

Client Alert

July 2020

Tax Decoupling During COVID-19

Introduction

The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) was signed into law by the President on March 27, 2020. The CARES Act includes numerous changes to the Internal Revenue Code of 1986 (the “Code”) that modify provisions related to qualified retirement plan distributions, as described in earlier client alerts, qualified improvement properties, excess business losses, net operating losses and business interest deductions for individuals.

In early April, Governor Cuomo signed the New York State 2020-2021 [budget](#) (the “NY Budget”), which “decoupled” certain New York State (“NYS”) income tax provisions from the Code provisions impacted by the CARES Act. The New York State Department of Taxation and Finance issued [Notice N-20-7](#) (the “Notice”) which announced that “due to changes in the Tax Law as part of the 2020-2021 New York State budget, any amendments made to the Code after March 1, 2020 will **not** apply to New York State or New York City personal income tax” (emphasis in original). Additionally, on June 17, 2020, Governor Cuomo signed [legislation](#) that disallowed some of the favorable CARES Act modifications for purposes of the following New York City (“NYC”) taxes: the unincorporated business tax; the general corporation tax; the city banking tax; and the city business corporation tax (collectively, “NYC Business Taxes”). In other words, when computing New York income tax and NYC Business Taxes, the CARES Act modifications to the Code will not apply to NYS and, where applicable, to NYC taxpayers.

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This alert discusses several issues that taxpayers in New York will encounter as a result of New York’s decoupling from the Code as modified by the CARES Act.

Individual Income Tax

Coronavirus-Related Distribution

The CARES Act provides for a new type of distribution from defined contribution retirement plans. This distribution, known as a “coronavirus-related distribution” (the “CRD”), is somewhat similar to a hardship distribution. The CRD allows a “qualified individual” (generally, an individual negatively affected by COVID-19) to receive a distribution of up to \$100,000 from an eligible retirement plan without being subject to the 10% early distribution penalty. Furthermore, the individual can generally include the distribution in income over a three-year period or pay back the distribution to the plan by the end of the three-year period without incurring Federal income taxes.

As a result of New York’s decoupling, an individual who receives a CRD will be required to include the entire amount in his/her New York income in 2020 and will not be allowed to include the amount ratably over three years.

Loans from Qualified Employer Plans

Generally, in the case of qualified retirement plans, individuals may borrow the lesser of \$50,000 or 50% of the participant’s vested account balance. The CARES Act temporarily increases the limit to the lesser of \$100,000 or 100% of the participant’s vested account balance.

As a result of New York’s decoupling, an individual who receives a loan from a qualified employer plan of more than either \$50,000 or 50% of the participant’s vested accrued balance will be required to include such amount in his/her New York income in 2020.

Qualified Improvement Property (“QIP”)

The Tax Cuts and Jobs Act (the “TCJA”) of 2017 inadvertently assigned to Qualified Improvement Property (“QIP”) a 39-year depreciation period, the so-called “retail glitch.” The CARES Act corrects the “retail glitch” and assigns a 15-year depreciation period to QIP, which enables QIP to be eligible for 100% bonus depreciation when placed in service. In other words, a taxpayer can fully and immediately expense the entire cost of QIP when placed in service.

As a result of New York’s decoupling, for New York income tax purposes, an individual who placed QIP in service during 2018, 2019 or 2020 will be required to expense the cost over 39 years.

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Individual Income Tax and NYC Business Taxes

Excess Business Loss

The TCJA placed a \$250,000 (\$500,000 filing jointly) limit on using excess business losses to offset non-business income (e.g., portfolio interest, dividends, capital gains, etc.). For tax years 2018, 2019 and 2020, the CARES Act removed this limitation.

As a result of New York's decoupling, for New York income tax and NYC Business Tax purposes, taxpayers will be limited in the amount of excess business losses available to offset non-business income for tax years 2018, 2019 and 2020.

Net Operating Losses ("NOLs")

The CARES Act enables net operating losses ("NOLs") from 2018, 2019 and 2020 to be carried back for five years and allowed NOLs to offset 100% of taxable income for those years.

As a result of New York's decoupling, for New York income tax and NYC Business Tax purposes, taxpayers will only be allowed to carryback NOLs for 2 years and the NOLs can only offset 80% of income.

Business Interest Deduction

The NY Budget decoupled from only one corporate income tax provision of the Code that was impacted by the CARES Act: the modification to business interest deduction. Note, this decoupling applies for individual income tax and NYC Business Taxes as well.

The TCJA limited the amount of business interest that a taxpayer can deduct to the sum of: (i) business interest income, (ii) 30% of the taxpayer's "adjusted taxable income" (approximately EBITDA until 2022) and (iii) floor plan financing interest expense (the interest that is (a) used to purchase cars held for sale or lease and (b) secured by the acquired inventory). For tax years beginning in 2019 and 2020, the CARES Act raises the threshold to 50% of adjusted taxable income.

As a result of New York's decoupling, a taxpayer will be allowed to deduct only 30% of adjusted taxable income.

Conclusion

Many New York taxpayers will face increased administrative burdens and costs as a result of New York's decision to decouple from the CARES Act's tax provisions. In addition to being required to prepare and file

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amended returns, taxpayers will also need to make separate calculations for New York and Federal income tax purposes.

We are continuously monitoring changes and guidance, and we will provide updates as they become available.

Olshan lawyers from multiple practice groups are working together with clients to address COVID-19-related matters, including the CARES Act stimulus programs (i.e., the PPP and EIDL) and other corporate matters, including contractual analysis and financing, tax, restructuring, employee benefits and employment practices, insurance coverage, and litigation. Click [here](#) to access additional materials addressing issues raised by COVID-19.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below if you would like to discuss this client alert or have questions about its content.

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