

**Morgan Lewis**

# **TAX DEVELOPMENTS AFFECTING AUTOMOTIVE AND MOBILITY COMPANIES**

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# Morgan Lewis Automotive Hour Webinar Series

Series of automotive industry focused webinars led by members of the Morgan Lewis global automotive team. The 10-part 2020 program is designed to provide a comprehensive overview on a variety of topics related to clients in the automotive industry. Upcoming sessions:

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**NOVEMBER 11** | Environmental Developments and Challenges in the Automotive Space

**DECEMBER 9** | Capitalizing on Emerging Technology in the Automotive and Mobility Space

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**SECTION 01**

# **INTRODUCTIONS**



## Today's Presenters



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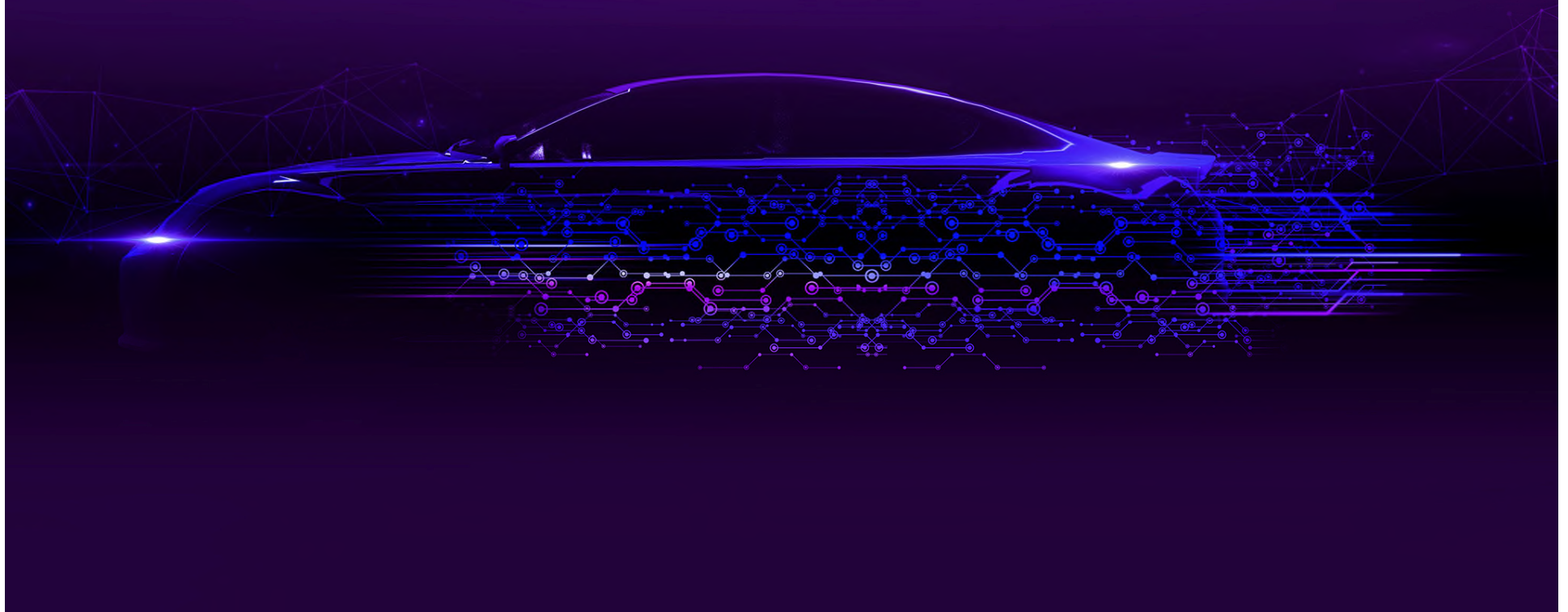
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**SECTION 02**

# **IMPORTANT COVID-19 TAX UPDATES**





## COVID-19 Tax Updates – Timeline of Guidance

- **March 13, 2020:** President Trump declares national emergency.
- **March 18, 2020:** President Signs the “Families First Coronavirus Response Act.”
- **March 18, 2020:** IRS issues Notice 2020-17 addressing federal income tax *payments* relating to the 2019 tax year.
- **March 20, 2020:** IRS issues Notice 2020-18 superseding and expanding on Notice 2020-17.
- **March 20, 2020:** IRS announces its plan to implement the Families First Coronavirus Response Act.
- **March 24, 2020:** IRS issues Frequently Asked Questions regarding Notice 2020-18.
- **March 25, 2020:** IRS issues IR 2020-59, the “People First Initiative.”
- **March 27, 2020:** President signs the “Coronavirus Aid, Relief, and Economic Security Act.”

