COVID-19 and U.S. tax impacts for infrastructure

June 10, 2020

Coronavirus disease 2019 (COVID-19) is having an unprecedented impact on the global economy and financial markets. At the same time, recent geopolitical developments have disrupted global trade arrangements and oil prices.

Infrastructure asset owners, operators, and developers are all affected, with consequences differing between sectors and the nature of arrangements (e.g., availability-based, regulated assets, or demand-based assets). This is also indirectly impacting individuals through pension fund investments.

These changes are challenging existing tax settings and require close focus to reassess assumptions at the same time as legislative and IRS responses are introducing new opportunities. This article considers key U.S. tax issues and questions that all infrastructure investors should consider.

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Overview

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law by President Trump, bolstering earlier legislative and administrative relief measures. The CARES Act contains a number of significant stimulus and tax changes that will benefit infrastructure projects. Many investors are considering these measures, while the fast-moving nature of the crisis creates a critical need to reevaluate existing models and assumptions to determine whether changes may be needed.

At the same time, debate is occurring in the United States on the makeup of further potential fiscal stimulus, with both parties raising infrastructure spending within that discussion.

This article steps back and looks at the key considerations for tax directors for existing structures under the CARES Act and what may lie ahead. We have broken this down by commercial issues, covering:

- Cash flow timing benefits
- Credits and permanent benefits
- Valuation considerations impacting investors, including U.S. real property issues
- Financing and debt restructuring issues
- Distributions and other payment considerations
- Transactional issues.

State tax conformity and other issues are beyond the scope of this article but should also be considered.

The KPMG Tax team continues to think through these developments and would welcome the opportunity to discuss any aspect with you.
# Summary of key U.S. tax considerations for infrastructure projects and investors

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| **Cash flow timing benefits** | — Federal and state income tax filing and payment postponements  
— Traditional accounting method changes and planning  
— Transfer pricing for COVID-19 costs and cash flow tax management in foreign jurisdictions for offshore entities  
— Accounting period tax planning  
— Accelerated deductions for “disaster losses” under Section 165(i) for 2019 year | — Net operating loss (NOL) carryback provisions to reduce/refund tax payments  
— Increased NOL recovery against 100 percent of taxable income for three years  
— Increased interest deductibility under Section 163(j) for projects not subject to the infrastructure safe harbor  
— Accelerated utilization of qualifying minimum tax credits (MTCs) under the corporate alternative minimum tax that existed prior to the legislation commonly known as the Tax Cuts and Jobs Act (TCJA)  
— Payroll tax deferrals (social security tax) | — Increased indebtedness may persist postcrisis. Industry stakeholders may advocate for the deductibility limit under Section 163(j) to increase above 50 percent and/or be extended to include tax years commencing after December 31, 2020.  
— Changes under the CARES Act have resulted in increased complexity when tracking NOLs in separate categories and rates. Simplification and an extension to the utilization period to offset taxable income may be sought by industry stakeholders. |
| **Credits and other permanent benefits** | — Tax credit eligibility for renewable wind projects with December 31, 2020 construction deadlines  
— Tax consequences arising from insurance proceeds and impact on loss claims | — Permanent benefit from NOL carrybacks to prior years under the former 35 percent federal income tax rate  
— Employer retention payroll tax credits  
— Paycheck Protection Program (PPP) and Small Business Administration (SBA) loans programs | — Renewable stakeholders may lobby for extended construction deadlines and/or enhanced (refundable) credits to mitigate potential reduced tax equity investor demand in the solar and wind industry.  
— PPP applications quickly exceeded initial lending capacity, resulting in extended funding. Further changes to the PPP have recently moved through Congress in response to uncertainty and concerns over restrictive conditions.  
— Potential tax credits for community development projects or other infrastructure investment |
| **Valuations** | — Out-of-cycle valuation changes may alter relative values between real property and other assets (foreign investor FIRPTA consequences for portfolio companies).  
— Increased losses and deferred tax impacts will need to be considered in valuations. | — Benefits under the CARES Act will affect future valuations.  
— Asset management teams will need to be briefed and model assumptions revisited. | — Further credits or tax stimulus relief will also need to be factored into future valuations. |

