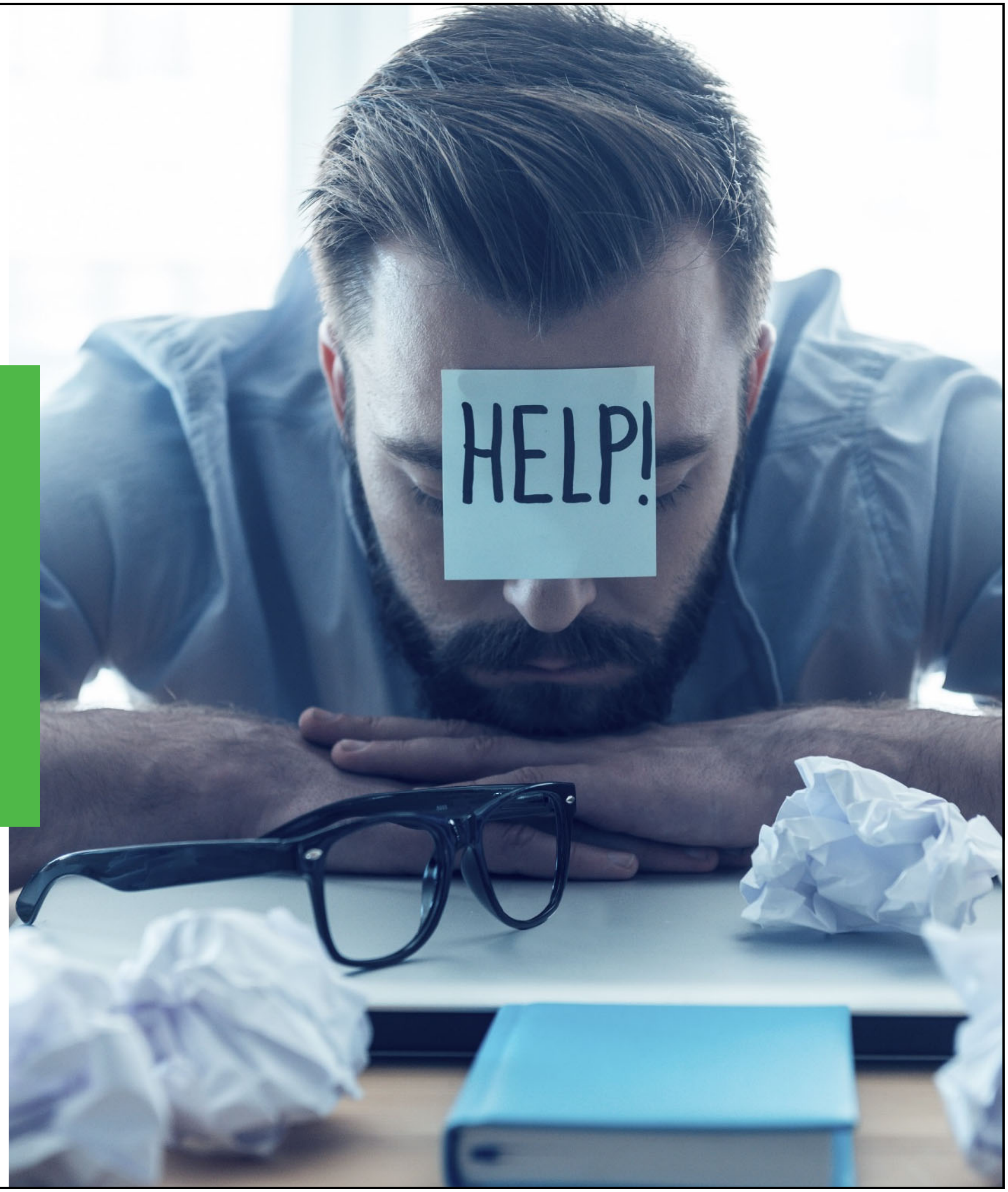
Resources:

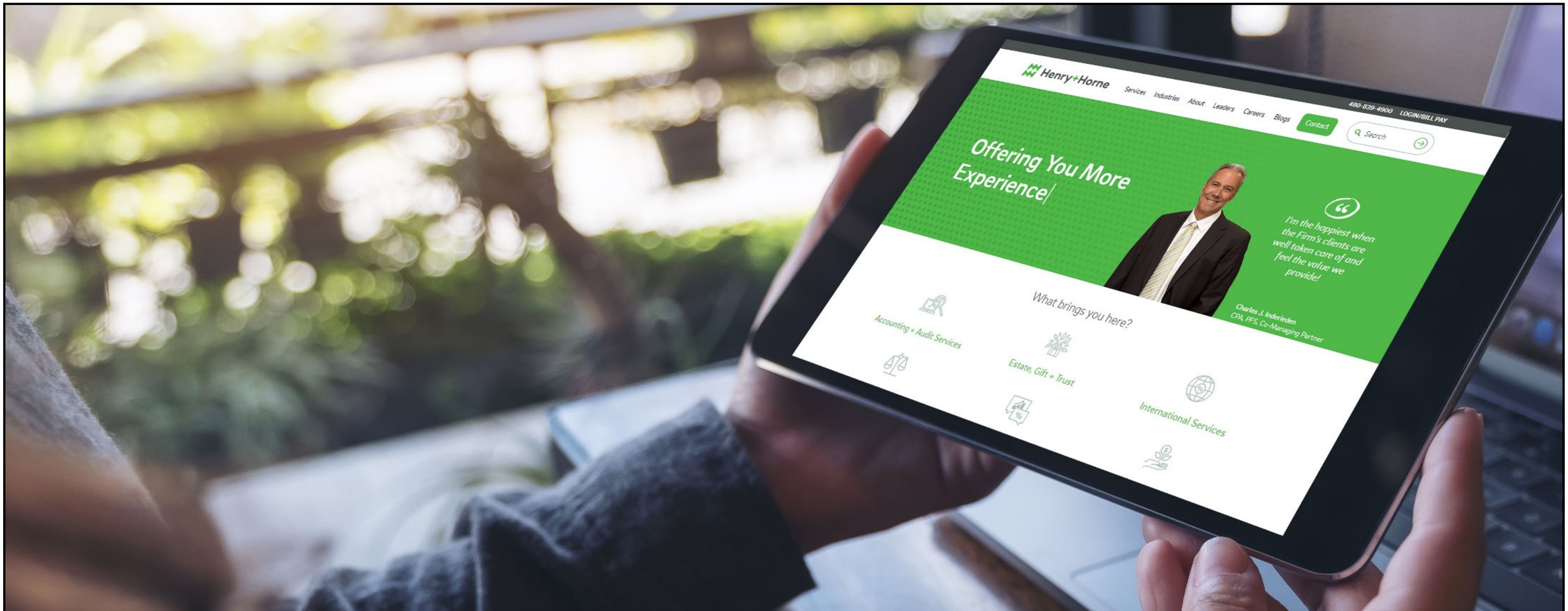
Henry+Horne
COVID-19 Updates
www.hhcpa.com/covid-19

CARES Act and qualified improvement property
https://www.hhcpa.com/blogs/the-side-dish/cares-act-and-qualified-improvement-property/

CARES Act restaurant tax provision
https://www.hhcpa.com/blogs/the-side-dish/cares-act-restaurant-tax-provision-2/

Questions?





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