Tax issues banks should CARE(S) about in light of COVID-19

The tax impact of COVID-19 on the banking industry, including observations on the CARES Act

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As in other industries, banks are facing unprecedented challenges from COVID-19. Customers are struggling to satisfy their financial obligations, and there is significant turmoil in the markets. Banks are also needing to face these headwinds with a remote workforce that is being pulled in multiple directions. The actions that banks are taking to handle these issues have tax consequences to the organizations and their customers. In addition, the government passed legislation in an effort to provide financial relief to both individuals and businesses. The "Coronavirus Aid, Relief, and Economic Security Act" (the CARES Act or the Act)[1] includes a number of tax provisions that affect the financial services industry.

This report addresses tax issues that are currently affecting banks and their customers, including the impact of the CARES Act. Additional information on tax provisions in the CARES Act can be found in KPMG Report: *Tax Provisions in the CARES Act (COVID-19 "Phase 3" Response): Analysis and Observations* that was published on March 30, 2020 (herein referred to as the KPMG Report on the CARES Act).

[1] P.L. 116-136, 134 Stat. 281 (2020).

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I. Debt considerations

a. Loan forbearance

In response to challenges from COVID-19, many banks have implemented loan forbearance programs to provide relief to distressed borrowers. For the bank's retail business, standardized programs are generally being offered to customers that will provide for the deferral of payments (e.g., payments are not due for 90 days) and the waiver of fees. However, the execution of these programs may vary across financial institutions. For example, while some banks may require that deferred payments are capitalized and paid at maturity, others may require that deferred payments be paid after the forbearance period (e.g., 90 days). In the latter example, banks are frequently offering to work with customers who are unable to make the payment at its due date.

While a uniform approach may be implemented for retail customers, restructuring commercial loans are generally more bespoke and may include payment deferrals, the release of certain financial covenants and interest rate concessions. Further, in addition to the direct impact of COVID-19, other market factors, such as the recent decline in oil prices, may negatively impact the ability for certain industries to service their debt.

In addition to the banks' internally developed forbearance programs discussed above (the non-statutory forbearance programs), banks may need to consider the forbearance provisions within the CARES Act for certain federally backed mortgage loans (the statutory forbearance programs). The CARES Act provides up to 180 days (as well as an extension of a second 180 days) of forbearance on federally backed mortgage loans if the borrowers are experiencing financial hardship related to COVID-19. The Act also provides 90 days of forbearance for multifamily borrowers with federally backed multifamily mortgage loans (provided certain criteria are met).[2] Both Fannie Mae and Freddie Mac publicly announced that borrowers will not be obligated to make a lump sum payment at the end of the forbearance period.[3]

While the objectives of the various loan forbearance programs may be similar, the underlying details and mechanics could lead to different tax conclusions.

[2] *See* sections 4022 and 4023 of the CARES Act. Additionally, the CARES Act provides for a temporary freeze of foreclosures and eviction filings for certain federally backed mortgages. *See* sections 4022 and 4024 of the CARES Act.

[3] *See e.g.*, "Understand Your COVID-19 Mortgage Options," press release, April 27, 2020, on Fannie Mae website, https://www.fanniemae.com/portal/media/corporate-news/2020/covid-19-mortgage-options-7010.html ("At the end of the forbearance plan, the homeowner will be provided with several options from the mortgage servicer for making up the missed payments and will not be required to pay everything back all at once."); "Freddie Mac: Lump Sum Repayment is Not Required in Forbearance," press release, April 27, 2020, on Freddie Mac website, https://freddiemac.gcs-web.com/news-releases/news-release-details/freddie-mac-lump-sum-repayment-not-required-forbearance?_ga=2.39748640.248490081.1588963099-2135635678.1588963099.

Key considerations for the banking industry

The tax ramifications of loan forbearance largely depend on whether the forbearance agreement rises to the level of a "significant modification" under Treas. Reg. section 1.1001-3.[4] More specifically, the regulations provide a two-part test for purposes of determining whether changes to the terms of a loan give rise to a taxable exchange of the original, unmodified loan for the new, modified loan. Under the first requirement, the loan must be modified. A loan undergoes a modification if there is an alteration to the legal rights or obligations of the holder or borrower.[5] Under the second test, the modification must be "significant."[6] Under Treas. Reg. section 1.1001-3(e)(1), a modification is significant if, based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are determined to be economically significant. However, Treasury also provided a number of mechanical tests to evaluate whether a modification is significant (the specific tests).[7] Certain specific tests that are relevant to the banks' forbearance programs are discussed in more detail below.

When analyzing the current forbearance programs, an important rule is that a temporary forbearance that does not exceed two years is generally not considered a modification (and, by extension, not a significant modification).[8] Therefore, there will generally not be a taxable exchange of the debt if the lender only agrees to stay collection for a period of two years or less. However, if there are other changes to the terms of the debt or the payment schedule is revised so that payments are due outside of the two-year forbearance period, there will be a modification and the parties must then evaluate whether the modification is significant.

Under the first specific test (the change in yield test), a modification is significant if the debt's yield changes by more than the greater of (i) 25 basis points, or (ii) 5 percent of the unmodified debt's yield.[9] The current forbearance programs are generally not changing a loan's stated interest rate, and therefore a lender may initially conclude there is no significant modification under the change in yield test. However, if the borrower was charged an upfront fee in connection with receiving the loan, and the fee is treated as interest (e.g., points, prepaid interest), the deferral of payments will reduce the loan's yield and therefore could result in a significant modification.[10] More specifically, upfront fees that are treated as interest, generally increase the yield of a debt by the application of time value of money principles. As such, an extension of the term of a debt reduces the yield under these principles.[11] Notably, if there are no upfront payments on a debt, the yield is generally equal to the stated interest rate and an extension of the term will not affect the yield of the instrument.[12]

Under the second specific test (the material deferral test), a modification that changes the timing of payments (including any resulting change in the amount of payments) due under the debt is a significant modification if it results in the material deferral of scheduled payments.[13] The determination is based on all of the facts and circumstances, including the length of the deferral, the original term of the debt, the amounts of the payments that are deferred, and the time period between the modification and the actual deferral of payments.[14] However, a deferral of scheduled payments is deemed to not be material if all deferred payments are unconditionally payable no later than the end of the safe-harbor period. The safe-harbor period begins on the due date of the first scheduled payment that is deferred and extends for a period equal to the lesser

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[4] Unless otherwise noted, all references in this document to "section" and "Treas. Reg. section" are to the Internal Revenue Code of 1986 (the "Code") and the Treasury Regulations promulgated thereunder, as amended and in effect when this memorandum was written.