# Families First Coronavirus Response Act

- Passed the House on March 14 with technical corrections package passed on March 16; passed the Senate on March 18 and signed by the President that day.
- Included legislation for:
  - Leave mandate and associated employer credit; established a federal emergency paid-leave benefits program for employers with fewer than 500 employees to provide two weeks of sick leave if employees are unable to work because they are subject to quarantine or isolation or experiencing symptoms of COVID-19, are caring for someone who is in quarantine, or have children who are in schools that are closed.
  - Provides employers with tax credits to offset the cost of paying leave.
  - IRS currently working to provide guidance and roll out implementation.
  - IRS Notice 2020-21 provides that this Act will apply to wages paid for the period beginning April 1, 2020 and ending on December 31, 2020.



## Notice 2020-18 (March 20, 2020)

- Restates and expands upon Notice 2020-17.
- Generally provides that the deadlines for both **filing** federal income tax returns and making certain **payments** are extended from April 15, 2020, to July 15, 2020.
- Extension automatically applies—taxpayers do not need to take action to take advantage of the relief.
- Removes the previously announced limitations on the amount of tax payments that may be deferred. Taxpayers may now defer any amount of federal income tax payments until July 15, 2020.
- No interest, penalties, or additions to tax for failure to file federal income tax returns or pay federal income taxes will accrue on the deferred filings or payments through July 15, 2020.

## Notice 2020-18 (cont.)

- Some questions remain after Notice 2020-18:
  - Deadlines for federal “information returns” are not extended.
  - Notice does not address payments due for other quarters or for fiscal year taxpayers.
  - Other material deadlines were not extended, including:
    - Payment of estate, employment, or excise tax;
    - Filing of estate, employment, or excise tax returns;
    - Filing of petitions with the US Tax Court;
    - Filing claims for credit or refund of any tax;
    - Filing of refund lawsuits; or
    - “Any other act required or permitted under the internal revenue laws specified by” the Treasury Secretary.”
- Notice 2020-20 issued to “update and amplify” this relief to include Gift Tax and Generation-Skipping Transfer Tax returns.

## FAQs on Notice 2020-18 (March 24, 2020)

- IRS issues Frequently Asked Questions regarding Notice 2020-18. Includes various informal guidance, such as:
  - “With respect to returns due on March 16, 2020, which include Form 1065, Form 1065-B, Form 1066, and Form 1120-S for calendar year taxpayers, the filing of those returns has not been postponed.”
  - “If your Federal income tax return for your fiscal year ending during 2019 is due on April 15, 2020, whether that is the original due date or the due date on extension, your due date is postponed to July 15, 2020.”
  - “Any taxpayers who have filing or payment due dates other than April 15 have not been granted relief at this time.”
  - “Second quarter 2020 estimated income tax payments are still due on June 15, 2020. First quarter 2020 estimated income tax payments are postponed from April 15 to July 15, 2020.”

## The “People First Initiative” (March 25, 2020)

- IRS to temporarily adjust processes to “help people and businesses during these uncertain times” ... and ... “be part of the solution to improve the lives of all people in our country.”
- What can we expect?
  - Suspension of new liens and levies (including any seizures of a personal residence) initiated by revenue officers. However, revenue officers will continue to pursue high-income non-filers and “perform other similar activities where warranted.”
  - Will “generally” not start new audits, but will continue to work refund claims “where possible,” without in-person contact.
  - Some business taxpayers may want to start audits “while people and records are available and respective staffs have capacity”—IRS may initiate audits in those instances.
  - Suspension of in-person meetings for current audits, but will work audits remotely “where possible.”
  - If possible, IRS encourages taxpayers to respond to IRS correspondence requesting additional information during this time.

