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Media Finance FOCUS 2020

Media Financial Management Association

Tax Summit

July 29, 2020

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Agenda

- Net Operating Loss Planning
- Accounting Method Changes for Audit Protection and Rate Benefit
- Bonus Depreciation – Section 168(k)
- Qualified Improvement Property
- Interest Expense Limitation – Section 163(j)
- BEAT and Planning Opportunities – Section 59A
- Section 199 Exam Updates
- Section 1341 - Repayment under Claim of Right
- Accounting Method Changes for CFC
- GILTI and Planning Opportunities – Section 951A

Net Operating Loss (NOL) Planning

- NOLs from 2018/2019/2020 years may now be carried back 5 years.
- IRS FAQ states that no AMT NOL is computed for these years.
  - Could result in AMT due in carryback year that is utilized in a later year.
  - Could result in general business credits being carried forward.
  - Ensure model out any carryback.
- IRS FAQ does not have any legal basis provided.
- Position that an AMT NOL is computed.
- Regardless, carryback processed if follow FAQ, and can file amended return to challenge FAQ is results in less that entire amount being refunded.
- Consider methods planning to maximize 2019/2020 NOLs.
  - Acceleration of income (in particular advance payments)
  - Acceleration of deductions (in particular pension and deferred FICA taxes)

Accounting Method Changes for Audit Protection and Rate Benefits

- **Accounting method changes are more than "just timing."**
  - Secure permanent tax rate benefits obtained in prior years by identifying and correcting improper methods to gain audit protection, locking in the deductions at 35% (32% if claimed 199 deduction).
- **Due dates for accounting method changes**
  - Automatic changes: due with extended tax return
  - Non-automatic changes: due by last day of taxable year
- **Rev. Proc. 2019-43**
  - Annual updated list of automatic changes (released on November 8, 2019).
  - Most automatic changes are consistent with the 2018 list, except sale, lease or financing transactions.
  - Generally effective for automatic method changes filed on or after November 8, 2019, for a year of change ending on or after March 31, 2019.

Bonus Depreciation – Section 168(k)

- Bonus depreciation extended and increased to 100% for qualified property placed in service (PIS) before January 1, 2023.
  - Percentage reduced by 20% each year PIS until December 31, 2026.
- Qualified property generally includes:
  - MACRS property with a recovery period of 20 years or less;
  - Certain computer software; and
  - Qualified film, television, or live theatrical production (f/k/a the section 181 property).
- Qualified property does not include:
  - Property primarily used in trade or business that has had certain floor plan financing indebtedness and interest is taken into account under Section 163(j)(1)(C) (business interest deduction limitation);
  - ADS property; and
  - Sound recordings (e.g., musical, spoken, or other sounds, regardless of the nature of materials).

Bonus Depreciation – Section 168(k)

- The Treasury and IRS released the final regulations (TD 9874) and the additional proposed regulations (REG-106808-19) under Section 168(k) on September 13, 2019.
- The final regulations adopted the August 2018 proposed regulations with certain modifications and clarifications.
- The additional proposed regulations contain new provisions that were not previously addressed in the August 2018 proposed regulations.
- Taxpayers may apply the final regulations and the additional proposed regulations to qualified property placed in service after September 27, 2017, in a taxable year ending on or after September 28, 2017 (provided that the taxpayers consistently apply all the rules therein).
- Final regulations expected in the coming weeks.

Bonus Depreciation – Section 168(k)

- **Highlights of the Final Regulations**
  - Property used and transferred by predecessor
    - The final regulations define the term "predecessor" of used property as follows:

      - a transferor of an asset to a transferee in a transaction to which Section 381(a) applies;

      - a transferor of an asset to a transferee in a transaction in which the transferee's basis in the asset is determined, in whole or in part, by reference to the basis of the asset in the hands of the transferor;

      - a partnership that is considered as continuing under Section 708(b)(2);

      - the decedent in the case of an asset acquired by an estate; or

      - a transferor of an asset to a trust.

    - The final regulations provide a safe harbor rule for look-back period of five calendar years in determining whether a taxpayer had a prior depreciable interest.