[5] *See* Treas. Reg. section 1.1001-3(c)(1)(i). The regulations include a number of exceptions to the definition of a modification, including a modification occurring by operation of the terms of the debt (subject to certain limitations), the failure of an issuer to perform its obligations under the debt, and the holder's temporary forbearance of payments.

[6] Treas. Reg. section 1.1001-3(e).

[7] *See* Treas. Reg. sections 1.1001-3(e)(2)-(6). Note that if a modification is evaluated under one of the specific tests, the same modification is also not evaluated under the general, economic significance test. *See* Treas. Reg. section 1.1001-3(e)(1).

[8] Treas. Reg. section 1.1001-3(c)(4)(ii). More specifically, under the forbearance safe harbor, there is generally not a modification, absent a written or oral agreement to alter other terms of the debt, unless and until the forbearance remains in effect for a period that exceeds two years plus an additional period during which the parties conduct good faith negotiations or during which the issuer is in a title 11 or similar case.

[9] Treas. Reg. section 1.1001-3(e)(2)(ii).

[10] In many cases, points and prepaid interest on mortgage loans give rise to de minimis OID, and a bank may account for the de minimis OID on an aggregate, or pool, basis. *See* the principal-reduction method provided in Rev. Proc. 97-39, 1997-33 I.R. B. 48. The change in yield test generally evaluates the change in yield on an individual loan basis, rather than a pool of loans, and as a result, the application of the change in yield test to these loan portfolios raises administrative complexities. Further, there is uncertainty with respect to how taxpayers apply the change in yield test to a loan issued with de minimis OID. *See*, e.g., NYSBA Tax Section, "Effect of de Minimis OID under Reg. § 1.1001-3(e)(2)" (Dec. 22, 2010).

[11] *See generally* section 1272.

[12] However, the yield of an instrument could change if there is a modification resulting from a forbearance program that provides for the deferral of stated interest payments, and the deferred interest is not capitalized into principal.

[13] Treas. Reg. section 1.1001-3(e)(3)(i).

[14] *Id.*

of (i) 5 years, or (ii) 50 percent of the original term of the instrument.[15] Thus, in the case of a 15 or 30-year mortgage loan, the forbearance arrangement will not be covered by the material deferral safe harbor if any payment is deferred by more than 5 years. However, if there are less than 5 years remaining on the mortgage loan, and the deferred payments are added to the end of the loan, the deferral may still fall within the safe-harbor period.

If a loan undergoes a significant modification, the bank must calculate the amount of gain or loss recognized from the taxable exchange. Very generally, the realized gain or loss is equal to the difference between (i) the issue price of the new, modified loan, and (ii) the bank's tax basis in the unmodified loan. For loans with an outstanding stated principal amount that does not exceed $100 million, the loan's issue price generally equals its stated principal amount in a significant modification.[16] As such, a lender may not realize gain or loss if the loan's tax basis equals its stated principal amount.[17] If the original loan was issued with upfront fees (e.g., points, prepaid interest), the lender's basis in the original loan is reduced by the amount of upfront fees that have not yet been taken into account in income, and as a result, the significant modification may accelerate the recognition of the fees.[18] Also, if the bank purchased loans on the secondary market, the significant modification may accelerate the recognition of the loans' discount or premium.

If the outstanding stated principal amount of the debt exceeds $100 million, the calculation of the new debt's issue price (and as a result, the amount of gain or loss recognized by the lender), depends on whether the debt is publicly traded for purposes of the original issue discount (OID) regulations. If the debt is not publicly traded, the debt's issue price equals the stated principal amount (i.e., the same answer as above). If the debt is publicly traded, the debt's issue price generally equals its fair market value. Note that under the OID regulations, it is very common for debt to qualify as publicly traded.[19] Therefore, if the debt has depreciated in value and the lender's basis in the unmodified debt equals its principal amount, the lender realizes a loss in connection with the significant modification.[20]

Following the significant modification, the modified loan is treated as a new loan for all tax purposes. As such, if the bank is a section 475 dealer in securities, the bank may need to re-identify the loan under section 475(b) if it does not want to subject the new loan to mark-to-market tax accounting. Further, the lender must evaluate the information reporting consequences of the significant modification.[21]

Finally, a bank's customers may seek to renegotiate the terms of non-debt agreements, including derivative contracts and lease agreements. The significant modification rules only apply to debt, and there is limited guidance addressing how to evaluate modifications to the terms of non-debt financial contracts.[22] If one of these contracts undergoes a taxable exchange, the bank also needs to evaluate the tax treatment of the new contract, including (i) the application of the non-periodic payment rules to swap contracts and whether the new contract could include a deemed loan, and (ii) considering the application of section 467 and true lease determination to lease agreements.

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[15] Treas. Reg. section 1.1001-3(e)(3)(ii)

[16] Section 1273(b)(4); section 1274; Treas. Reg. section 1.1273-2(f)(6). Note that for certain loans (e.g., loans with total payments that do not exceed $250,000), the new loan's issue price may equal its stated redemption price at maturity, rather than its stated principal amount. *See* section 1273(b)(4); section 1274(c). Frequently these amounts are the same. However, if a loan is issued with original issue discount, the stated redemption price at maturity includes original issue discount. *See* Treas. Reg. section 1.1273-1(b). Therefore, if the modified loan is issued with original issue discount and its issue price is based off its stated redemption price at maturity, the lender may realize gain in connection with the significant modification (even though the lender's tax basis in the unmodified loan equaled the loan's stated principal amount).

[17] Note that if the lender previously recognized a bad debt deduction on the original loan, and as a result the lender's basis was reduced by the bad debt deduction, the bad debt regulations generally provide a mechanism to prevent the taxpayer from recognizing net gain in connection with the significant modification. *See* Treas. Reg. section 1.166-3(a)(3).

[18] Up-front fees that represent interest generally reduce the lender's issue price and basis in the loan. See Treas. Reg. section 1.1273-2(g). If the up-front discount is de minimis and accounted for on a pool basis under the principal reduction method, a significant modification of a loan requires the lender to take into account a percentage of the pool's unamortized discount. *See* Rev. Proc. 97-39, 1997-2 CB 485, section 5.04.

[19] *See* Treas. Reg. section 1.1273-2(f). In order to qualify as publicly traded, the debt only needs to receive an indicative quote from at least one broker, dealer, or pricing service during the 31-day period ending 15 days after the issue date. A detailed discussion of the publicly traded rules is outside the scope of this article.