## The “People First Initiative” (cont.)

- What can we expect?
  - IRS Appeals will continue to work cases. Not holding in-person conferences, but may be held over the telephone or videoconference. Taxpayers are encouraged to promptly respond to any outstanding requests for information for all Appeals cases.
  - IRS will take steps to protect applicable statutes of limitations. Where statute expirations might be jeopardized, taxpayers are encouraged to cooperate in extending such statutes. IRS may issue Notices of Deficiency or other actions to protect the interests of the government. Where a statutory period is not set to expire during 2020, the IRS is unlikely to pursue the foregoing actions until at least July 15, 2020.
  - “More specifics about the implementation of these provisions will be shared soon.”

# Coronavirus Aid, Relief, and Economic Security Act

- Passed the Senate on March 25; passed the House on March 27 and signed by the President that day.
- Included legislation for:
  - A refundable credit, paid in cash for 2020 of \$1,200 to individuals and \$2,400 to married couples with an additional \$500 for each “qualifying child,” the credit is subject to AGI limits and phase outs;
  - A temporary suspension of net operating loss limits and a 5-year carryback period;
  - An increase of the limitation on deductible business interest; and
  - A reduction of the applicable recovery period for qualified improvement property.
- Regulations, forms, and guidance implementing CARES soon to come.

## Temporary Suspension of NOLs and 5-Year Carryback

- Temporary repeal of 80% of taxable income limitation and ability to carryback 2018, 2019, and 2020 NOLs to five preceding taxable years.
- NOLs cannot be carried back to offset income included pursuant to section 965(a) and taxpayers can elect not to offset any income generated in a year with a section 965(a) inclusion.
- Observations:
  - Carrybacks to pre-2018 years will mean refunds of taxes paid at the higher rate of 35%;
  - Be mindful of the Joint Committee Review of refunds over \$5 million and use Form 1139 if possible to carryback (subject to some limitations, however);
  - Consider the impact on previously reported section 965 liabilities, BEAT, and GILTI;
  - Remember that a carryback to an otherwise closed year can “reopen” that year;
  - State filing obligations can be triggered when filing amended federal returns; and
  - Review agreements related to transactions that may have taken into account TCJA restrictions on carrybacks to see if there are options available to you.



## Increase in the Limitation of Deductible Business Interest (Section 163(j))

- The limitation is increased to 50% of a taxpayer's adjusted taxable income ("ATI").
- Taxpayers can use 2019 ATI to calculate 2020 deductions.
- Special rules for partnerships:
  - 50% for 30% only applies for 2020;
  - Allows partner to take 50% of the excess business interest allocated to the partner (computed using the 30% limitation in 2019) and deem it to accrue in 2020.
- Observations:
  - Taxpayers may elect out to defer the deduction and avoid increasing an already existing NOL;
  - Taxpayers subject to BEAT should be mindful of the interplay with the section 163(j) deduction – decreasing your taxable income may increase your liability under BEAT; and
  - The CARES act did not address the problem for manufacturers who cannot increase their ATI by adding back depreciation, amortization and depletion expense deductions.

## Reduction of the Applicable Recovery Period for “QIP”

- Corrected the “retail glitch” by shortening the recovery period for qualified improvement property to 15 years and making it eligible for bonus depreciation.
- Observations:
  - Unlike other CARES provisions, this is a correction to the TCJA and applies retroactively to 2018 and 2019 and prospectively;
  - Taxpayers who incurred costs related to QIP during 2020 and before January 1, 2023 can deduct the full cost immediately; and
  - Taxpayers who incurred costs related to QIP in 2018 and 2019 should consider amending returns to fully expense the cost and obtain refunds or to generate NOLs which can be carried back.

# Stay Tuned – So Much More to Come

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As the coronavirus COVID-19 crisis rapidly evolves, global companies are looking for resources to protect their people and their businesses. Morgan Lewis lawyers are providing guidance on healthcare provider issues, business supply chain disruption, data privacy concerns, employer questions, energy and environmental industry ramifications, financial services guidelines, immigration status requirements, life sciences protocols, tax implications, and ongoing government guidance from around the world.