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| Financing and debt restructuring | Existing debt:  
- Consideration of transfer pricing consequences if repricing is desirable in the current credit environment  
- For other restructuring of debt, consideration of significant modifications, cancellation of indebtedness income or withholding tax  
- For new debt facilities, consideration of debt terms and borrower circumstances (e.g., thinly capitalized) and adequate documentation of emergency shareholder funding  
- Consideration of treatment of deferred/capitalized interest payments as nondeductible expenses | Restructuring may realize ordinary or capital losses for lenders (e.g., infrastructure debt funds), which may be available under carryback NOL rules.  
- Costs of debt capital will reduce due to the increased deductibility of interest under Section 163(j).  
- Federal Reserve lending programs (e.g., Main Street Lending Program) | Potential reintroduction of Build America Bonds or new tax credit bonds for state and local governments  
| | | | Potential further federal funding facilities for private sector or state/county/city infrastructure programs across various sectors, e.g., road, rail, water, ports/harbor, renewables, fiber, and telecommunications |
| Distributions and other payments | Reduction of current and accumulated earnings and profits due to COVID-19  
- Application of the recast rules under Section 385 where liquidity restrictions result in funding of distributions from existing or new debt  
- Consideration of tax implications of reduced distributions, e.g., real estate investment trust (REIT) distribution management | Consideration of offshore payments and whether Base Erosion and Anti-Abuse Tax (BEAT) liabilities may increase if NOLs reduce regular taxable income  
- Refunds arising from the carryback of NOLs may generate additional earnings and profits, which may impact current-year distributions and tax withholding requirements. | Some of the federal relief programs contain limits on future distributions and stock buybacks (for listed equity securities), e.g., Main Street Lending Program loans. Similar constraints may be included in future stimulus measures and should be carefully evaluated to the extent they impact future activity such as refinancing distributions. |
| Transactional issues | Tax treatments for aborted or deferred transaction costs  
- Asset disposals may trigger ownership changes or capital raising may impact NOL availability. | Carryback NOLs and prior-year refunds arising from tax-deductible transaction costs and asset acquisitions or Section 338(h)(10) deemed asset acquisitions that are eligible for 100 percent expensing | Future stimulus and funding directed to infrastructure will create new transaction opportunities, including P3 transactions and potential opportunities for state or local asset sales of new/refurbished assets. |
Detailed commentary

1. Cash flow timing benefits

Existing tax law and administrative relief measures

Income tax filing and payment postponements
IRS Notice 2020-18 postpones the filing date of specific federal income tax returns and the due date of specific federal income tax payments due on April 15, 2020 until July 15, 2020 for any person with a federal income tax return filing requirement or payment due April 15, 2020. Affected taxpayers, meaning those entitled to relief under the notice, do not have to file extension Forms 4868 or 7004 to qualify for the automatic three-month postponement relief described in Notice 2020-18.

The notice places no limitation on the amount of payment that may be postponed.

IRS Notice 2020-23 was issued on April 9, 2020 and automatically postpones due dates for "Affected Taxpayers," with respect to an expanded list of federal tax returns, tax payments, forms, and schedules due on a date during the period beginning April 1, 2020, and ending July 15, 2020. The postponed due date is July 15, 2020.

Notice 2020-23 also provides relief with respect to “Specified Time-Sensitive Actions” that are due to be performed on or after April 1, 2020, and before July 15, 2020, such as filing all petitions with the Tax Court, seeking review of a decision rendered by the Tax Court, filing a claim for credit or refund of any tax, and bringing suit upon a claim for credit or refund of any tax. Affected taxpayers have until July 15, 2020 to perform the Specified Time-Sensitive Actions.

Different postponement measures have been announced by the states.