[20] If the loan is held by the bank, the loss is ordinary under section 582(c). However, if the loan is held by a non-bank member of the group, and the loan is a capital asset, the loss may be capital. Further, if the borrower is a corporation and the debt qualifies as a security for purposes of section 354, the significant modification may qualify as a tax-free recapitalization under sections 354(a) and 368(a)(1)(E). Finally, the lender may be able to defer any gain recognized in connection with a significant modification under the installment sale rules. *See generally* section 453. A detailed discussion of the recapitalization rules and installment sale rules is outside the scope of this article.

[21] To the extent there is a cash payment or cancellation of indebtedness in connection with a significant modification, there could be information reporting obligations on Forms 1099-B or 1099-C.

[22] Non-debt financial contracts are frequently analyzed under the "fundamental change" doctrine outlined in Rev. Rul. 90-109, 1990-2 C.B. 191.

b. Interest nonaccrual

In spite of the forbearance programs discussed above, there is still an expectation that challenges related to COVID-19 will lead to a significant increase in the number of loans that are ultimately uncollectible. When loans begin to deteriorate in value, for tax purposes, lenders should evaluate both (i) when interest is no longer required to accrue on the loan, and (ii) when the lender may be eligible to recognize a loss on the loan.

Generally, accrual method taxpayers must include interest in taxable income when the right to the income is fixed and can be determined with reasonable accuracy.[23] An exception applies if, at the time the right to income arises, the interest is uncollectible.[24] To determine if interest is uncollectible, there must be an identifiable event to establish this conclusion (e.g., insolvency, bankruptcy) and a taxpayer cannot use hindsight to apply nonaccrual before the event that establishes doubtful collectability.[25] Notably, the mere lack of payment for an extended period of time does not establish doubtful collectability for these purposes. The Internal Revenue Service (IRS) has also concluded that a bank placing a loan on nonaccrual for regulatory accounting purposes does not support the application of the doubtful collectability exception when the bank "reasonably expect[ed] the borrower to continue making some but not all payments on the loan."[26] Further, banks must continue to accrue interest even if the bank has made a bad debt conformity election under Treas. Reg. section 1.166-2(d)(3) (discussed further below). However, in such case, banks are generally able to take a tax bad debt deduction for interest that has not accrued for regulatory purposes.[27]

The ability to stop the accrual of OID and market discount is less clear.[28] The IRS released informal guidance indicating that OID must continue to accrue over the life of a loan notwithstanding an event that establishes doubtful collectability.[29] However, many practitioners question the guidance's conclusion. Regarding market discount, current tax rules generally limit the ability to stop the accrual of market discount.[30]

[23] Treas. Reg. section 1.446-1(c)(1)(ii); Treas. Reg. section 1.451-1(a).

[24] *Corn Exchange Bank v. US,* 37 F.2d 34 (2nd Cir. 1930); *Jones Lumber Co. v. Comm'r,* 404 F2d 764 (6th Cir. 1968); Rev. Rul. 80-361, 1980-2 C.B. 164.

[25] *Id.*

[26] *See* Rev. Rul. 2007-32, 2007-21 I.R.B. 1278.

[27] In Rev. Rul. 2007-32, the bank had made a conformity election under Treas. Reg. section 1.166-2(d)(3). The IRS concluded that the nonaccrual of interest income was "tantamount to recognizing the accrued interest as income and immediately charging off the uncollected accrued interest receivable as a loss asset." Notably, in this scenario, if a bank later receives payment on the loan, Treas. Reg. section 1.446-2(e) requires the payment to be treated as a payment of interest; however, for regulatory financial statement purposes, the bank characterizes the payment as a payment of principal. If the bank had previously deducted the uncollected accrued interest as a bad debt deduction for tax purposes, the subsequent payment is characterized as a partial recovery of the debt.

[28] Very generally, market discount arises when debt is purchased on the secondary market at a discount. The accrual and recognition of market discount is governed by the rules under sections 1276 through 1278.

[29] I.R.S. Tech. Adv. Mem. 9538007 (Sept. 22, 1995).

[30] The market discount rules under sections 1276 and 1278 generally require the accrual of market discount regardless of whether the loan is performing or distressed. A detailed discussion of the market discount rules is outside the scope of this article, including an overview of those situations where it may be appropriate to not accrue market discount.

Key considerations for the banking industry

- For financial accounting purposes, banks typically stop accruing interest income after 90 days without payment. As discussed above, the tax law may require a loan to accrue interest even when the loan has been placed on nonaccrual for financial accounting purposes. Therefore, banks frequently have an unfavorable book-tax difference for this item.[31]
  - Notably, federal banking agencies have released a statement indicating that certain short-term arrangements made in response to COVID-19 should not be reported on nonaccrual for regulatory reporting purposes.[32] Although this consideration likely does not affect the nonaccrual conclusion for tax purposes, it may impact the process for computing adjustments to taxable income.
- If challenges from COVID-19 are preventing a borrower from making timely interest payments on a loan, but the bank still anticipates that it will eventually collect the interest payments, the bank must generally continue to accrue interest income for federal income tax purposes. If the accrued interest is ultimately determined to be uncollectible, the bank may be eligible to claim a bad debt deduction for the uncollected interest.
- As discussed above, the federal banking agencies are providing relief for placing loans on nonaccrual for regulatory reporting purposes. However, the changes to the regulatory accounting guidance do not impact the tax analysis. In an effort to ease cash taxes and reduce the bank's deferred tax account balance, the tax department may want to consider whether it can accelerate placing a loan on nonaccrual for tax purposes.
- In an economic downturn, there may be an increase in the number of loans acquired with market discount. For example, if challenges from COVID-19 ultimately result in the failure of certain banks and the sale of the failed banks to other institutions, the sale is generally required to be treated as an asset sale if the FDIC provides financial assistance. As such, the banks may want to revisit their tax positions and calculations for market discount loans. Finally, if FDIC assistance is provided in an acquisition, the bank must consider the rules under section 597.[33]

c. Bad debt deductions

Generally, to sustain a bad debt deduction, a taxpayer must be able to demonstrate that the instrument became wholly or partially worthless during the year.[34] This determination is made based on the facts and circumstances, and the taxpayer bears the burden of proof that the debt became worthless during the year (rather than in a prior period). Additionally, partial worthlessness deductions are allowed only to the extent that the debt is charged off for nontax reasons.[35]

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[31] Note that banks may be able to claim a bad debt deduction for the interest income that has continued to accrue for tax purposes but not for regulatory accounting purposes. *See supra* discussion accompanying n. 27.