Bonus Depreciation – Section 168(k)

- Qualified film, television and live theatrical productions
  - Qualified property now includes a qualified film or television production as defined in Section 181(d), or a qualified live theatrical production as defined in Section 181(e), for which a deduction would have been allowable without regard to Section 181(a)(2) (relating to dollar limitations for the cost of productions) or 181(g) (relating to the termination date of Section 181 for productions commencing after December 31, 2017);

  - The amount allowable for bonus depreciation is the applicable percentage for the tax year of the unadjusted depreciable basis of the qualified property.

  - The final regulations clarify that the owner of a qualified film, television, or live theatrical production that makes an election under Section 181(a) reduces the basis of the production by the amount of the Section 181 deduction before computing the bonus depreciation deduction.

Bonus Depreciation – Section 168(k)

- Self-constructed property:
  - Proposed regulations focused strictly on WBC date.
  - Final regulations retain the historical rules and when construction begins.

    - 10% safe harbor is back, who owns property when, 461 method of accounting, etc.
  - Example 6, Treas. Reg. § 1.168(k)-2(b)(5)(viii)(F): On August 15, 2017, EE, an accrual basis taxpayer, entered into a written binding contract with FF to manufacture an aircraft described in Section 168(k)(2)(C) for use in EE's trade or business. FF begins to manufacture the aircraft on October 1, 2017. The completed aircraft is delivered to EE on February 15, 2018, at which time EE incurred the total cost of the aircraft. EE places the aircraft in service on March 1, 2018. Pursuant to paragraphs (b)(5)(ii)(A) and (b)(5)(iv)(A) of this section, the aircraft is considered to be manufactured by EE. Because EE began manufacturing the aircraft after September 27, 2017, the aircraft qualifies for the 100-percent additional first year depreciation deduction, assuming all other requirements are met.

Bonus Depreciation – Section 168(k)

- **Highlights of the Proposed Regulations**

- Components of self-constructed property
  - The Proposed Regulations allow a taxpayer to elect (affirmative election) to treat component as acquired after September 27, 2017, and potentially eligible for 100% bonus depreciation, when—
    - "Larger property" acquired (construction begins) before September 28, 2017, and
    - Component acquired (construction begins) after September 27, 2017.
  - Larger property generally must meet the following requirements:
    - Would have been qualified property under pre-TCJA Section 168(k);
    - Phase-down (pre-TCJA bonus depreciation) percentage is not zero;
    - Taxpayer began construction before September 28, 2017; and
    - May not be –

    - PIS before September 28, 2017 or after December 31, 2019;
    - Property in which taxpayer has previous depreciable interest; or
    - Primarily used in regulated public utility trade or business, trade or business that has had floor plan financing indebtedness, or QIP, among other restrictions.

Bonus Depreciation – Section 168(k)

- Component election for components of self-constructed property
  - Prop. Treas. Reg. § 1.168(k)-2(c)(3) describes eligible components as "acquired" components and "self constructed" components
  - Further provides a special rule permitting installation costs, including labor costs, to install a component of the larger self-constructed property.

  - Comparison to Rev Proc 2011-26:
    - Rev Proc 2011-26: applied to "any" part, which IRS interpreted as any dollar of cost.
      - Any component part, dollar of labor, dollar of interest expense, etc.
    - Proposed regulations: no definition of component, but IRS has verbally stated that components are "physical components".
    - Why not consistent with Rev Proc 2011-26?