Accounting method changes
Traditional tax accounting method and credits techniques and procedures in general may provide companies with efficient and effective means to support cash management efforts. Further, accounting method changes may enhance the ability to access relief under the CARES Act provisions; for example, increasing current-year NOLs using accounting method changes in certain factual circumstances would allow a greater amount of NOLs for carryback purposes.

The KPMG Washington National Tax Income Tax & Accounting Group has produced an article that provides a summary of 15 opportunities (some of which are extremely time sensitive) that use accounting methods and credits to help drive cash flow.

Disaster loss deductions
Section 165(i) permits taxpayers to claim certain losses attributable to a federally declared disaster (otherwise allowable as a deduction for the tax year) in the tax year immediately preceding the tax year in which the loss is sustained.

COVID-19 was declared a nationwide emergency on March 13, 2020 enabling portfolio companies to access Section 165(i) for deductible losses that are attributable to COVID-19. This requires a taxpayer to demonstrate that the loss is attributable to COVID-19. Examples of potentially eligible losses include:

- Failed deal costs where a transaction is not pursued
- Management decisions to permanently close a site or facility
- Permanent retirement of fixed assets
- Sale or exchange of business property at a loss, i.e., forced transactions due to the impacts of COVID-19.

The long-term nature of infrastructure assets may require extra care and documentation to demonstrate the extent to which COVID-19 drives decisions to permanently close facilities or retire fixed assets.

Measures under the CARES Act

NOL carryback
The CARES Act grants taxpayers a five-year carryback period for NOLs arising in tax years beginning after December 31, 2017 and before January 1, 2021 (i.e., calendar years 2018, 2019, and 2020). Taxpayers may elect to relinquish the entire five-year carryback period with respect to a particular year’s NOL, with the election being irrevocable.

For infrastructure portfolio companies and projects, the benefit of carrying back NOLs will depend on the stage of the asset. For projects that are in the early stages of their lifecycle, there may be limited benefit from carrying back NOLs to prior years where losses already exist due to large deductible expenses such as immediate depreciation deductions, bonus depreciation, or interest on debt financing if the project qualifies for the infrastructure safe harbor from Section 163(j).

A consequence of carrying back losses to earlier years is that various calculations for those carryback years will need to be redone. For example, a carryback of an NOL to 2018 or 2019 could require a recalculation of various taxable income limitations applicable in the carryback year, such as the Section 163(j) interest deduction limitation (if applicable). It will be necessary to revisit tax models to assess the benefit of changes to the timing of NOL utilization.
Temporary increased rate of NOL recovery

The CARES Act temporarily suspends the 80 percent of taxable income limitation on the use of NOLs for tax years beginning before January 1, 2021, thereby permitting corporate taxpayers to use NOLs to fully offset taxable income in these years regardless of the year in which the NOL arose.

Similar considerations to NOL carrybacks will arise for infrastructure assets.

Temporary changes to the business interest expense disallowance rules under Section 163(j)

The CARES Act makes several temporary changes to Section 163(j). For tax years beginning in 2019 and 2020, the 30 percent limit on deducting business interest measured against adjusted taxable income (ATI) is increased to 50 percent.

Special rules apply to partnerships, as the increased (50 percent) ATI limit does not apply to a partnership tax year beginning in 2019, but any of the partnership’s 2019 excess business interest expense allocated to a partner will be treated as follows:

— 50 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)

— The other 50 percent will be subject to the limitations of Section 163(j)(4)(B)(iii) in the same manner as any other excess business interest so allocated.

This change will benefit infrastructure investors where a project does not qualify under the infrastructure safe harbor exception to Section 163(j). To the extent increased business interest deductions generate NOLs that can be carried back to prior tax years, the combination of these changes may also be beneficial and should be modeled.

Transactions involving partnership interests (such as a sale of a partnership interest) should also consider these changes, because if a partner had excess business interest expense in 2019, the partnership interest transaction may preclude a partner from deducting the excess business interest expense in 2020.