[32] *See* BD. OF GOVERNORS OF THE FED. RESERVE SYS., ET AL., INTERAGENCY STATEMENT ON LOAN MODIFICATIONS AND REPORTING FOR FINANCIAL INSTITUTIONS WORKING WITH CUSTOMERS AFFECTED BY THE CORONAVIRUS (REVISED) (April 7, 2020).

[33] Since the most recent financial crisis, the IRS and Treasury have significantly revised the regulations addressing the sale of financial institutions in which the acquirer receives federal financial assistance. *See generally* Treas. Reg. section 1.597-5. There have also been changes to the accounting guidance for purchased credit-deteriorated loans. As such, banks may need to update tax models that were used in the prior crisis to take into account the rule changes.

[34] Section 166(a).

[35] Section 166(a)(2).

The bad debt regulations also provide certain rules that are unique to financial institutions. First, under the conclusive presumption rules, a debt is conclusively presumed to be worthless if (i) the debt is charged off in obedience with specific regulatory orders, or (ii) the debt is charged off in accordance with an established policy of the bank's regulatory authorities and such charge off is confirmed in the next regulatory exam.[36] Second, if a bank makes a so-called "conformity election," a debt is conclusively presumed to be worthless if (i) the debt is charged off for regulatory purposes pursuant to a specific order from the bank's regulator, or (ii) the bank classifies the debt as a "loss asset" in accordance with its loss asset classification standards.[37] The conformity election requires a bank to receive an express determination letter from its regulator.

Key considerations for the banking industry

- Very generally, for financial accounting purposes, a bank categorizes a restructured loan as a troubled debt restructuring (TDR) if the following requirements are satisfied: (i) the bank agrees to a concession, and (ii) the borrower is having financial difficulties. Under the CARES Act and interagency guidance, financial institutions are able to elect to suspend the TDR categorization of certain loan modifications related to challenges from COVID-19.[38] Banks may leverage their TDR analysis for purposes of evaluating whether a loan is worthless for tax purposes. The tax departments of these institutions should inquire whether TDR characterization has been affected by this provision of the CARES Act, and how the election may change the tax analysis.

- For banks that have not made a conformity election, the bank can defer the recognition of partial bad debt deductions and only recognize a bad debt deduction when the debt is wholly worthless (or the bank disposes of the loan). If the bank is concerned about recognizing an NOL that would need to be carried forward, the bank may want to evaluate whether it should suspend the recognition of partial bad debt deductions.[39]

- Under section 166(e), most taxpayers are unable to claim a bad debt deduction for worthless securities (as defined under section 165(g)(2)(C)).[40] Instead, the taxpayer can only claim a worthless securities loss, and if the debt security is a capital asset, the loss is capital. Banks are not subject to this rule and instead can recognize a bad debt deduction for worthless securities.[41] However, financial institutions may want to evaluate whether any non-bank entities within their organizational structure hold section 165(g)(2)(C) securities, and if so, take steps to manage the risk that the non-bank entity would be required to recognize a capital loss if the security became worthless.

- In 2014, the Large Business & International (LB&I) division of the IRS released a directive that advised LB&I examiners not to challenge certain bad debt positions taken by financial institutions. Many of the issues addressed in the directive came to light in the prior financial crisis, and the guidance was "intended to provide an efficient manner of resolving many bad debt deduction issues for Banks and Bank Subsidiaries."[42] Taxpayers could apply the directive no later than a tax year that begins in 2014, and there is ambiguity as to whether LB&I examiners are required to continue to follow the directive's advice. The issues that gave rise to the release of the directive may reoccur in the current environment. As such, financial institutions may want to revisit their current positions on these items, as well as evaluate whether they can continue to apply the directive's guidance.

- The CARES Act allows financial institutions an option to temporarily defer adoption of the FASB Current Expected Credit Losses (CECL) methodology during the period beginning on the CARES Act enactment date and ending on the earlier of December 31, 2020 or the date in which the national emergency concerning COVID-19 terminates. Although CECL is not expressly relevant to the tax bad debt deduction, this temporary delay may affect the process by which banks calculate their tax bad debt deductions.

[36] Treas. Reg. section 1.166-2(d)(1).

[37] Treas. Reg. section 1.166-2(d)(3).

[38] *See* section 4013 of the CARES Act.

[39] However, as a result of the changes to the NOL carryback provisions under the CARES Act, many financial institutions that generate an NOL in 2020 may be able to carryback the NOL. See further discussion below.

[40] Under section 165(g)(2)(C), a debt security is defined as a bond, debenture, note, or certificate, or other evidence of indebtedness, issued by a corporation or by a government or political subdivision thereof, with interest coupons or in registered form.

[41] *See* section 582(a).

[42] LB&I-04-1014-008 (Oct. 24, 2014). For a summary of the directive, see Liz L'Hommedieu, Matt Mosby, and Anthony Rodriguez, *The Much Anticipated Bad Debt Guidance for Banks*, KPMG's What's News in Tax (Dec. 22, 2014).

d. The Paycheck Protection Program (PPP) (Section 1102 of the CARES Act)

The CARES Act initially provided $349 billion for Small Business Administration (SBA) loan guarantees under the new Paycheck Protection Program (PPP). On April 24, 2020, President Trump approved an additional $310 billion of funding for this program, bringing the total to $659 billion. PPP loans are 100 percent SBA guaranteed loans made available to small businesses, including sole proprietors, independent contractors, certain nonprofits, veterans' organizations and tribal businesses. The 100 percent SBA guarantee applies through December 31, 2020. PPP loans can be offered by any existing SBA 7(a) lender or through any eligible and participating federally insured depositary institution, federally insured credit union, Farm Credit System institution, and certain other depository or non-depository financing providers who are approved by the SBA. Lenders will be reimbursed for covered loan processing fees based on a schedule published in the CARES Act. The deadline to apply for PPP loans is August 8, 2020.[43]

Eligible PPP borrowers must have been operational on February 15, 2020 and must have, as of that date, employees to whom the borrower paid salaries and payroll taxes, or paid independent contractors. Unlike most SBA loans, PPP loans are unsecured, requiring no collateral, no personal guarantee, and no showing that credit is unavailable elsewhere. The maximum PPP loan per borrower is the lesser of: (a) $10 million, or (b) 2.5 x its average total monthly payroll costs. Loan proceeds are permitted to be used for employee salaries, medical leave, insurance premiums, mortgage, rent, and utility payments. It is the borrower's responsibility to provide a good faith certification to the lender that the information it provides when applying for a PPP loan is accurate, including with respect to eligibility, accuracy of payroll costs and proper application of the employer affiliation rules. The lender is only expected to perform a good faith review of the payroll cost calculations.

