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Taxing Times
A COVID-19 Tax Update as of April 7, 2020

Brief Summary

During these difficult times, government authorities in the United States and the United Kingdom are taking extraordinary measures aimed at curbing the economic impact of the COVID-19 pandemic. While the world is in lockdown, new rules regarding taxation are expected to have a significant impact on corporate and individual taxpayers and their remedies against tax authority actions.

Some of the initial measures in the United States and the United Kingdom include significant short-term changes to:

1. **Tax payment deadlines;**
2. **Tax status and tax liability; and**
3. **The powers of revenue authorities.**

This memorandum provides an update on the most recent tax measures and highlights some key areas for taxpayers.

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COVID-19 Tax Measures

Recent COVID-19 tax measures in the United States include:

- Extensions to filing and payment deadlines
- The Coronavirus Aid, Relief and Economic Security ("**CARES**") Act
- The "People First Initiative" of the Internal Revenue Service ("**IRS**")

Recent COVID-19 tax measures in the United Kingdom include:

- Extensions to payment deadlines
- Guidance on the Statutory Residency Test
- Extensions of Her Majesty's Revenue & Custom's ("**HMRC**") functions

Recent Tax Measures in the United States: An Overview

1. TIME TO PAY: DEFERRAL OF TAX PAYMENTS

In March 2020, the IRS issued Notice 2020-18 (the "**Notice**"), postponing the deadline for filing income tax returns and making tax payments from April 15, 2020 to July 15, 2020. This relief is available to a broad range of taxpayers, including individuals, trusts, estates, corporations, and unincorporated business entities, to the extent the individual or entity had an income tax return or income tax payment due on April 15, 2020. To be eligible for the July 15, 2020 extended filing deadline, it is not necessary for the tax filer to have been sick, quarantined, or have had any other impact from the COVID-19 pandemic.

Importantly, the tax extension does not apply to federal income tax returns and income tax payments due on June 15, 2020 or thereafter. As such, payments related to second quarter estimated taxes are still due on June 15, 2020. The extension also does not apply to returns that were due on March 16, 2020, which include calendar-year partnership and S corporation returns (Form 1065, Form 1065-B, Form 1066, and Form 1120-S).

The Notice does, however, postpone the filing and payment of federal income taxes reported on the following forms if they previously had a due date of April 15, 2020:

- Individual income tax Forms 1040, 1040-SR, 1040-NR, 1040-NR-EZ, 1040-PR, 1040-SS

- Estate and trust Forms 1041, 1041-N, 1041-QFT

- Corporate income tax Forms 1120, 1120-C, 1120-F, 1120-FSC, 1120-H, 1120-L, 1120-ND, 1120-PC, 1120-POL, 1120-REIT, 1120-RIC, 1120-SF

In light of the filing extension and the deferral of payment obligations, businesses may consider seeking guidance from a qualified tax professional to discuss accounting method planning and determine whether there are viable options for decreasing cash payments and increasing cash flows during the COVID-19 pandemic. Those options may include the deferral of advanced payments, the acceleration and maximization of deductions for certain business expenditures, and/or the taking of enhanced deductions for charitable donations of inventory by C corporations.

2. THE CARES ACT

The United States also recently passed the CARES Act, a $2 trillion (USD) stimulus package aimed at providing relief to workers, businesses, and states dealing with the very serious economic implications of the COVID-19 outbreak. The CARES Act includes a number of significant tax provisions that impact individuals and businesses.

For businesses, the CARES Act provides at least the following notable forms of tax-related relief, subject to certain exceptions and limits:

- Defers the deposit of the employer's share of Social Security taxes for the period beginning with the date of enactment through December 31, 2020, with such taxes to be paid over the next two years;

- Creates a refundable Social Security tax credit equal to 50% of qualified wages paid by an "eligible employer" from March 12, 2020 through December 31, 2020;

- Modifies the Net Operating Loss ("NOL") rule by, among other things, temporarily removing the 80% taxable income limitation for NOL deductions taken in a taxable year prior to the 2021 tax year as well as permitting NOLs from 2018 through 2020 to be carried back, for up to five taxable years; and

- Provides exemptions from taxable income and/or increased limitation thresholds for certain deductions, such as charitable contributions.