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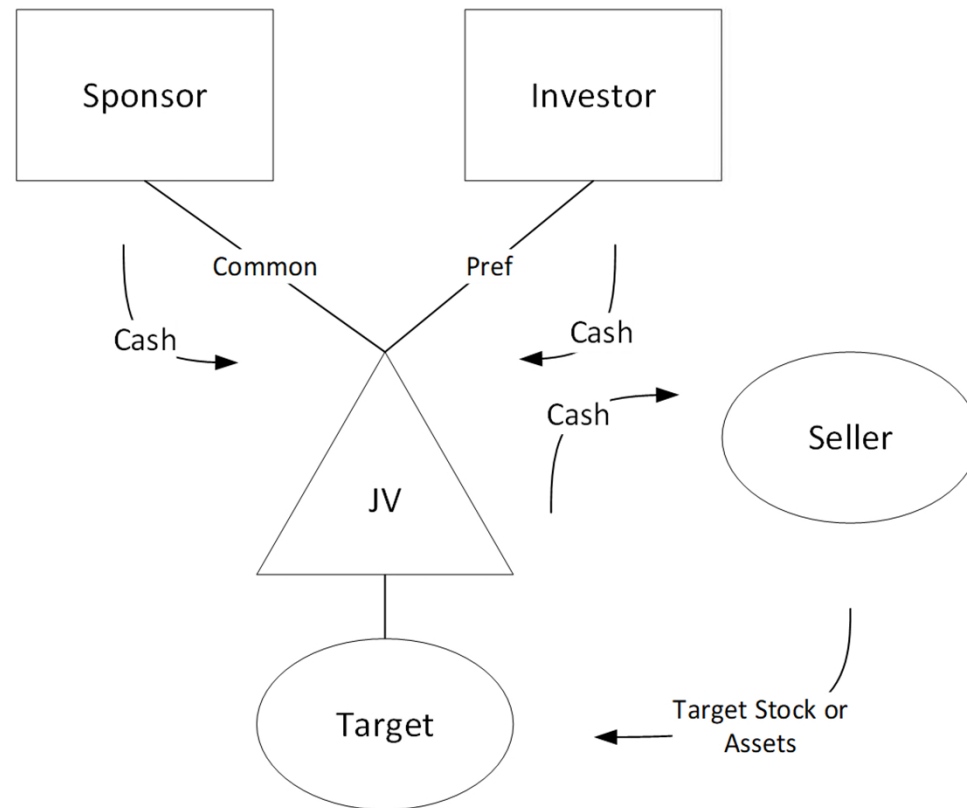
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## SECTION 03