The Paycheck Protection Program Flexibility Act of 2020 (Flexibility Act),[44] which was signed into law on June 5, 2020, includes several significant changes affecting both borrowers and lenders participating in the PPP. Loan forgiveness is provided in the CARES Act for amounts spent on payroll costs, rent and utilities payments, and interest payments on mortgages. The CARES Act required that these amounts be spent during the eight-week period after the lender makes the first disbursement. The Flexibility Act extends this period from eight weeks to 24 weeks (or until Dec. 31, 2020, whichever is earlier). The Flexibility Act also allows borrowers that received a PPP loan before enactment of the Flexibility Act to elect the eight-week covered period. The loan may be fully forgiven if the funds are used entirely for payroll costs, interest on mortgages, rent, and utilities. Further, the CARES Act provided that at least 75 percent of the forgiven amount must have been used for payroll, or the loan will only be forgiven to the extent it was used for payroll. The Flexibility Act reduces this percentage to 60 percent to be eligible for full loan forgiveness. The amount of the PPP loan forgiveness will be reduced by any reduction in employees retained except to the extent the borrower restores its workforce count and associated payroll. The CARES Act provided that this restoration of workforce must occur by June 30, 2020. The Flexibility Act extends this deadline to December 31, 2020 and provides additional exceptions to the forgiveness reduction based on restoring workforce and payroll. Lenders must collect documentation from borrowers in order to determine the forgiveness amount.

Lenders must make the first disbursement of the PPP loan no later than 10 calendar days from the date of loan approval. As a result, neither lenders nor borrowers have much flexibility in choosing when the eight-week or 24-week period begins.

The CARES Act prohibited employers from taking advantage of the payroll tax deferral provided in Section 2302 of the CARES Act after the employer had a PPP loan forgiven. The Flexibility Act removes this restriction, allowing PPP borrowers to take advantage of the CARES Act payroll tax deferral from March 27, 2020 to December 31, 2020.

To the extent not forgiven, the CARES Act provided that PPP loans had (i) a two-year term (ii) an interest rate of 1 percent, and (iii) principal and interest deferred for six months. The Flexibility Act extended the minimum term to five years for new loans. It permits PPP borrowers and lenders to mutually agree to modifications to the term of PPP loans that were already made with a two-year term. The Flexibility Act also extends the deferral period for principal and interest until the date on which the amount of the loan forgiveness is remitted to the lender by the SBA.

Applications for PPP loans began on April 3, 2020, and loans were made on a on a first-come, first-served basis. The SBA hit its initial $349 billion limit on April 16, 2020; however, as discussed above, an additional $310 billion for the program was approved on April 24, 2020. Of the additional $310 billion of funding, $30 billion is set aside for financial institutions with consolidated assets less than $10 billion to lend to participating borrowers, and $30 billion is set aside for financial institutions with consolidated assets between $10 billion and $50 billion to lend to participating borrowers.

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[43] S. 4116, 116th Cong. (enacted July 4, 2020). The original deadline in the CARES Act was June 30, 2020, however, the deadline has been extended to August 8, 2020.

[44] H.R. 7010, 116th Cong. (enacted June 5, 2020).

Key considerations for the banking industry

- By its terms, the PPP authorizes banks to make loans to qualifying small businesses to be used for qualifying purposes, with all financial obligations of such small businesses 100 percent guaranteed by the SBA. Further, the small business's obligation may be forgiven if certain requirements are satisfied. In such cases, the SBA repays the lender. The SBA guarantee and forgiveness raises questions with respect to the appropriate tax characterization of the arrangement. For example, among other interpretations, the PPP program could arguably be interpreted as authorizing a loan from a bank to the SBA, which then distributes funds to qualifying small businesses through (i) subsequent loans, (ii) contributions to the capital of the small businesses, or (iii) conditional governmental grants that spring into loans if a borrower fails to satisfy the forgiveness provisions. These alternative characterizations might affect the federal income tax consequences for borrowers, but may have less of an impact on banks acting as lenders in the program.
- Under section 1106(i) of the CARES Act, any forgiven amounts are excluded from the borrower's gross income.[45] Banks will need to develop policies, as well as update their information reporting systems, to address the tax reporting requirements associated with the forgiveness and corresponding exclusion from the borrower's gross income.
- State considerations: As part of the program, banks will earn certain fees paid by the SBA. Banks should consider how the states will treat these fees from a sales apportionment perspective. The appropriate sourcing will need to be analyzed on a state-by-state basis as to whether the fees should be sourced to the location of the borrower, or another method (such as the location of the SBA). In addition, the characterization of the receipt (interest versus non-interest income) could vary for a state if the borrower ultimately pays the loan back, as opposed to the loan being forgiven.

e. Temporary changes to business interest expense disallowance rules

(Section 2306 of the CARES Act)

Prior to the CARES Act, section 163(j) generally disallowed a deduction for net business interest expense of any taxpayer exceeding 30 percent of adjusted taxable income (ATI) (generally EBITDA for years before 2022 and EBIT thereafter). The CARES Act made the following changes to section 163(j), which are generally intended to mitigate the countercyclical nature of the ATI-based limitation:

Fifty percent of ATI: For tax years beginning in 2019 and 2020, the 30 percent limit on ATI is increased to 50 percent.

Partnerships: The so-called "50 percent-instead-of-30 percent ATI rule" does not apply to a partnership tax year beginning in 2019, but (unless a partner otherwise elects out) for any of the partnership's 2019 excess business interest expense that is allocated to a partner:

[45] Under section 265(a)(1), no deduction is allowed for amounts otherwise allowable as a deduction that are allocable to a class of income exempt from tax. In Notice 2020-32, the IRS concluded that the forgiveness of a PPP loan gives rise to a class of income exempt from tax, and as a result, borrowers cannot deduct amounts that are allocable to the resulting loan forgiveness. The IRS's position in Notice 2020-32 has been heavily criticized, and proposed legislation would allow these amounts to be deducted. *See, e.g.,* the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, H.R. 6800, 116th Cong., section 20235 (2020).