Corporate alternative minimum tax relief

The CARES Act accelerates the ability of corporations to utilize any remaining MTCs they may have under the pre-TCJA corporate alternative minimum tax regime. Instead of allowing a 50 percent credit for tax years beginning in 2018 through 2020, with a 100 percent credit allowed in 2021, the legislation now allows a 50 percent credit for 2018 and a 100 percent credit for 2019. Alternatively, a taxpayer may elect to claim the entire refundable credit amount for 2018.

Portfolio companies with remaining MTCs should consider this change, including the ability to file an application for a tentative (quickie) refund under the CARES Act, which would accelerate the timing of a refund.

This change interacts with the new NOL carryback rule, as portfolio companies that fully utilized their MTCs to offset regular tax liability for their first tax year beginning after 2017 may be due a refund since the temporary reinstatement of the NOL carryback may eliminate all or a portion of their 2018 federal income tax liability.

Deferral of employer payroll taxes

The CARES Act allows portfolio company employers 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.

2. Credits and other permanent benefits

Existing tax law and administrative relief measures

Renewable energy credits

Renewable energy facilities are eligible for certain tax credits (including an investment tax credit (ITC) and electricity production tax credit (PTC)) if construction of the facilities proceeds according to timelines designated by the IRS.

Broadly speaking, in order to qualify for and claim the full ITC or PTC, projects are required to begin construction by specific dates (e.g., wind projects seeking the PTC were required to begin construction in 2016). To satisfy the begin construction requirement, taxpayers can either meet the Physical Work Test whereby a continuous program of construction was pursued from the date construction commenced or alternatively meet the 5 percent Safe Harbor Test whereby at least 5 percent of total project costs are paid and continuous efforts toward completion of construction are pursued from the date construction commenced. Both tests require continuous progress toward completion and the IRS has provided a “Continuity Safe Harbor” that deems the continuity requirement as satisfied when the project is in service no more than four calendar years after the calendar year during which construction began.

The COVID-19 crisis is significantly impacting the construction of projects including issues of labor stoppages, delivery delays for supplies, key equipment and components, as well as delays in obtaining permits from the relevant government agencies. These issues are resulting in construction delays and leading to projects being unable to meet the continuity requirements.
In response to the COVID-19 crisis, the IRS has issued Notice 2020-41, which extends the Continuity Safe Harbor. Specifically, for projects that began construction in either calendar year 2016 or 2017, the Continuity Safe Harbor is satisfied if a taxpayer places the project in service by the end of a calendar year that is no more than five calendar years after the calendar year when construction began. Thus, projects that began construction in 2016 have until the end of 2021 to be placed in service, and 2017 projects have until the end of 2022.

Although the relief granted by Notice 2020-41 is provided because of COVID-19, application of the Continuity Safe Harbor does not require the taxpayer to prove that delays were related to the COVID-19 pandemic.

For additional KPMG insights, please refer here.

Measures under the CARES Act

NOL carrybacks and permanent benefits

Companies carrying back losses from the 2018 to 2020 tax years will need to consider the impact of tax rates in the carryback year to which the losses are applied. For example, an NOL from 2018 that previously created a deferred tax asset measured at 21 percent under the CARES Act may be carried back to offset taxable income from 2013 that would have been taxed at a 35 percent federal income tax rate. As such, the refund receivable recognized may be measured at the 35 percent rate applicable to the carryback year, while the deferred tax asset that is derecognized may have been measured at a 21 percent rate. For a 2020 loss expected to be carried back to a pre-2018 year, this may result in a benefit in the estimated annual effective tax rate at the 35 percent rate.

Companies should consider updating the scheduling of the reversal of temporary differences in determining the total amount of deferred tax assets supported by reversing taxable temporary differences. An entity may have fewer carryforwards after the CARES Act and the reversal of existing temporary differences may result in a change in the amount of valuation allowance required.