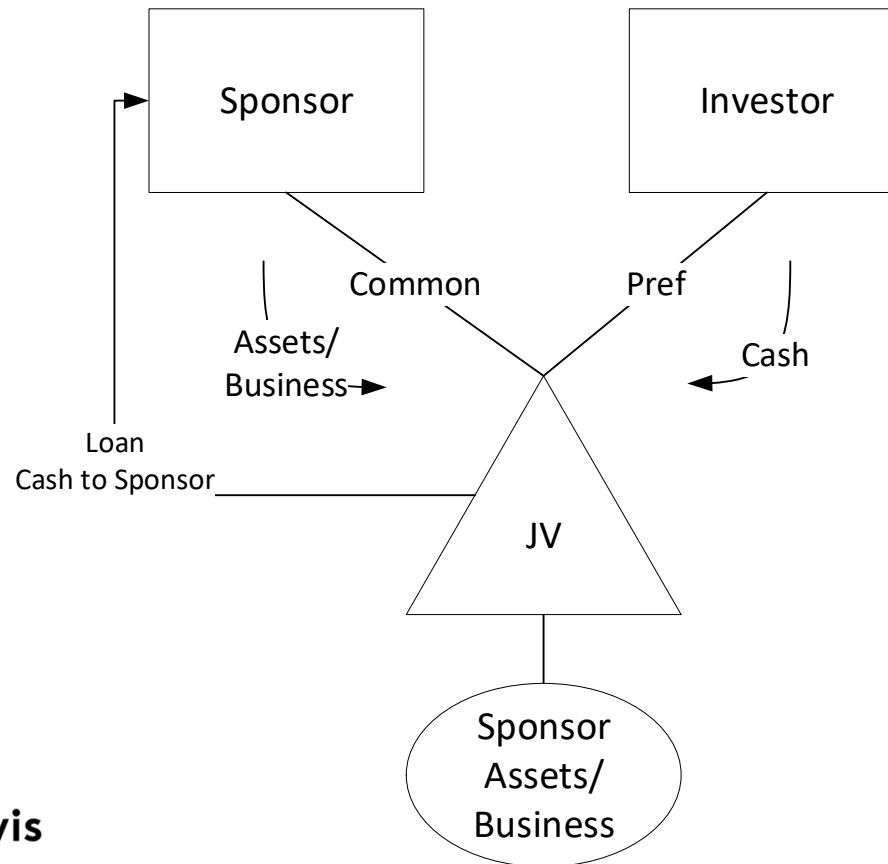
# FINANCING: NEW ACQUISITIONS, EXISTING ASSETS, AND ALTERNATIVES



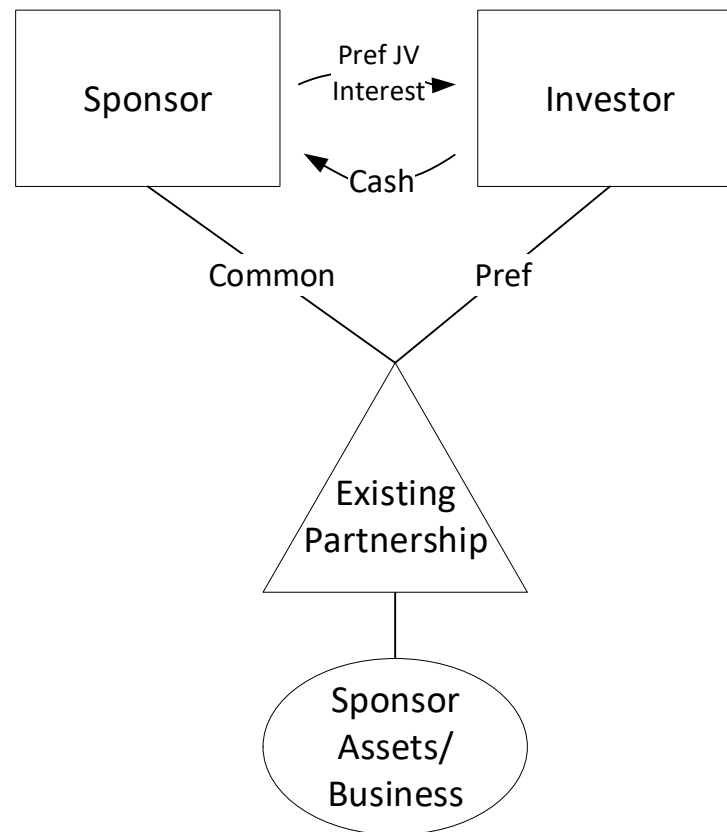
# Financing New Acquisition



# Financing Existing Assets / Business



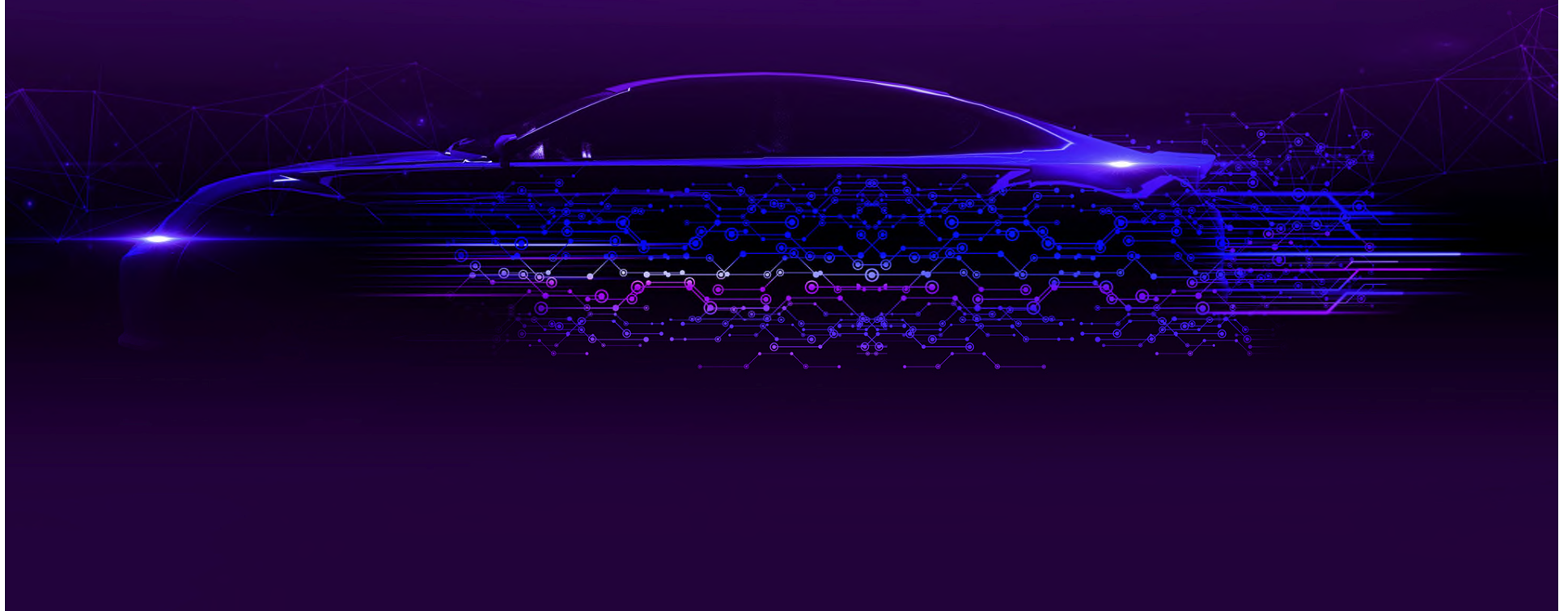
## Financing Existing Assets / Business (Alternative)





