Congressional Research Service
Informing the legislative debate since 1914

INSIGHT

Interaction of International Tax Provisions with Business Provisions in the CARES Act

April 6, 2020

The Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) included two general tax benefits for business: net operating losses (NOLs) and interest deductions, which reduce taxable income and tax liability. These provisions may interact with existing international tax provisions enacted in the 2017 tax revision, popularly known as the Tax Cuts and Jobs Act, or TCJA (P.L. 115-97). The TCJA also decreased tax rates, including reducing the corporate rate from 35% to 21%.

International Provisions in the TCJA

In transitioning from the prior international tax regime that taxed earnings of foreign subsidiaries controlled by U.S. firms only when repatriated (paid as a dividend, with credits allowed for foreign taxes up to the U.S. tax paid on foreign source income) to a system that exempted dividends but taxed some foreign income currently, the TCJA imposed a transition (repatriation) tax (at 15.5% for cash and 8% for other earnings) on accumulated untaxed earnings abroad (with proportional foreign tax credits allowed). Firms could elect to spread the tax (a section 965 tax) over eight years.

The TCJA also enacted three regimes to address international profit-shifting. The global intangible low taxed income (GILTI) provision imposes a tax on foreign subsidiary income, after deducting a deemed return on tangible assets. A deduction of 50% is allowed for the remainder, with 80% of foreign taxes credited. A deduction is also allowed for domestic foreign derived intangible income (FDII), to equalize the treatment of intangible assets held domestically and abroad. The combined GILTI and FDII deductions (under section 250) cannot exceed taxable income. The base erosion and anti-abuse tax (BEAT) is a minimum tax applied to a base that adds back a number of deductions for payments to related foreign parties and taxes the larger base at 10% (5% in 2018). BEAT applies to large firms with base erosion payments of 3% or more of deductions.

(Some income of foreign subsidiaries that is easily shifted is currently taxed fully under both systems; this income is termed Subpart F income.)

Congressional Research Service
https://crsreports.congress.gov
IN11314

CRS INSIGHT
Prepared for Members and
Committees of Congress

Business Deduction Benefits in the CARES Act

Under current permanent law, when a firm has a net operating loss, or NOL, taxes are not reduced immediately beyond zero. Rather, the business owes no income tax in that tax year and the loss can be carried forward indefinitely to reduce up to 80% of taxable income. These rules were enacted in the TCJA and became effective for 2018. Prior to that revision, losses could be carried back two years and carried forward for 20 years, fully offsetting tax liability. Carrybacks of losses yield immediate tax reductions,

The CARES Act allows firms to elect to carry back losses from 2018 through 2020 for five years and also suspends the 80% of taxable income limit for 2018-2020.

Tax rules limit the amount of debt that can generate deductible interest for the purpose of calculating taxable income. Prior to the TCJA, these rules were narrowly focused and limited to related party interest of corporations whose debt to equity ratio exceeded 1.5 to 1. Interest deductions were limited to 50% of earnings before interest, taxes, depreciation, amortization, and depletion (EBITDA). Disallowed deductions could be carried forward for three years.

The TCJA expanded coverage to all businesses and all interest, regardless of debt to equity ratios, and reduced the interest deduction cap to 30%. The TCJA also changed the income measure to income (earnings) before interest and taxes (EBIT), imposing a further limit on interest deductions, although this change was not scheduled to take place until 2022. The CARES Act increased the cap to 50%. Taxpayers can opt out of this additional deduction.

Interactions

NOLs carried back to years with transition tax (section 965) inclusions will not be offset against the transition tax income. Section 965 made it optional whether to allow NOL offsets, but in the case of the NOL carryback it is not an option. In general, there are both advantages and disadvantages to this rule. If the NOL reduces transition tax, it saves taxes at a 15.5% or 8% rate, rather than the 21% rate if it is applied in the future to ordinary income, which is disadvantageous. If the NOL is expected to be used very far in the future, however, this delay may be more costly than offsetting income taxed at a lower rate, although the latter is unlikely at low current interest rates. The lack of an option is detrimental to taxpayers. Another rule allows the taxpayer to skip over years with a section 965 inclusion, which could be beneficial when the loss is foreign sourced and would reduce foreign tax credits due to the foreign tax credit limit. The firm can also elect to opt out of the full carryback rules, which could be beneficial in general if losses reduced foreign source income and foreign tax credits that could not be used in the 10-year foreign tax credit carryforward period.

The revision also indicates that, once the 80% taxable income restriction is reinstated in 2021, the 80% limit will be calculated before the GILTI/FDII deduction. This rule is beneficial for firms whose GILTI/FDII deductions do not exceed taxable income, as it allows larger loss deductions. It can be harmful if the GILTI/FDII Section 250 deduction is binding or will be binding due to the NOL. The GILTI/FDII deduction cannot be carried forward.

NOLs carried back to years in which BEAT was in effect may offset income that was taxed at a lower rate causing the losses to be less valuable than if offsetting ordinary income.

Taking additional interest deductions is optional. For some taxpayers, this rule is beneficial, if the additional interest expense would push the firm into application of BEAT by causing the firm's base erosion payments to exceed 3% of deductions and trigger BEAT or reduce section 250 GILTI/FDII deductions by reducing taxable income.

Author Information

Jane G. Gravelle
Senior Specialist in Economic Policy

Disclaimer