Bonus Depreciation – Section 168(k)

- Procedural aspects of favorable rules for self-constructed property/components
  - Property PIS in 2017:
    - Self-constructed property: File automatic method change with 2019 return.
    - Component: Request 9100 relief to make affirmative election
      - Automatic 9100 relief may be forthcoming
  - Property PIS in 2018:
    - Self-constructed property: Amend 2018 return or file automatic method change with 2019 return.
    - Component: Request 9100 relief.
      - Automatic 9100 relief may be forthcoming

Bonus Depreciation – Section 168(k)

Acquisition Year	PIS Year	Non-LPPP Qualifying Property	LPPP	Basis limitations
Pre 9.28.2017	Pre 9.28.2017	50%	50%	
Pre 9.28.2017	9.27.2017 - 12.31.2017	50%	50%	
9.27.2017 - 12.31.2017	9.27.2017 - 12.31.2017	100%	100%	
Pre 9.28.2017	2018	40%	50%	LPPP on all basis
Post 9.27.2017	2018	100%	100%	
Pre 9.28.2017	2019	30%	40%	LPPP on all basis
Post 9.27.2017	2019	100%	100%	
Pre 9.28.2017	2020	MACRS	30%	LPPP on basis incurred before 1/1/2020
Post 9.27.2017	2020	100%	100%	

Qualified Improvement Property (QIP)

- QIP now eligible for bonus depreciation.
  - IRS view is up to before bill was signed it was permissible to not claim bonus on QIP, but once signed in law now impermissible to not have claimed bonus on QIP.
    - Assets PIS in 2018: can amend 2018 or correct with 3115 in 2019 or 2020 (or 2021….).
    - Assets PIS in 2019:
      - If already filed return, then can amend 2019 or file 3115 for 2020.
      - If were about to file 2019 return around time of the technical correction as many pass-thrus were, then same options.
      - If haven't filed 2019 return, then claim on original return.

Qualified Improvement Property (QIP)

- QIP now eligible for bonus depreciation.
  - QIP technical made a modification to the definition of QIP. Specifically, by adding in that the improvement must be "made by the taxpayer". This means that you can't acquire QIP made by someone else and claim bonus on it.
  - For example, assume taxpayer A makes QIP to a building but treats it as part of the building. Taxpayer B acquires the building and does a cost seg and identifies that there is QIP that can be carved out of the building. JCT intent, and the intent of the technical, was to prevent QIP bonus on acquired QIP. Only the taxpayer that makes the improvement can claim bonus.
  - If a taxpayer hires a contractor to make the improvement, then that is treated as "made by the taxpayer".

Qualified Improvement Property (QIP)

- Rev Proc 2020-25 re: QIP elections.
  - Recoup missed QIP by amending 2018/2019/2020 returns by amending or 3115.
  - Make a bonus or ADS election by amending 2018/2019/2020 return by amending or 3115.
  - Revoke a bonus election by amending 2018/2019/2020 return by amending or 3115.
  - Revoke an ADS election only by amending.

  - Consider doing any actions to maximize cash flow, in particular to claim any resulting adjustments in a year that would increase a NOL for carryback.

Disaster losses- Section 165(i)

- Section 165(i) provides that any loss occurring in a disaster area and attributable to a federally declared disaster may, at the election of the taxpayer, be taken into account for the taxable year immediately preceding the taxable year in which the disaster occurred.

- Are COVID-19 related loss eligible for section 165(i)?
  - Abandonment of property?
  - Abandonment/destruction of inventory?
  - Operating losses from state-mandated closures?
  - Worthless stock deductions?
  - Capitalized costs from abandoned transactions?

- IRS/Treasury expected to issue guidance.

Interest Expense Limitation - Section 163(j)

- Section 163(j) limits a taxpayer's deduction for business interest to (1) business interest income, (2) 30% of adjusted taxable income (ATI), and (3) floor plan financing interest.
- ATI is taxable income adjusted by disregarding certain income and deductions (thus added back), such as depreciation, amortization, and depletion ("DAD") for tax years beginning before 2022.
- Proposed regulations under Section 163(j) provides that DAD capitalized to inventory under Section 263A and recovered through COGS is not a DAD deduction for purposes of Section 163(j) and does not increase ATI.
  - Comments on current rule?
  - Planning opportunities:
    - Capitalize costs to self-constructed property under Section 263A.
    - Capitalized DAD under 263A.
    - "Create" depreciation/amortization.
- Proper planning to decrease business interest or to increase ATI can mitigate the potential exposure to valuation allowance on financial statements.