**SECTION 04**

# **RELEVANT IRS ENFORCEMENT CAMPAIGNS**



## Relevant IRS Enforcement Campaigns

- **January 31, 2017:** IRS announces 13 initial Large Business & International (LB&I) “compliance campaigns.”
  - Part of an “extensive effort to redefine large business compliance work and build a supportive infrastructure inside LB&I.”
- **November 3, 2017:** IRS adds campaign regarding “economic development incentives.”
  - I.e., the tax treatment of incentives (including tax refunds, payroll tax relief, and others) states provide to businesses to encourage economic activity.
- **February 27, 2020:** IRS adds campaign regarding research and development expenditures.
  - I.e., the tax treatment of incentives the Federal government provides to businesses to encourage research and development activity.

# Research and Development Expenditures Campaign

- I.R.C. § 41 gives taxpayers a tax credit for increases in qualified research expenses (“QREs”) for a taxable year.
- Basic structure:
  - **Qualified research** is **activity** meeting certain tests;
  - **QREs** are **expenses** incurred in conducting qualified research:
    - Qualified wages;
    - Qualified supply costs; or
    - Contract research expenses.

# What is Qualified Research?

1) Research activities that satisfy the basic “4-Part Test”:

## **Technological in Nature**

The activity must fundamentally rely on principles of the physical or biological sciences, engineering or computer science.

## **Technical Uncertainty**

The activity must be intended to discover information to eliminate uncertainty concerning the capability, method or design for developing or improving a product or process.

## **Process of Experimentation**

The activity must include an evaluative process and generally should be capable of identifying and evaluating more than one alternative to achieve a result. This may include modeling, simulation, or a systematic trial and error method.

## **Permitted Purpose**

The activity must relate to a new or improved business component's  
Function,  
Performance,  
Reliability, or  
Quality.

## What is Qualified Research? (cont.)

2) And are not **excluded activities**:

- Research after commercial production has begun;
- Adaptation or duplication of existing business components;
- Surveys, studies, research relating to management functions, etc.;
- Research outside US and territories;
- Research in the social sciences, etc.;
- Research funded by grant, contract, otherwise; and
- Internal use software (special regulations apply).

# What are QREs?

## **Qualified wages**

Taxable wages of employees engaged in:

- Research;
- Qualified support of research;
- Direct supervision of research.

## **Supply costs**

Costs of tangible property used to conduct or support research, except:

- Capitalized expenses;
- General and administrative expenses;
- “Indirect research expenses”.

## **Contract Research Expenses**

65% of amounts paid to third parties to conduct or support qualified research.

- If payment is contingent on success, then deemed for product not research.

## Determining the Credit

- Broadly, the lesser of:
  - 20% of the increase in QREs over a base period amount; or
  - 20% of half of claim-year QREs.
- Alternative Simplified Credit:
  - 14% of the amount by which the claim-year QREs exceed 50% of the average QREs for the preceding 3 years.
- Network of advisors to:
  - Determine eligibility for the credit and design study;
  - Educate employees about qualifying activities and how to record;
  - Oversee study; and
  - Facilitate determinations of credit amounts.