— Fifty percent of that excess business interest expense will be treated as business interest that is paid or accrued by the partner in its first tax year beginning in 2020 and will not be subject to the limits of section 163(j)(1) and is thus deductible in such tax year (subject to any other limitations that may apply), and

— The other 50 percent will be subject to the section 163(j) limitations in the same manner as any other excess business interest so allocated.

Electing out of the 50 percent-of-ATI rule: Taxpayers can elect not to have the 50 percent-of-ATI rule apply to the 2019 and/or 2020 tax years.

Using 2019's ATI in 2020: For any tax year beginning in 2020, taxpayers can elect to use their ATI from their last tax year beginning in 2019 for their ATI in the 2020 tax year.

In response to these changes and the qualified improvement property (QIP) technical correction described on page 14, the IRS released Rev. Proc. 2020-22,[46] which provides taxpayers with:

— The ability to withdraw prior elections to be an electing real property trade or business under section 163(j)(7)(B) or an electing farming business under section 163(j)(7)(C)—referred to as an "Excepted Business Election,"

— The ability to make a late Excepted Business Election, and

— Guidance on making the election out of the 50 percent-of-ATI rule, the election out of the special rule applicable to partnerships in 2019, and the election to use 2019 ATI in 2020.

On July 28, 2020, final and proposed regulations were released under section 163(j) that provide detailed guidance on these topics.[47]

For more information on this topic, see page 5 in the KPMG Report on the CARES Act.

Key considerations for the banking industry

- While banks and their consolidated groups are rarely subject to interest expense deduction limitations under section 163(j), there may be certain non-consolidated affiliates that face limitations (e.g., controlled partnerships, CFCs). Accordingly, the temporary changes to section 163(j) may provide relief for certain bank affiliates. As with any elective provision, detailed modeling is needed to ensure that the temporary section 163(j) provisions are advantageous after taking into account the complex interaction between section 163(j) and other tax provisions.

- Many banking customers are likely to benefit from the temporary section 163(j) changes. Banks may want to consider factoring the temporary changes to section 163(j) into their pricing models (such as borrower underwriting models or credit deal pricing models to the extent the models take into account customers' interest expense limitations).

- Banks are significant investors in low-income house tax credit partnerships (LIHTC investments). LIHTC investments frequently use a significant amount of debt financing, and many previously made an Excepted Business Election to avoid an interest expense limitation under section 163(j). Banks need to analyze, and potentially reassess, whether an Excepted Business Election is advantageous for their LIHTC investments in light of the QIP technical correction and potential for increased interest expense capacity as a result of the CARES Act changes to section 163(j). Also, if a LIHTC investment did not make an Excepted Business Election but would now like to do so, Rev. Proc. 2020-22 provides an opportunity to make a late election.

- State considerations: Although banks are rarely subject to limitations under section 163(j) for federal tax purposes, entities within the same consolidated group as a bank could have section 163(j) limitations for state tax purposes if a state requires the filing of separate entity returns. For tax year 2019, there are a number of states that do not conform to section 163(j) because they have either specifically decoupled or because they have unique conformity provisions. For these states, the CARES Act changes to section 163(j) will have no impact. Rolling conformity states[48] will generally update for the temporary increase, as well as the elections to not apply the 50 percent limitation and to use the 2019 ATI in 2020. Fixed conformity states will not adopt the changes until the state legislature takes some further action. Adopting state legislation that would impact 2019 state returns is likely to be procedurally challenging since many states have adjourned their legislative sessions either for the year, or temporarily due to COVID-19. To the extent a state conforms to section 163(j), but does not adopt the changes to the CARES Act, there will be an additional layer of complexity for taxpayers. The temporary changes to section 163(j) are another item that will need to be tracked on a state-by-state basis since not all states will conform to the new provision.

[46] 2020-18, I.R.B. (2020).

[47] *See* T.D. 9905 (Jul. 28, 2020); REG-107911-18 (Jul. 28, 2020).

[48] *See infra* for further discussion on state tax considerations, including federal and state conformity.

II. Payroll provisions in the CARES Act

a. Payroll tax deferral

(Section 2302 of the CARES Act)

The CARES Act allows employers and self-employed individuals to defer payment of the employer share (6.2 percent) of the social security tax they otherwise are responsible for paying in 2020, effective for payments due after the date of enactment. Fifty percent of the deferred payroll taxes are due on December 31, 2021, and the remaining amounts are due on December 31, 2022.

For more information on this topic, see page 4 in the KPMG Report on the CARES Act.

Key considerations for the banking industry

- Deferred payroll tax can be paid *on or before* the maximum deferral period (50 percent is deferred to December 31, 2021 and 50 percent is deferred to December 31, 2022).
- Banks should evaluate opportunities to claim 2020 deductions for deferred payroll tax paid in 2021 under the recurring item exception in Treas. Reg. section 1.461-5.

b. Employee retention payroll tax credit for certain businesses (ERC)

(Section 2301 of the CARES Act)

The CARES Act also provides a refundable payroll tax credit for 50 percent of wages paid by certain employers to employees. The bill provides the credit is available to eligible employers carrying on a trade or business in calendar year 2020 whose:

— Operations were fully or partially suspended, due to COVID-19, or

— Gross receipts declined by more than 50 percent when compared to the same quarter in the prior year.

In the case of an employer that qualifies by virtue of the gross receipts test, eligibility ceases at the end of the calendar quarter in which gross receipts are greater than 80 percent of gross receipts for the same calendar quarter for the prior year. For tax-exempt entities, they are eligible if the operations are fully or partially suspended due to COVID-19.

The credit is for "qualified wages." For employers with greater than 100 full-time employees, qualified wages are wages paid to employees when they are *not providing services* due to COVID-19 circumstances. For eligible employers with 100 or fewer full-time employees, all employee wages qualify for the credit. The average number of full-time employees is based on 2019 and is determined under section 4980H.

The credit is capped at the first $10,000 of compensation, including health benefits, paid to the employee. The credit is refundable to the extent it exceeds the employer portion of social security taxes reduced by the paid sick leave and paid FMLA established by the "Families First Coronavirus Response Act."[49] The provision is effective for wages paid or incurred from March 13, 2020 through December 31, 2020.

For more information on this topic, see page 4 in the KPMG Report on the CARES Act.

Key considerations for the banking industry

- While the recent FAQs confirm that some "essential" businesses may be eligible for the ERC, careful analysis is required to confirm eligibility status based on each organization's unique circumstances.
- In the wake of TARP and other reputational considerations, some financial institutions have expressed hesitation in applying both the payroll tax deferral provision and the ERC.
- A revised Form 941 is expected to be published soon, which will assist with the operational aspect of the payroll deferral and ERC.