Employer retention payroll tax credits

The CARES Act provides a refundable payroll tax credit for 50 percent of the wages paid by certain employers to employees. The legislation 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 to comply with orders from an appropriate government authority due to the COVID-19 crisis, or
— Gross receipts declined by more than 50 percent when compared to the same quarter in the prior year.

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 extended FMLA.

An eligible employer that receives a covered loan under the SBA pursuant to the PPP provisions added under the CARES Act is not eligible for the employer retention credit. As discussed below, many portfolio companies within fund structures may not qualify for a PPP loan because they may exceed size limits due to the SBA’s affiliation rules. Where this is the case, the employer retention payroll tax credit measures offer an alternative to achieve some relief.

The PPP and other SBA loan programs are discussed in more detail below:

Paycheck Protection Program (PPP) and Small Business Administration (SBA) loans programs

The CARES Act established two important lending programs: (1) the SBA-administered PPP and (2) the Treasury Department’s economic stabilization fund.

Together, these two programs provide over $1.1 trillion to support lending to both small and large businesses.

Overview of PPP

Eligible borrowers under the PPP include almost all small businesses. The requirement to qualify as a “small business” is generally either 500 or fewer employees, or the organization satisfies the definition of “small business” for purposes of its industry (as defined under existing SBA standards). For a number of infrastructure sectors, the maximum number of employees is significantly greater, e.g., 1,000 employees for electric power or gas distribution businesses.

Most businesses will need to calculate their employee numbers by including the employees of any applicable affiliates. Certain eligible businesses may waive the affiliation rules and, therefore, will not need to calculate affiliate employee totals (e.g., food service, hospitality, and franchised businesses). Although the affiliation rules for calculating the 500 or fewer employees test initially caused uncertainty across the private equity sector and in particular the application to portfolio companies within infrastructure fund structures, the IRS has since clarified a number of issues in a published set of FAQs, including that applicants must count all employees of U.S. and foreign affiliate entities. This clarification by the IRS together with the potential for future audits has diminished the initial hopes of many infrastructure funds in the PPP.
The loan may be utilized to pay employee compensation, mortgage interest payments, employee benefits, rent, and utilities. However, not more than 25 percent of any loan subsequently forgiven may be used for nonpayroll costs. This will inhibit the use of PPP loans for substantial nonpayroll operating costs.

- PPP loans are not secured and the loans have a fixed interest rate of 1.0 percent.
- Prepayment penalties do not apply.
- Any portion of the principal amount not forgiven is subject to a maturity of up to two years from the date of loan application.

To qualify for forgiveness in respect of PPP loan amounts used to fund payroll costs, those payroll costs must be incurred within an eight-week period starting on the date of disbursement of the PPP loan. Alternatively, the commencement of the eight-week period may be deferred to the first day of the next payroll cycle commencing after the date of disbursement of the PPP loan.

The amount of loan forgiveness may be reduced if the borrower reduces full-time equivalent employees and/or salary and wage amounts during the eight-week covered period noted above.

On June 5, 2020, President Trump signed into law the Paycheck Protection Program Flexibility Act of 2020, which provides several important changes to the PPP, including an extension of the time line for the expenditure of funds (increasing the eight-week period to 24 weeks), easing the requirement that 75 percent of funds be used for wages (decreasing the requirement to 60 percent) and allowing the deferral of payroll taxes without losing forgiveness of indebtedness under the PPP. Any PPP borrowers should consider these changes.

Treasury Department stabilization programs overview
The CARES Act includes a $500 billion authorization for the Treasury Department to make loans, guarantees, and provide other financial support to eligible businesses as well as state and local governments.

Of the $500 billion, $46 billion was specifically allocated to support passenger airlines, cargo airlines, and certain businesses that are deemed critical to national security.

The remaining $454 billion is broadly intended to provide financial assistance through programs or facilities established by the Federal Reserve. Part of this has been utilized as funding for the Main Street Lending Program announced by Treasury. Refer to the comments below regarding the Main Street Lending Program, which is designed to provide relief for midsize U.S. businesses (i.e., 500 to 15,000 employees).

