COVID-19: STATE CONFORMITY TO CARES ACT TAX RELIEF: AN INTRODUCTORY Q&A

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As states and taxpayers settle in for a longer-term pandemic recovery than many first expected, taxpayers are increasingly focused on assessing whether the states in which they do business will conform to certain federal tax relief provisions of the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act). Although the CARES Act has been law since March 27, 2020, only a handful of states have begun issuing guidance on their responses to the CARES Act. We expect more to follow in the coming weeks and months, particularly as states begin to appreciate the full picture of the impact of the pandemic on their economic conditions.

HOW DO STATES ELECT TO CONFORM (OR NOT) TO FEDERAL TAX PROVISIONS?

Whether and how state income taxes and other business taxes conform to the Internal Revenue Code (the IRC) generally depend on whether a state's tax code conforms to the IRC on a rolling basis or a static basis. Rolling conformity states generally automatically adopt changes to the IRC as they are enacted at the federal level. Static conformity states, on the other hand, generally adopt versions of the IRC as in effect on a specific date and, therefore, must pass legislation to conform to new IRC amendments enacted after that date.

Without legislative action, a rolling conformity state generally will conform to the CARES Act tax provisions, and a static conformity state with a conformity date prior to March 27, 2020, generally will not. However, both rolling and static conformity states may choose expressly to decouple from, or conform to, certain specific provisions of the IRC.

WHICH BUSINESS TAX PROVISIONS OF THE CARES ACT HAVE STATES BEEN ANALYZING?

Certain CARES Act business tax relief provisions have attracted significant attention from states during the coronavirus pandemic. These key provisions include the following:

- **PPP Loan Forgiveness:** The CARES Act grants loan forgiveness to small businesses for certain amounts the businesses receive pursuant to the federal Paycheck Protection Program (PPP), and excludes from the businesses' gross income for federal income tax purposes PPP loan amounts that are forgiven.[1]
- **NOL Provisions:** The CARES Act generally permits taxpayers to carry net operating losses (NOLs) arising in taxable years beginning in 2018, 2019, and 2020 back to each of the five years preceding the

year of the loss. The CARES Act also suspends the 80 percent of taxable income limitation on the use of NOLs arising in taxable years beginning in 2018, 2019, and 2020.[3]

- **Qualified Charitable Contribution Deduction for Corporations:** The CARES Act generally allows for a deduction, capped at 25 percent of the taxpayer's taxable income, of 2020 cash contributions to qualifying charitable organizations.[4]
- **Business Interest Limitations:** The CARES Act generally increases the IRC Section 163(j) business interest expense limitation from 30 percent of adjusted taxable income to 50 percent of adjusted taxable income for taxable years beginning in 2019 and 2020.[5]
- **Qualified Improvement Property:** The CARES Act changes the depreciation recovery period of qualified improvement property (QIP) from 39 years to 15 years under the modified accelerated cost recovery system, and from 40 years to 20 years under the alternative depreciation system.[6]

Several CARES Act tax relief provisions impact IRC amendments implemented by the Tax Cuts and Jobs Act of 2017 (TCJA), including the NOL modifications, business interest limitations, and QIP modifications described above. States will weigh each of these provisions' impacts on their revenue forecasts in deciding whether to conform to CARES Act and TCJA provisions on a wholesale basis and/or to decouple from, or conform to, only certain specific provisions.

WHAT HAVE SOME STATES SAID SO FAR ABOUT CONFORMITY TO THE CARES ACT?

Several states, regardless of their general conformity approach, have yet to publish guidance on CARES Act conformity. Of the states that have published guidance on CARES Act conformity, some states have released guidance implying that they do not intend to pass legislation (or have not yet passed legislation) to deviate from their general conformity status. For example:

- California, a static conformity state, has indicated that it does not conform to certain CARES Act provisions, including PPP loan forgiveness, NOL carrybacks, charitable contributions, and business interest limitations, and the California Franchise Tax Board has not provided further guidance on whether California may take future legislative action.[7]
- Hawaii, a static conformity state, has also published guidance stating that it does not currently conform to the CARES Act PPP loan forgiveness provisions, but the Department of Taxation has indicated that it will recommend that the legislature conform to those CARES Act provisions.[8]

Certain other states have passed legislation and released guidance on CARES Act conformity specifically indicating a deviation from their general conformity status. For example:

- New York, a rolling conformity state, passed legislation to decouple from certain tax relief provisions of the CARES Act.[9]
- North Carolina and Georgia, both static conformity states, have passed legislation to conform to the IRC as of March 27, 2020 (or later), but have also expressly decoupled from certain federal tax relief provisions of the CARES Act.[10]

HOW SHOULD TAXPAYERS ANALYZE THE IMPACT OF THE CARES ACT ON THEIR STATE TAX LIABILITIES?

A state's typical rolling or static approach to conformity provides an important initial framework for analyzing potential conformity to CARES Act provisions; however, due to the wide range of variation among states' tax codes and their approaches to IRC conformity, even a longstanding conformity approach will not necessarily reflect how a state will implement - or not - the provisions of the CARES Act in applying the state's own tax code. Taxpayers should pay particularly close attention to CARES Act conformity guidance published by the taxing jurisdictions in which they do business. New tax interpretations and laws about marketplace facilitators, remote employees, and strained state tax budgets will encourage states to take an aggressive approach in asserting taxing jurisdiction, so businesses may find the list of states in which they do business is a longer list than they anticipate. We expect states will continue to publish guidance regarding CARES Act conformity as they analyze the potential fiscal impact of certain CARES Act provisions at the state level.

FOOTNOTES

[1] *See* CARES Act, Pub. L. 116-136, Section 1106(i).

[2] *See id.,* Section 2303(b).

[3] *See id.,* Section 2303(a).

[4] *See id.,* Section 2205(a)(2).

[5] *See id.,* Section 2306(a).

[6] *See id.,* Section 2307(a); *see also* Rev. Proc. 2020-25, Internal Revenue Service, (Apr. 17, 2020), Section 2.

[7] *See* Press Release, State of California, Franchise Tax Bd., California's Conformity with Federal CARES Act (May 2020).

[8] *See* Tax Information Release 2020-02 (Revised), State of Hawaii, Dep't of Taxation, Hawaii Tax Treatment of Various Federal COVID-19 Relief Programs and Payments (May 4, 2020).

[9] *See* State of New York, Dep't of Tax. and Fin., N-20-7, Impact of Changes to the Internal Revenue Code (IRC) on the 2019 New York State Personal Income Tax Returns (June 10, 2020); *see also* N.Y. S. 7508, Leg. Sess. 2019-2020 (2020).

[10] *See* Ga. H.B. 846, Reg. Sess. 2019-2020, (2020); N.C. H.B. 1080, Reg. Sess. 2019-2020 (2020).

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