[49] Act Sec. 7001 and 7003 of P.L. 116-127, 134 Stat. 177 (2020).

III. Other applicable tax provisions in the CARES Act

a. Changes to the net operating loss (NOL) rules (Section 2303 of the CARES Act)

The CARES Act made several changes to the net operating loss (NOL) tax rules. Most significantly, the CARES Act allows a taxpayer a five-year carryback for NOLs arising in tax years beginning after December 31, 2017 and before January 1, 2021 (i.e., calendar years 2018, 2019, and 2020).[50] Taxpayers have the ability to relinquish the entire carryback period for a particular year's NOL if a waiver is timely filed.

The Tax Cuts and Job Act (the TCJA)[51] imposed an 80 percent of taxable income limitation on the use of NOLs arising in tax years beginning after December 31, 2017. The CARES Act suspends this limitation for tax years beginning before January 1, 2021. Thus, taxpayers are not subject to the 80 percent of taxable income limitation for tax years 2018–2020.[52]

There are effectively three buckets of federal NOLs:

NOL generated in tax years	Eligible for carryback	Eligible for carryforward	Eligible to offset % of taxable income
Beginning on or before December 31, 2017	Two tax years	20 tax years	100% of taxable income
Beginning after December 31, 2017 and beginning before January 1, 2021	Five tax years	Indefinite	100% of taxable income (prior to 2021) 80% of taxable income (2021 or after)
Beginning on or after January 1, 2021	Generally, no carryback	Indefinite	80% of taxable income

The CARES Act puts limitations on the use of carrybacks for real estate investment trusts (REITs). NOLs of a taxpayer may not be carried back to any year in which the taxpayer was a REIT. Similarly, NOLs of a REIT may not be carried back to any tax year, regardless of whether the taxpayer was a REIT in that tax year.

[50] If an NOL is carried back to a prior tax year, the taxpayer may have to make special considerations for other federal tax provisions such as the section 163(j) interest deduction limitation, the section 250(a)(2) limitation on the global intangible low-taxed income (GILTI)/foreign-derived intangible income (FDII) deduction, and the section 965 transition tax.

[51] P.L. 115-97, 131 Stat. 2054 (2017). P.L. 115-97 is technically entitled "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," but is commonly referred to as the Tax Cuts and Jobs Act.

[52] For limitation purposes, the CARES Act provides that taxable income is computed without regard to deductions under section 199A (qualified business income) and section 250 (GILTI/FDII).

For more information on this topic, see page 6 in the KPMG Report on the CARES Act.

Key considerations for the banking industry

- The ability to carryback 2018–2020 NOLs to years with a higher tax rate (i.e., calendar years
- 2013–2017) may provide taxpayers with a permanent tax benefit and cash tax savings.
- Financial institutions may consider various planning strategies, including method of accounting changes, to accelerate deductions or defer income so they can take advantage of an NOL carryback and tax rate differential opportunity.
- Section 165(i) permits taxpayers to claim certain current year losses attributable to federally declared disasters on the prior year's original or amended return. In order to be eligible for this rule, the loss must occur in a disaster area and be attributable to a federally declared disaster. As of March 20, 2020, the entire country qualified as a disaster area. Banks should evaluate whether certain losses may be eligible for this election, as well as whether it would be advantageous to claim the losses on the bank's 2019 tax return.[53]
- Capital loss carryover periods remain unchanged from the CARES Act. As such, financial institutions are allowed a three-year carryback and five-year carryforward for capital losses.
- Bank stress testing may be under heightened scrutiny due to challenges from COVID-19. The temporary changes to NOL rules may provide a welcome relief to regulatory capital calculations.

b. Corporate alternative minimum tax relief
(Section 2305 of the CARES Act)

When the alternative minimum tax regime was repealed by the TCJA, transition rules were adopted to allow taxpayers to utilize their remaining minimum tax credits (MTCs) before 2022. Under the TCJA, MTCs were able to be carried forward and utilized to the extent of the taxpayer's regular tax liability (as reduced by certain other credits). In addition, MTCs in excess of the regular tax liability were 50 percent refundable in years 2018, 2019, and 2020, and fully refundable by 2021.

Under the CARES Act, MTCs remain 50 percent refundable in 2018, but are fully refundable in 2019. Alternatively, a taxpayer may elect to claim the entire refundable credit amount for 2018.

For more information on this topic, see page 12 in the KPMG Report on the CARES Act.

[53] The application of section 165(i) could have various state tax impacts. Most states conform to section 165(i), but a few do not (e.g., Massachusetts and Mississippi). Thus, in most states, the federal election will control, but note that some states may allow a different state election than the federal (e.g., California). Further, in considering the effect of claiming the 2020 losses in 2019, a bank should consider the increased complexity when analyzing its state tax positions. For example, the state filing footprint may differ significantly between tax years. Additionally, banks should consider federal and state basis differences (e.g., bonus depreciation) that may affect the amount of the state loss.

c. Technical correction regarding qualified improvement property (QIP)
(Section 2307 of the CARES Act)

Generally, the TCJA provided for 100 percent expensing of certain property acquired after September 27, 2017 and before January 1, 2023. Under the TCJA, this 100 percent expensing rule unintentionally did not apply to qualified improvement property (QIP). The CARES Act provides a technical correction to the 2017 legislation and generally allows for the 100 percent expensing of QIP.

For more information on this topic, see page 14 in the KPMG Report on the CARES Act.

Key considerations for the banking industry

- Banks, as lessors, will receive the benefit of this technical correction for QIP held in lease portfolios (assuming the bank is treated as the owner of the property for tax purposes).
- Banks may consider reassessing criteria used to determine whether a contract qualifies as a "true lease" for federal income tax purposes (as compared to a secured financing).
- In light of the changes to QIP, banks may need to reevaluate the application of elections under section 163(j) for LIHTC investments to attain optimal tax efficiency (see related discussion on page 10 above). Very generally, if a taxpayer makes an Excepted Business Election under section 163(j) (as defined above), the taxpayer is not subject to the disallowance of business interest expense under section 163(j); however, the electing taxpayer is not able to apply the 100 percent expensing rule for qualifying depreciable property.[54]

d. Modification of charitable contribution limitation for corporations (Section 2205 of the CARES Act)

The CARES Act increases the limitations on deductions for charitable contributions who make cash contributions in 2020 from 10 percent of taxable income to 25 percent of taxable income.

