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Federal Tax Regs To Watch In 2021

By **Joshua Rosenberg**

Law360 (January 3, 2021, 2:24 PM EST) -- Even as President-elect Joe Biden and his administration are set to assume office in January, the Internal Revenue Service is still working to release final regulations deriving from the 2017 Tax Cuts and Jobs Act.

Here, Law360 looks at some of the federal regulatory tax developments that could be in store for 2021.

Deductible Penalties

Internal Revenue Code Section 162(f), enacted by the TCJA, allows businesses to deduct some fines and penalties. Such tax-deductible fines must be reported to the IRS. The IRS proposed regulations in May related to Section 162(f), and practitioners are awaiting finalized guidance.

The rules address the TCJA's stipulation that companies may not deduct penalties imposed by federal, state or local governments, except those considered to be restitution or paid to achieve compliance with the law.

To qualify for those exceptions under the rules, the businesses and government authorities involved would need to identify, in court orders or settlement agreements, which payments meet those standards. At that point, the government entities would report the determinations to the IRS, which can challenge those characterizations.

Practitioners are hopeful the final regulations will provide additional clarity about the agency's definition of what constitutes restitution, S. Starling Marshall, a partner in Crowell & Moring LLP's tax and litigation groups, told Law360.

The goal is for "taxpayers who are at the table with a governmental entity in the settlement are aware of what will be and won't be considered taxable, instead of having to guess," she said.

It's important for the agency to get those kinds of definitions correct in the guidance, she said, because the scope of 162(f) is quite broad.

"This is a big one that relates to cases involving prescription settlements and environmental settlements," among others, she said.

Net Operating Losses

The IRS released proposed regulations under Section 382 in November 2019 that would, if finalized, restrict the extent to which businesses may push back on the provision's net operating loss limitations, thereby decreasing the incentive to acquire businesses saddled with losses.

Practitioners have been waiting to see whether the IRS will finalize the proposed rules without significant modifications, which could exert an especially deleterious effect on the economy, given the ravages of the coronavirus pandemic, David Schnabel, head of tax at Davis Polk & Wardwell LLP, told Law360.

The agency's proposed regulations would nullify a taxpayer-favorable formula in Notice 2003-65, 2003 guidance that describes how businesses may use recognized built-in gains from so-called wasting assets in order to raise Section 382's limitation on NOLs.

Some tax professionals fear the net effect of eliminating that formula, known as the 338 approach, would be to discourage businesses from acquiring struggling corporations, or hamper the efforts of struggling companies to raise capital.

Crucially, the 338 approach is much more taxpayer-friendly, Eric Solomon, a partner at Steptoe & Johnson LLP, who previously served as assistant secretary for tax policy at the U.S. Department of the Treasury, told Law360.

That's because it provides a pathway for certain gains to raise the NOL limitation. Specifically, the notice allows for wasting assets, which depreciate over time but simultaneously "throw off" value, to increase the limitation, he said. The formula works by comparing the cost recovery as if the assets were purchased on the date of the ownership change to the actual cost recovery for the assets, Solomon said.

While the IRS listed Section 382 on its priority guidance plan for 2020, the decision-making process for which rules projects will see the light of day will soon be taken over by the Biden administration, which may have different priorities.

And the timing for finalizing the Section 382 rules would be curious in the near-term, Schnabel said, given that Congress sought to liberalize the use of NOLs during the pandemic when it passed the Coronavirus Aid, Relief and Economic Security Act in March.

The CARES Act included provisions designed to free up the ability of companies to use NOLs and certain similar attributes, he said.

"That was a way to get cash to companies that are losing money," he said. "Notice 2003-65 similarly frees up the ability of companies to use an NOL, and a repeal of that notice will reduce the available cash of some companies and may chill significant equity infusions into those companies and acquisitions of those companies, even where necessitated by the pandemic."

Carbon Capture and Sequestration

In proposed rules from this summer, the IRS definitively prescribed which avenues could be used to demonstrate secure geological storage for the purposes of Section 45Q, which provides for a tax credit of up to $50 per metric ton of carbon captured in qualified facilities. For the first time, the rules also provided details on when the credit could be recaptured.

But practitioners are still awaiting final regulations from the agency, Peter Connors, a tax partner at Orrick Herrington & Sutcliffe LLP, told Law360.

Carbon capture and sequestration is a process by which carbon oxides are seized at the point of emission — at power plants, for example — and then permanently stored, or sequestered, deep underground in saline reservoirs or in oil and gas fields. The aim is to reduce atmospheric greenhouse gases that contribute to climate change.

The agency proposed a five-year recapture period, which would be in line with credits for renewable energy projects such as those in wind and solar energy.

While that's helpful, practitioners are also looking for guidance regarding the extent to which the life cycle analyses they'd submit would need to demonstrate the amount of atmospheric carbon mitigated by the use process.

Business Interest Deduction

The TCJA changed IRC Section 163(j) to cap the deduction for net business interest expense at 30% of adjusted taxable income.

The IRS issued proposed rules on those deduction limits in 2018. In July, the IRS finalized those rules while publishing proposed rules on the interest expense with respect to pass-through entities as well as controlled foreign corporations.

Getting out the final guidance for the latter tranche remains a priority for the Treasury Department, David Kautter, Treasury assistant secretary for tax policy, said at a webinar hosted by the International Fiscal Association.

"Some things that we know that are on the horizon that will affect multinational businesses and international tax practitioners are things like ... changes to the 163(j) calculations, coming from EBITDA to EBIT," he said, referring to the accounting measures of earnings before interest, taxes, depreciation and amortization and earnings before interest and taxes.

The Office of Information and Regulatory Affairs began reviewing the Treasury Department's final regulations under 163(j) in December.

--Additional reporting by Amy Lee Rosen. Editing by Tim Ruel and Joyce Laskowski.