Interest Expense Limitation - Section 163(j)

- **Planning opportunities**
  - Section 59(e) election: An annual election to capitalize R&D costs and amortize them for 10 years.
  - Software costs under Rev. Proc. 2000-50: In lieu of an immediate deduction, (i) internal-use software development costs may be capitalized and amortized for either 60 months or 36 months, and (ii) acquired software costs may be capitalized and amortized for 36 months.
  - Capitalization of internal costs: annual election under section 263(a) to capitalize employee compensation, overhead and de minimis costs to acquired or created tangible or intangible assets.
  - Section 266 election: An annual election to capitalize otherwise deductible interest and taxes associated certain property. Could interest expense be capitalized to inventory under Section 266 and recovered as COGS?
  - UNICAP: Capitalized interest recovered through depreciation loses character as interest subject to Section 163(j) limitation.
  - "Inverse" methods study to increase ATI.

BEAT and Planning Opportunities – Section 59A

- **Section 59A in general**
  - 10% minimum tax (5% for tax year beginning in 2018)
    - Excess of [applicable rate x modified taxable income (MTI)] over regular tax
    - MTI is TI increased by base erosion tax benefits and % of NOLs
  - Base erosion payment generally means amount paid or accrued to foreign related party (FRP) in tax years after December 31, 2017, "allowable" as a deduction.
  - Imposed on certain C corporations with base erosion percentage of 3% or more
    - Base erosion % = Base erosion benefits (deductions "allowed") / total deductions (deductions "allowable")
    - Reducing or foregoing base erosion benefits (numerator) may reduce base erosion percentage.
    - Allowed v. Allowable: BEAT % includes only "allowed" deductions in numerator. Deductions "allowed" and "allowable" generally have distinct meaning within the Code.
  - Final regs confirm Section 15 "blended rate" for fiscal year beginning in 2018 **does not apply.**

BEAT and Planning Opportunities – Section 59A

- **Planning opportunities**
  - Amounts capitalized into inventory and recovered through COGS are not base erosion payments since the item "reduces" gross receipt not gross income.
    - Sales-based royalty/license fees related to production.
    - Commissions paid for inventory procurement, fees paid for inventory warehousing, management fees.
  - Capitalization of BEAT deductions
    - Examples include electing to capitalize and amortize R&D costs under Section 59(e) or 174, capitalizing internal costs, making depreciation elections, etc.
  - "Foregoing" deductions
    - Removes amounts from numerator to reduce BEAT %.
    - Proposed regs: annual election to forego any portion of any deduction.
    - Foregone deductions stay in denominator? Statute versus proposed regs.

BEAT and Planning Opportunities – Section 59A

- **Reduce exposure with methods planning**
  - Certain pass-through payments may not be base erosion payments.
  - For example, U.S. entity pays amount to foreign related party (FRP) to remit to 3rd party, or 3rd party pays U.S. amount to remit to FRP. The character of transaction determined by economic substance of contractual relationship between U.S. and FRP.
  - The following case-law principles may mitigate the potential BEAT exposure:
    - Agency general principles
    - Conduit general principles
    - Revenue sharing general principles
    - Cost reimbursement general principles
  - Final regs do not provide additional insights other than referring to general federal income tax principles.

Section 199 Exam Updates

- The TCJA repealed Section 199 for taxable years beginning after December 31, 2017.
- Amended returns and refund claims related to the Section 199 deductions.
  - LB&I Directive for Section 199 Risk Review Campaign (released in 2018).
- Many taxpayers are still going through exams, appeals, and law suits.
  - Benefits & Burdens (B&B): *Meredith Corp. v. United States*: Southern District Court of Iowa ruled in March 2020 that Meredith had the B&B during the printing process.
    - Unlike Advo, Meredith owned at all times the paper used during the printing process.
    - Beginning to see more favorable IRS settlements.
  - Producer of 24-hour feed: IRS continues to challenge whether production of a 24-hour feed is not an eligible production activity.
  - Set top box (STB) software: IRS continues to challenge determination/value of DPGR related to software embedded in STB.