3. Valuations
KPMG has prepared analysis of how market disruption from COVID-19 is impacting infrastructure valuations and consequential key considerations. That article can be obtained here.

Many of the tax considerations under existing law, the CARES Act, or future stimulus will also affect infrastructure valuations and should be incorporated into briefings given to asset management and valuation teams.

4. Financing and debt restructuring

Existing tax law and administrative relief measures

Debt modifications
As a result of the current global economic environment, many businesses are reviewing their debt structures and actively restructuring and negotiating the terms of their existing debt.

Modification of the debt terms (including, for example, changes in the yield, timing of payments, obligor, security/collateral, or the nature of the instrument) can trigger adverse tax consequences, and taxpayers should be aware of the impact of cancellation of debt income (CODI) for the borrower or, if CODI is excluded from income, the reduction of particular tax attributes (NOLs, general business credits, MTCs, capital loss carryovers, tax basis of the borrower’s property, passive activity losses, and foreign tax credits). Generally, CODI is included in a taxpayer’s taxable income unless the discharge or indebtedness occurs where the taxpayer is either declared bankrupt or insolvent, in which case the amount of CODI excluded from income reduces the tax attributes listed above. Taxpayers may be able to reduce or mitigate the effect of CODI in certain situations, including where the debt is considered as “worthless stock” or “wholly worthless bad debts,” which require the satisfaction of particular tests.

In addition, taxpayers should also be aware of other tax issues associated with debt modifications including the potential disallowance of interest deductions for the borrower, phantom taxable gain or income for the lender, or U.S. trade or business concerns for tax-exempt or non-U.S. investors.

Many existing infrastructure projects have long-term debt that may not be affected by the current disruption of credit markets due to COVID-19. However, new projects will be impacted by reduced availability and higher pricing of debt, particularly for projects that have not yet progressed through significant construction de-risking.
Where additional shareholder debt becomes necessary to overcome short-term liquidity issues, all of the above tax considerations should be evaluated and appropriate documentation prepared to support pricing, particularly for cross-border debt from foreign investors.

KPMG has prepared a brief report that further discusses key debt restructuring tax considerations for private equity funds and their portfolio companies.

**Change of ownership and NOLs**

A corporation's ability to utilize its NOLs, net unrealized built-in losses, and other tax benefits can be severely limited if the corporation experiences an "ownership change" within the meaning of IRC Section 382.

Emergency refinancing needs to be closely considered, particularly if the terms may result in instruments being characterized as equity, which would alter relative ownership interests for Section 382 purposes.

Broadly, an "ownership change" generally occurs if the percentage of the stock of the loss corporation owned by one or more "5 percent shareholders" (determined by value) has increased by more than 50 percentage points over the lowest percentage of stock of the loss corporation owned by such shareholders during the last three years.

The Section 382 rules are complex and to the extent financing restructures impact equity ownership, changes should be reviewed in detail to determine the limitation impact (if any) for the utilization of NOLs and other tax attributes against taxable income.

**Section 385 recast rules**

The Regulations under Section 385 relate to certain related-party debt instruments issued by members of an expanded corporate group (as defined in the Regulations), and where applicable (unless an exception applies) can recharacterize a related-party debt instrument as equity for U.S. federal income tax purposes.

In particular, under the "Per Se Funding Rule," if certain debt instruments are issued within the "per se" period (a 72-month period starting 36 months before and ending 36 months after a corporate distribution or other economically similar transaction), the debt instrument is treated as funding that distribution, potentially causing the debt instrument to be recast as equity in whole or in relevant part. Accordingly, refinancing events now will restart this 36-month clock in respect of future distributions.

In October 2019, Treasury and the IRS announced an intention to eliminate the Per Se Funding Rule such that a debt instrument would only be recast under Section 385 where the issuance of the debt has "a sufficient factual connection" to a distribution to a member of the taxpayer’s expanded corporate group.