## IRS Treatment of the R&D Credit

- “Research credit scams” included in IRS’s 2019 “dirty dozen.”
  - “Improper claims for this credit generally involve a failure to participate in or substantiate qualified research activities and/or a failure to satisfy the requirements related to [QREs].”
  - “The IRS often sees expenses for nonqualified activities included in claims for the Research Credit. In addition, [QREs] include only in-house wages and supply expenses and a portion, typically 65 percent, of payments to contractors. [QREs] do not include expenses without a proven nexus between the claimed expenses and the qualified research activity.”

## IRS Treatment of the R&D Credit (cont.)

- IRS litigation success last year:
  - Siemer Milling Co. v. Commissioner (denying credits where taxpayer failed to show how research activities were part of a scientific process or systematic process of experimentation).
- Ongoing litigation:
  - Audio Technica U.S., Inc. v. United States (taxpayer-favorable opinion currently on appeal to United States Court of Appeals for the Sixth Circuit).
- Recent IRS LB&I directive:
  - “Research issues are examined on a substantial number of LB&I cases and consume significant LB&I resources.”
  - While it does not apply to “campaign” cases, the directive “communicates the requirements and process for centralized risking of cases with potential research issues.”

# Economic Development Incentives Campaign

- States routinely provide various financial and economic incentives to businesses designed to encourage businesses to locate activities in particular states or areas.
  - The goal is often to create jobs and help revitalize the state and local economy.
- Common examples:
  - Cash grants;
  - State and local tax relief;
  - Land or other property; or
  - Subsidized services.

## Economic Development Incentives Campaign (cont.)

- Prior to the Tax Cuts and Jobs Act, section 118 stated:
  - “In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.”
- Treas. Reg. section 1.118-1 provides that section 118:
  - “[A]pplies to contributions to capital made by persons other than shareholders. For example, the exclusion applies to the value of land or other property contributed to a corporation by a governmental unit or by a civic group for the purpose of inducing the corporation to locate its business in a particular community, or for the purpose of enabling the corporation to expand its operating facilities.”
- Brown Shoe Co. v. Commissioner, 339 U.S. 583 (1950):
  - Supreme Court held that community groups made contributions to a corporation’s capital where they gave a manufacturing company cash and property pursuant to contracts requiring the corporation to build or enlarge manufacturing plants in the communities at issue and also meet minimum payroll requirements or create additional jobs.

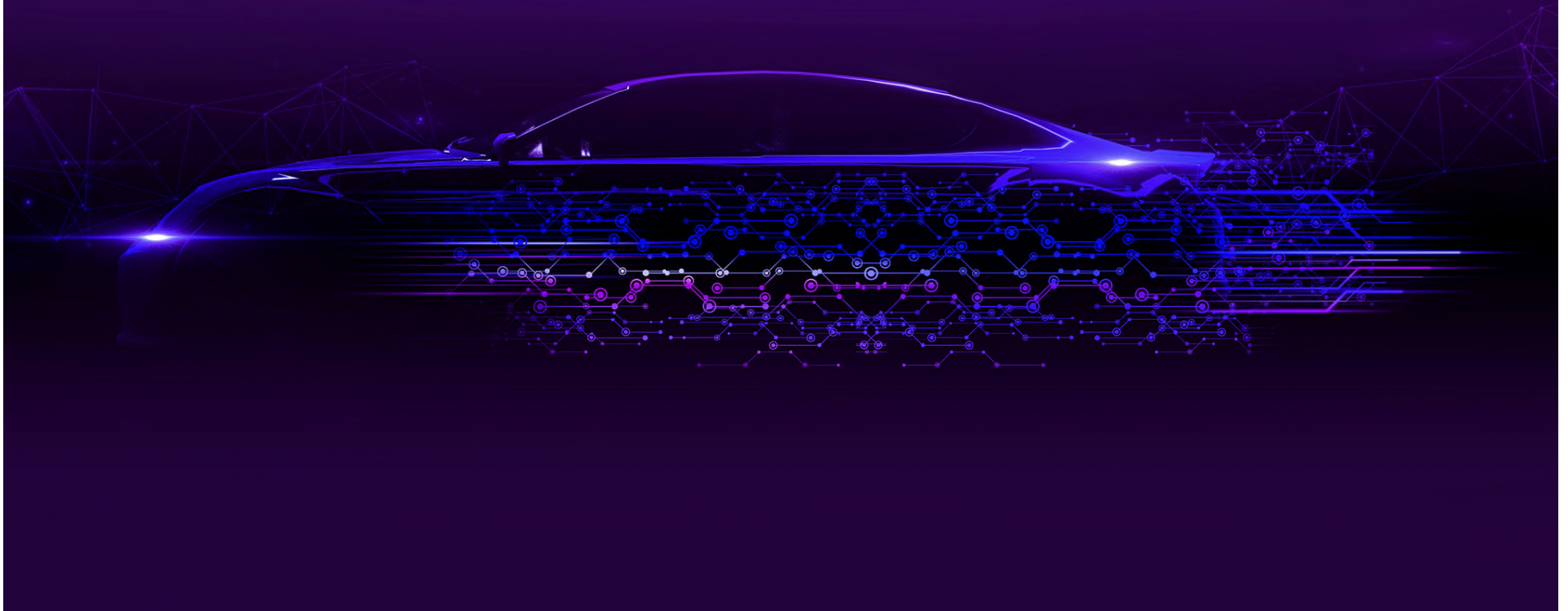
# IRS Treatment of Economic Development Incentives