Section 1341 - Repayment under Claim of Right

- Section 1341 provides an alternative computation of tax that is intended to place the taxpayer in roughly the same economic position it would have been in if it had not included the item in income in the earlier year, or if the tax rates had remained the same. The relief can apply when an item of income reported in an earlier tax year (at a higher tax rate) is returned in a subsequent year (at a lower tax rate) if it is determined that the taxpayer did not have an unrestricted right to the item of income when reported.
  - Example: A corporate taxpayer appears to have an unrestricted right to $10,000 under a contract with a customer and includes that amount in income in 2017. The taxpayer pays $3,500 in tax at the 35% corporate rate. Due to a contract dispute, the taxpayer returns the $10,000 to the customer in 2018 when the corporate rate is 21% and reduces tax by $2,100 ($1,400 less than tax paid).
  - Result: The taxpayer appears to qualify for Section 1341 relief. Accordingly, the taxpayer deducts $10,000 on its federal income tax return under Section 162, saving $2,100 in tax. The taxpayer then computes an amount to compensate for the $1,400 reduced tax benefit and takes a credit against tax for the computed amount.

Section 1341 - Repayment under Claim of Right

- **Possible applications of section 1341**
  - Most cases focus on whether repayment was a reduction of future gross receipts or deductible expense.
  - Patent infringement
  - Royalties
  - Purchase price disputes (Arrowsmith doctrine)
  - Settlements/judgements
- **Exclusions from application of section 1341**
  - Deductions attributable to repayment of items included in gross income in a previous year on account of sale or disposition of inventors
  - Deductions attributable to bad debts
  - Legal fees or other expenses incurred in resisting repayment

Section 965 and CFC Accounting Method Changes

- New LB&I section 965 campaign
- Limitation on audit protection under the 150% rule due to the Section 965 transition tax
  - Section 8.02(5) of Rev. Proc. 2015-13 applies a limitation on audit protection to a CFC in any tax year when the foreign taxes deemed paid under Sections 902 and 960 with respect to the CFC exceed 150% of the average amount of the foreign taxes deemed paid for the prior three tax years (the "150% rule").
- In many cases, the amount foreign taxes deemed paid for the transition tax year of 2017 (or, as applicable, 2018) is significantly higher due to the income inclusion resulting from Section 965. Therefore, the foreign taxes deemed paid in the transition tax year may exceed 150% of the average amount of the deemed taxes paid in the prior three tax years.
- The interaction with the 150% rule and the Section 965 transition tax have caused many taxpayers unable to file accounting method changes in computing the foreign E&Ps, on behalf of their CFCs, to secure audit protection until the transition tax year of 2017 (or as applicable, 2018) closes.
- Although the Treasury and IRS are aware of this matter, no formal guidance has been released to mitigate the unintended consequence.

GILTI and Planning Opportunities – Section 951A

- **GILTI in general**
  - GILTI taxes global intangible low-taxed income of CFCs, which generally is the excess of net CFC tested income over net deemed tangible income return.
  - Taxpayers allowed 50% deduction against GILTI tax through December 31, 2025 (37.5% after), such that GILTI inclusion net of deduction taxed at 21%.
  - Tested income effectively equivalent to U.S. taxable income (with same materiality rule applicable to E&P).
  - Generally assumed that methods previously used for E&P or Sub F taxable income have been adopted for GILTI.
  - Return generally 10% of qualified business asset investments (QBAI) of each CFC over interest expense, where QBAI is adjusted basis under Section 168(g).

GILTI and Planning Opportunities – Section 951A

- **Planning opportunities**
  - Method planning to reduce tested income (accelerate deductions or defer income)
    - Traditional methods planning.
    - Bonus depreciation, advance payments, etc.
  - Strategies to increase return on QBAI
    - Capitalize more costs (e.g., repairs, UNICAP costs) to basis of tangible property.
    - Use ADS depreciation, as required to compute QBAI [allows elective exception for assets placed in service before GILTI regime].\

Thank you!

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FEDERAL TAX UPDATE

- Session CPE Code
  - RT7AF
- Link to session survey
  - https://www.surveymonkey.com/r/KWCKTXC

If you need assistance, please contact:

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