

Maryland

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Maryland Impact of the federal CARES Act on 1) Business Interest Expense Deduction, 2) Limitation of Excess Business Losses for Noncorporate Taxpayers, 3) Net Operating Losses, and 4) QIP Bonus Depreciation

In response to the COVID-19 pandemic, the United States Congress passed the Coronavirus Aid, Relief, and Economic Security Act, also known as the CARES Act. The CARES Act became law on March 27, 2020. The Act temporarily altered several tax provisions enacted under the Tax Cuts and Jobs Act (TCJA) intended to increase cash flow and reduce the income tax burden on corporations, partnerships, and individuals. Relief includes: the temporary and retroactive reinstatement of Net Operating Loss (NOL) carryback provisions for tax years 2018, 2019, and 2020 previously repealed under the TCJA in Internal Revenue Code (IRC) § 172; a decreased limitation on business interest expenses subject to deduction in tax years 2019 and 2020 under IRC § 163(j); and the elimination of loss limitations imposed on non-corporate taxpayers by the TCJA under IRC § 461(l) for tax years 2018, 2019, and 2020. The CARES Act also provided a technical correction giving qualified business improvements (QIP) a 15-year recovery period, thereby making those assets eligible for 100% bonus depreciation under IRC § 168.

As a conformity state, Maryland generally conforms to federal income tax laws except where the Maryland Legislature has enacted decoupling legislation. Additionally, Maryland law provides that if the revenue impact of an IRC amendment for a taxable year that begins in the calendar year in which the amendment is enacted is greater than \$5 million, the amendment does not affect the determination of Maryland taxable income for that tax year¹; that is, Maryland automatically decouples from those federal changes. The revenue impact is determined by the Bureau of Revenue Estimates in a report issued 60 days after an amendment to the IRC².

In its report dated June 12, 2020³, the Bureau of Revenue Estimates concluded that each of the key provisions would have an impact of greater than \$5 million in each year affected, 2018, 2019 and 2020. However, the Maryland decoupling statute permits decoupling only for the purposes of calculating Maryland taxable income for the year in which the amendment is enacted⁴. Therefore, Maryland is automatically decoupled from the CARES Act provisions affecting tax year 2020, but conforms to CARES Act provisions affecting tax years 2018 and 2019.

The Maryland impact of each key provision is discussed below.

Business Interest Expense Deduction

Prior to the CARES Act, Federal law limited the allowed deduction for business interest expense to the sum of: (1) business interest income for the taxable year; (2) 30% of the adjusted taxable income of the

¹ Tax-General Article (TG) § 10-108(c) of the Annotated Code of Maryland.

² TG § 10-108(b)

³ https://www.marylandtaxes.gov/reports/static-files/revenue/federalimpact/CARES_Act_60_Day_Report_Final_2020.pdf

⁴ TG § 10-108(a)

taxpayer for the taxable year; and (3) the floor plan financing interest of such a taxpayer for the taxable year. IRC § 163(j). Maryland conforms to the federal law on business interest expense; prior to the enactment of the CARES Act, no Maryland modification had been required.

The CARES Act § 2306 amended IRC § 163 to raise the percentage of adjusted taxable income that may be included in the business interest expense deduction from 30% to 50% for all business types, except partnerships⁵, for taxable years beginning in 2019 and 2020⁶. Additionally, in the case of any taxable year beginning in 2020, a taxpayer may elect to substitute its 2019 taxable income in the calculation of its business interest expense deduction⁷, unless 2019 is a short taxable year⁸.

If a taxpayer amends their federal 2018 or 2019 return to increase the business interest expense deduction, they may also amend their Maryland return based on the reduced federal adjusted gross income. No decoupling modification for business interest expense is required for amended returns for tax years 2018 or 2019. Any NOL generated in tax years 2018 or 2019 may be carried forward to tax year 2020.