- IRS Campaign Announcement (Nov. 3, 2017):
  - “Taxpayers may improperly treat government incentives as non-shareholder capital contributions, exclude them from gross income and claim a tax deduction without offsetting it by the tax credit received. The goal of this campaign is to ensure taxpayer compliance.”
- Ongoing litigation:
  - BrokerTec Holdings, Inc. v. Commissioner (taxpayer-favorable opinion currently on appeal to United States Court of Appeals for the Third Circuit).
  - CF Headquarters Corp. v. Commissioner, Tax Ct. Docket No. 22321-12 (awaiting opinion).

## Legislative Update

- Tax Cuts and Jobs Act amends section 118 (as of December 22, 2017):
  - “Contribution to capital” does not include “any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such).”
- However, the amendments “shall not apply to any contribution, made after [December 22, 2017] by a governmental entity, which is made pursuant to a master development plan that has been approved prior to such date by a governmental entity.”

# QUESTIONS?





# THANK YOU

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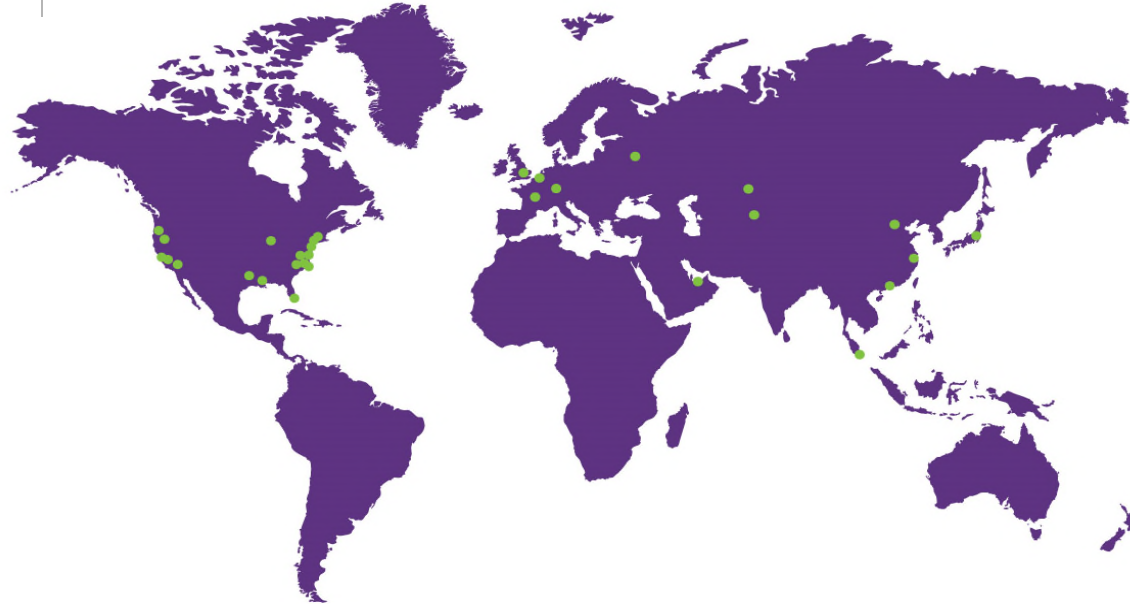
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