As these proposed changes to eliminate the “per se” limitation are still pending and not finalized, taxpayers should remain aware of the punitive application of the recast rules when making distributions to related parties. This will be particularly important for new debt instruments issued as part of any COVID-19-related refinancing.

Additional information and KPMG insights on these Regulations are found here.

**Measures under the CARES Act**

**Federal Reserve lending programs**

Treasury and the Federal Reserve have established three Main Street Lending Programs (Main Street New Loan Facility, Main Street Priority Loan Facility, and Main Street Expanded Loan Facility).

The purpose of these programs is to provide support for small and midsize businesses by providing four-year loans to companies with up to 15,000 employees or with revenues of less than $5 billion in 2019.

Treasury’s announcements included a broad overview of the lending program, noting that principal and interest payments will be deferred for one year; firms seeking Main Street loans must commit to make reasonable efforts to maintain payroll and retain workers; borrowers must follow compensation, stock repurchase, and dividend restrictions that apply to direct loan programs under the CARES Act (as described above); and firms that have previously taken advantage of the PPP may also apply for Main Street loans.

Treasury is currently finalizing the lending programs and has provided details of each facility on its website.

While the Main Street Lending Program may be attractive for portfolio companies that are too large to qualify under the PPP (either alone or due to the SBA’s affiliate rules), the restrictions on distributions and stock buybacks during the term of each loan should be carefully analyzed against existing financial models. These restrictions may also prevent the realization of future benefits, such as refinancing gains when credit markets eventually return to normal.

**Build America Bonds and tax credit funding instruments**

Broadly, Build America Bonds were introduced in 2009 (and expired in 2011) following the 2008 financial crisis. These bonds were taxable bonds and featured a federal subsidy for a large portion of the borrowing costs with the purpose of encouraging state and local governments to undertake certain capital projects (including infrastructure projects for roads, transportation, water and sewer, energy, public utilities, etc.).

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In January 2020, the House Democrats released an infrastructure investment framework that included similar taxable bonds and tax credit funding instruments.

In the current environment where entities will generate losses, thereby already reducing taxable income, these infrastructure financing instruments may be more attractive than an exemption on interest income.

5. Distributions and other payments

Existing tax law and administrative relief measures

REIT distribution management
Generally, to satisfy REIT tax treatment, a REIT is required to distribute at least 90 percent of its “ordinary” taxable income (subject to adjustments for certain “noncash” items) and is subject to a corporate-level tax on any undistributed taxable income, which may include net capital gain.

In light of the current environment, managers may prefer to conserve cash and maintain liquidity rather than distribute cash dividends to shareholders. To do so, a REIT might consider:

— Section 1031 Like-Kind Exchanges (i.e., recycling capital into new assets to defer taxable income that would otherwise increase the REIT’s required distribution amount)

— Reducing taxable income by increasing cost recovery deductions, including, for example, electing out of the interest-deductibility limitations under Section 163(j) for the 2019 income year, accelerating depreciation for newly acquired assets, or electing for bonus depreciation

— Delaying or cutting planned distributions where circumstances permit

— Accessing NOL carryovers to offset taxable income

— Utilizing “cash/stock election dividends.”

For a detailed analysis of these strategies along with other strategies including the consequences of retaining income and paying income tax and undertaking structure reorganizations, please refer to the following article prepared by the KPMG Washington National Tax team. Additional KPMG commentary is also provided here.

Measures under the CARES Act

Base Erosion and Anti-Abuse Tax (BEAT) consequences of CARES Act measures
The BEAT is an additional tax that targets certain deductions or similar tax benefits attributable to payments made to foreign related parties by certain taxpayers. Broadly, an applicable taxpayer for these purposes is a corporation that is a member of a group of related corporations (an aggregate group) that has average annual gross receipts of at least $500 million for the three-tax-year period ending with the preceding tax year, and has a “base erosion percentage” during the tax year in excess of 3 percent.