Maryland is decoupled from IRC § 163 as amended by the CARES Act § 2306, as it applies to a tax year beginning in 2020. A decoupling modification is required to add back to federal taxable income any amount included in the federal business interest expense deduction that exceeds 30% of federal taxable income. This decoupling modification may affect the amount of NOL that may be carried forward. NOLs incurred in tax year 2020 may not be carried back.

Limitation of Excess Business Losses for Noncorporate Taxpayers

Prior to the CARES Act, an individual, trust, or estate, could offset up to \$250,000 (\$500,000 for individuals filing jointly) of nonbusiness income with business losses. Any loss beyond that limit could be carried forward as an NOL. Maryland has conformed to this provision; no Maryland modification has been required.

The CARES Act § 2304 amended IRC § 461(l) to eliminate the limitation on individuals, trusts, and estates and allow them to use business losses to offset the full amount of their nonbusiness income for tax years 2018 through 2020⁹. Any excess loss is considered an NOL.

Maryland conforms to this provision as it applies to tax years 2018 and 2019. If a taxpayer amends their 2018 or 2019 federal returns to use business losses to offset the full amount of their nonbusiness income, they may also amend their Maryland return for those years. Any excess loss may be carried forward.

Maryland is decoupled from IRC § 461(l) as amended by the CARES Act § 2304 as it applies to tax year 2020. At the Maryland level, noncorporate taxpayers' business losses incurred in tax year 2020 may only offset up to \$250,000 (\$500,000 for joint filers) of nonbusiness income. A decoupling modification is required to add back to federal taxable income any deduction of business loss that exceeds \$250,000 (\$500,000 for joint filers). This decoupling modification may affect the amount of NOL that may be carried forward. NOLs incurred in tax year 2020 may not be carried back.

⁵ For partnerships, this amendment only applies to taxable years beginning in 2020, but 50% of any excess business interest expense allocated from a partnership for any taxable year beginning in 2019 shall be treated as business interest that is paid or accrued by the partner in the partner's first taxable year beginning in 2020 and that is not subject to the partner's § 163(j) limit in 2020. IRC § 163(j)(10)(A)(ii).

⁶ IRC § 163(j)(10)(A)(i)

⁷ IRC § 163(j)(10)(B)(i)

⁸ IRC § 163(j)(10)(B)(ii)

⁹ IRC § 461(l)(2)(B)

NOLs

Prior to the passage of the federal Tax Cuts and Jobs Act (TCJA) in 2017, IRC § 172 allowed taxpayers to carryback NOLs for up to two years, with an election for 5 years in some cases. Maryland decoupled from the five-year election, which had been found in IRC § 172(b)(1)(H), with the result that Maryland allowed a carryback for up to two years only. The TCJA repealed the carryback federally, allowing a 20-year NOL carryforward to offset up to 80% of taxable income each year for tax years beginning after December 31, 2017. This change by the TCJA rendered Maryland's decoupling moot; the Maryland statute¹⁰ specifically decoupled from IRC § 172(b)(1)(H), which was repealed by the TCJA. Maryland reverted to conformity by default, and for tax years beginning after December 31, 2017, no carryback has been allowed, only carryforward¹¹. Maryland also conformed to the 80% limitation. Prior to the CARES Act, Maryland conformed to IRC § 172; no Maryland modification has been required for tax years beginning after December 31, 2017.

The CARES Act § 2303 amended the NOL provisions enacted under the TCJA to allow a five-year carry back for NOLs and suspend the 80% carryforward limitation for tax years beginning after December 31, 2017 and before January 1, 2021 (2018, 2019, and 2020)¹². As a result, businesses may amend their federal 2018 tax year returns to carryback current year losses and offset federal taxable income for tax years as far back as 2013. Losses incurred in 2019 and 2020 may be carried back as far as 2014 and 2015, respectively, at the federal level.