For more information on this topic, see page 15 in the KPMG Report on the CARES Act.

[54] Further, as enacted under the TCJA, electing taxpayers are required to use the alternative depreciation system for certain assets.

IV. State tax considerations

In addition to the various state tax considerations already addressed in this document, banks should consider broader state tax issues in light of COVID-19 and the CARES Act.

> *For more information on this topic, see page 21 in the KPMG Report on the CARES Act.*

Key considerations for the banking industry

State and federal conformity issues—Generally, states adopt a rolling conformity or a fixed conformity to the federal code. Rolling conformity states typically incorporate all changes to the federal code as passed by Congress unless the state passes legislation to decouple from specific provisions. Fixed conformity states typically conform to the federal code as of a particular date (e.g., January 1, 2020). This could have implications to a number of the issues described above. For an illustration of this issue, see the state tax discussion on page 10 related to the temporary changes to the section 163(j) business interest expense disallowance.

Nexus implications from working from home—The significant expansion of remote workers in response to COVID-19 creates the potential for new nexus risks for banks, potentially triggering tax and filing responsibilities for taxpayers in states in which they previously did not file returns. Notably, a limited number of states (e.g., New Jersey and Mississippi) have issued guidance that they would alleviate certain nexus implications if working from home is solely the result of COVID-19. For taxpayers anticipating being in a taxable loss situation in 2020, however, establishing nexus in 2020 could result in the creation of new state NOLs rather than a significant new tax exposure.

Income tax apportionment sourcing—All states with an income tax apportion taxable income or loss based, at least in part, on a sales factor, consisting of a ratio of a taxpayer's receipts or sales in the taxing state over its sales everywhere. For sales of services, in some states the determination of whether a sale is attributable to the state and included in the numerator of this ratio may be based (at least in part) on where the person performing that service is located. Similarly, some states may source receipts attributable to investment or trading activities to the location where that investment or trading function is performed. This ultimately affects the amount of income apportioned and taxed by states. Financial institutions with large numbers of newly remote employees could see shifts in where some receipts are sourced for sales factor purposes if working remotely becomes a long-term reality.

State tax withholding—In general, state income tax withholding is required based upon the state where employees perform services. There are exceptions to this rule, most notably for states that have reciprocal agreements with neighboring states, which allow state income taxes to only be withheld in the employee's resident state. When employees are working from their home, which may be in a different state than their primary work location, state income tax withholding may be required in the employee's resident state rather than the normal primary work state. Whether state withholding requirements on an employee's wages will be affected is a fact-specific analysis based upon employee home locations, an employer's business locations, and review of state-specific withholding regulations including reciprocal agreements. In addition, five states (Connecticut, Delaware, Nebraska, New York, and Pennsylvania) have specific regulations around telecommuting when employees work from home for their own convenience.

Sales and use tax implications—Changes in work locations and office environments made in response to COVID-19 can create opportunities to reduce sales and use taxes related to existing purchases, particularly with respect to technology, information, and data related services. Similarly, new purchases to better enable working from home or to facilitate employees returning to office locations offer potential opportunities to reduce indirect tax spend through proper planning and documentation. A review of existing spend and proper planning regarding new purchases can help companies reduce overall indirect tax costs. Potential savings opportunities likely arise from three categories—(i) revising allocations with respect to existing purchases, (ii) potential exemptions related to COVID-19 related office purchases, and (iii) various considerations with respect to work from home enablement purchases.

V. Accounting for income taxes

The CARES Act includes changes to the tax law that apply retroactively. Special consideration must be given to these changes when applying U.S. GAAP.

The tax effects of retroactive changes in tax laws or rates on income taxes receivable (payable) for a prior year are recognized in income tax expense (benefit) from continuing operations as of the date of enactment. Additionally, to the extent that a retroactive change impacts income taxes receivable (payable) of the current year, the impact must be reflected in the estimated annual effective tax rate beginning in the interim period that includes the enactment date.

Deferred tax assets and liabilities are re-measured to reflect the effects of enacted changes in tax laws as of the date of enactment. The impact of the re-measurement is reflected in the interim period that includes the enactment date and is allocated directly to income tax expense (benefit) from continuing operations.

For more information on this topic, see page 24 in the KPMG Report on the CARES Act and ***KPMG Hot Topic: Coronavirus, Income tax accounting impacts, including interim estimates and valuation allowances***

Key considerations for the banking industry

- Financial institutions carrying back NOLs to tax years with a higher federal income tax rate will need to consider the impact of the rate differential for GAAP purposes. The below example illustrates this point:
  - A bank has a 2018 NOL of $100, and recorded a deferred tax asset (DTA) of $21 by applying the 2018 federal tax rate.
  - The bank carries back the 2018 NOL to tax year 2013, where income was taxed at 35 percent.
  - Accordingly, a refund receivable is recognized for $35, and the DTA of $21 is reversed. The difference of $14 is recorded through income tax expense (benefit), and results in a discrete adjustment to tax expense.
- The tax law changes under the CARES Act may require banks to update the scheduling of the reversal of temporary differences.
- Banks should revisit their existing judgements on valuation allowances in light of the current environment. For example, changes to the NOL rules, rescheduling of the reversal of temporary differences, and increased losses due to challenges from COVID-19 could all influence the need for valuation allowances.
- Banks may have trouble reliably estimating their annual effective tax rate. Various steps should be taken to conclude that a bank is unable to reliably estimate its annual effective tax rate, and such conclusion should generally be consistent with assumptions and forecasts used for other financial reporting matters. For example, if a bank uses a forecast as part of an impairment analysis, such forecast may need to be considered in estimating the annual effective tax rate. If a bank is unable to reliably estimate individual items in consolidated ordinary income or the related income tax expense or benefit, the tax effect of those items should be recognized in the interim period in which they are reported.
- The impact that the CARES Act has on deferred tax assets and liabilities will impact regulatory capital calculations. For example, the technical correction for QIP may generate a deferred tax liability (DTL), which could provide additional DTLs to allocate against carryforward DTAs. This netting could result in lower capital reduction and could improve regulatory capital.
- If a bank files a non-automatic method change, the bank should generally recognize the impact of the method change in its financial statements after the non-automatic method change is filed and to the extent the method change is more likely than not to be sustained.
- To the extent that the government provides non-income tax aid (such as the employee retention payroll tax credit), such items need to be accounted for under other GAAP instead of ASC 740.

Notes

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