The BEAT acts as a minimum tax that applies to the extent that a tentative BEAT calculated on “modified taxable income” exceeds regular tax liability. For these purposes, modified taxable income generally is calculated like taxable income, but with no deduction allowed for (i) “base erosion tax benefits” attributable to base erosion payments to foreign related parties, or (ii) a portion of the NOL deduction allowed during the taxable year. The tentative BEAT also does not allow the benefit of most credits.

Where a taxpayer chooses to carry back NOLs to an income year where the BEAT was applicable, the NOL carryback will reduce the taxpayer’s regular tax liability, which will consequently lead to an increase in the taxpayer’s BEAT amount. Taxpayers with a BEAT liability in prior years should consider the adverse impact that carryback NOLs may have to their overall tax liability. For example, portfolio companies with shareholder debt funding from foreign investors should consider this issue where the portfolio companies are subject to the BEAT due to the aggregate size of a group or are companies under an infrastructure fund.

Looking forward – Future legislative packages or other tax relief

Under the CARES Act, Treasury may make loans, guarantees, and provide other financial support to eligible businesses, which to date has included industry-specific finance (e.g., to passenger and cargo airlines and certain businesses that are deemed critical to national security). The terms of these programs have included certain requirements including limitations on distributions and other capital management strategies such as stock buy-backs as well as (in some cases) equity stakes provided to Treasury. To the extent that future stimulus packages specifically target infrastructure sectors and assets, any similar repatriation restrictions and limitations should be carefully considered prior to undertaking the financing.

6. Transactional issues

Existing tax law and administrative relief measures

Aborted or deferred transaction costs
As noted above, taxpayers can claim certain losses attributable to a federally declared disaster in the tax year immediately preceding the tax year in which the loss is sustained (Section 165(i)).

To the extent a taxpayer has deal costs arising from aborted or failed transactions, and the taxpayer can demonstrate that based on the particular facts and circumstances that the loss is attributable to COVID-19, then the taxpayer may under Section 165 be able to
claim the loss as a deduction in the 2019 income year.

**Asset disposals and ownership changes impacting NOL availability**

As noted above, Section 382 seeks to prevent loss trafficking by imposing a limitation on the use of prechange losses to offset postchange income after a loss corporation undergoes an ownership change. In general, a Section 382 limitation is equal to the value of the stock of the loss corporation immediately before the ownership change, multiplied by the long-term tax-exempt rate in effect on the change date, with certain potentially significant adjustments. One such adjustment includes the treatment of net unrealized built-in gains (NUBIGs) and losses (NUBILs) recognized during the five-year period beginning on the change date with respect to assets owned by the loss corporation immediately before ownership change.

In September 2019, the IRS issued proposed regulations (REG-125710-18) (“Proposed Regulations”) that sought to significantly impact the determination of built-in gains and losses by loss corporations and impacting the taxpayer’s overall NOL limitation.

In particular, the Proposed Regulations eliminate many taxpayer-favorable provisions under Sections 338 and 1374(d). These proposed regulations remain in draft and to the extent an entity has an ownership change, taxpayers can continue to rely on the previous long-standing calculation methods adopted.

### Measures under the CARES Act

**Carryback of NOLs and Section 338 elections**

In a taxable purchase of the target stock, taxpayers can make an election to treat the purchase of stock as a deemed asset purchase for tax purposes. The deemed asset purchase can allow for an increase to depreciation deductions, which can in turn generate NOLs for the taxpayer, e.g., where an immediate write-off may be available. The interaction of these rules with the NOL changes under the CARES Act should be considered in structuring transactions.

This may have limited relevance for fund purchasers where a special purpose vehicle is established to undertake the acquisition. Corporate purchasers should consider which vehicles they use to acquire targets and whether prior-year taxable income exists against which NOL carrybacks could be utilized.

In negotiating the terms of any transaction for a portfolio company, parties may need to consider and agree on how future benefits may be shared if NOLs arising posttransaction can be carried back to pretransaction tax years.
Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

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