Maryland conforms to this provision as it applies to tax years 2018 and 2019. NOLs incurred in tax years 2018 and 2019 may be carried back for up to five years. If a taxpayer incurred a federal NOL in tax year 2018 or 2019, and they amend prior year federal returns to carry the NOL back, they may also amend their Maryland returns for each year a federal amended return was filed.

Please note, the IRS has implemented procedures for quick refunds due to the carryback of NOLs, but Maryland has no such procedures; taxpayers must file amended returns to claim the state refund.

Maryland is decoupled from IRC § 172 as amended by the CARES Act § 2303 as it applies to tax year 2020. Taxpayers may continue to carry forward losses incurred in tax years beginning after December 31, 2017; they may not amend prior year returns to carry back current year federal NOLs incurred in tax year 2020. Additionally, any NOLs carried forward from prior years is limited to 80% of Maryland taxable income for 2020. The remaining unused NOL may be carried forward to tax year 2021.

Because tax year 2020 NOLs may not be carried back at the Maryland level, taxpayers may deplete a 2020 federal NOL by carrying it back before the federal NOL is depleted at the Maryland level. A decoupling modification is required for each year to which a 2020 NOL is carried back at the federal level, as allowed by the CARES Act. A decoupling modification is also required to add back to tax year 2020 any NOL carryforward that exceeds 80% of taxable income for the tax year. The modification is determined using Maryland Form 500DM and instructions. Pro forma federal returns must be completed in order to determine the decoupling modification.

Example 1. Taxpayer A incurred a federal NOL of \$100,000 in tax year 2019. The taxpayer amends its federal returns to offset its 2018 income of \$110,000, bringing 2018 federal taxable income to \$10,000,

¹⁰ TG § 10-210.1(b)(2)

¹¹ COMAR 03.04.03.07.B.

¹² IRC § 172(b)(1)(D)

and receives a federal refund. Taxpayer A may amend its 2018 Maryland return to carry back the 2019 NOL.

Example 2. In tax year 2020, Taxpayer B incurs a federal NOL of \$100,000. Taxpayer B amends prior year federal returns to carry the NOL back. The NOL offsets income of \$80,000 in 2018, and reduces 2019 income of \$90,000 to \$70,000 at the federal level. 2018 and 2019 Maryland returns may not be amended to carryback the 2020 NOL. Prior to tax year 2021, the 2020 NOL is depleted at the federal level; taxpayer used its entire 2020 NOL by carrying it back to 2018 and 2019. However, at the Maryland level, Taxpayer B may use Form 500DM to carry forward the 2020 NOL to reduce 2021 income by up to 80% of 2021 Maryland taxable income. For further discussion of net operating losses and associated Maryland addition and subtraction modifications, please see Administrative Release 18.

Qualified Improvement Property and Bonus Depreciation

The CARES Act § 2307 made a technical correction to the TCJA, allowing qualified improvement property (QIP) placed in service after December 31, 2017, to be classified as 15-year property and eligible for federal 100% bonus depreciation. The CARES Act accomplishes the correction by amending IRC § 168(e) and (g). This provision is effective as if it were included in the TCJA, and applies to tax years beginning after December 31, 2017.

Maryland has legislatively decoupled from federal bonus depreciation, except when it is taken by a manufacturer, by decoupling from IRC § 167(a) and (k)¹³. Prior to the passage of the CARES Act, Maryland had not been specifically decoupled from IRC § 168(e)(3)(E)(vii), which the CARES Act amended to classify QIP as 15-year property.

The shortened depreciation period for QIP will have an unknown, but likely not significant, impact on revenue. Therefore, Maryland conforms to the provision that classifies QIP as 15-year property as it applies to all tax years beginning after December 31, 2017. QIP placed in service in tax years 2018 and beyond is 15-year property, and may be depreciated as such. Because Maryland has legislatively decoupled from federal bonus depreciation, non-manufacturers may not take bonus depreciation on QIP at the Maryland level, even though the property qualifies for federal bonus depreciation.

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13TG § 10-210.1(b)(1)(i), (ii)