For individuals, the CARES Act provides at least the following notable tax relief, also subject to certain exemptions and limits:

- Provides modifications to the NOL rules as identified above;

- Releases the Section 431(l) excess business loss limitation applicable to non-corporate tax payers for the 2018 through 2020 tax years; and

- Waives the 10% early withdrawal penalty for coronavirus-related distributions from certain retirement plans, up to $100,000 (USD).

3. The IRS's "People First Initiative"

Additionally, the IRS has unveiled the "People First Initiative", which includes a series of provisions aimed at providing relief to businesses and individuals on a variety of issues. These measures include the relaxation of certain payment guidelines and postponement of compliance actions. The People First Initiative is set to run from April 1, 2020 through at least July 15, 2020, and includes the following notable items that may affect forward-facing tax controversy matters:

- **Field, Office, and Correspondence Audits:** In general, the IRS will not start new field, office, and correspondence examinations, with certain exceptions. One exception is that the IRS may initiate a new examination where it is deemed necessary to protect the Government's interests in preserving the pertinent statute of limitations.

- **In-Person Meetings:** In-person meetings regarding current field, office, and correspondence examinations will be suspended. IRS examiners will continue their examinations remotely, where possible.

- **Independent Office of Appeals:** Appeals employees will continue to operate, and although the Office of Appeals will not hold in-person conferences with taxpayers in the near term, conferences may be held over the telephone or by videoconference.

- **Statute of Limitations:** In instances where the limitations period will expire during the applicable period, the IRS intends to issue Notices of Deficiency and will pursue other similar actions to protect the interests of the Government and in the absence of a taxpayer's consent to extend the deadline. Where a statutory period is not set to expire during 2020, however, the IRS is unlikely to pursue a new action until July 15, 2020, at the earliest.

Although the People First Initiative provides some guidance and relief from the uncertainties that have arisen from the administration of a current or pending tax dispute with the IRS, it does not provide taxpayers any relief from pending deadlines. It is therefore important for taxpayers to meet any existing deadlines for responses and submissions to the IRS, particularly for matters before the Independent Office of Appeals, as the IRS has expressly indicated that the Office of Appeals will continue to process cases during this time.

Recent Tax Measures in the United Kingdom: An Overview

1. Time to Pay: deferral of tax payments

There are now two tax payment date extensions in effect in the United Kingdom.

These include:

- **3 month VAT deferral**: Businesses will not have to make VAT payments due in the period of March 20, 2020 until June 30, 2020, and will be given until March 31, 2021 to pay any liabilities that have accumulated during the deferral period. Deferred amounts will not be subject to interest or penalties. However, VAT returns will still need to be submitted on time.

- **6 month self-assessment deferral**: The self-employed income tax payment deadline has been extended from July 2020 to January 2021.

In addition to the extensions noted above, all UK businesses and self-employed individuals may be eligible for the 'time to pay scheme' operated by HMRC if they are in financial distress and unable to pay current tax obligations. Under the 'time to pay' scheme, HMRC can implement an instalment arrangement, and has the ability to agree to suspend debt collection proceedings and cancel interest and penalties, if necessary

2. SOCIAL DISTANCING AND TAX RESIDENCY

Individuals
Social distancing and quarantine measures have created significant challenges for non-UK tax residents, because physical location is a determining factor for tax residency and can trigger UK tax liabilities. Generally, tax residency is determined by the UK's statutory residence test ("SRT"). Although this is a multi-factor test, a critical consideration is the number of days an individual spends in the UK. Ordinarily, in any given tax year, a taxpayer is allowed to exclude up to 60 days spent in the UK on account of 'exceptional circumstances' under the SRT. Recently, HMRC has issued guidance as to what constitutes 'exceptional circumstances' during the COVID-19 pandemic.

According to HMRC, 'exceptional circumstances' can now include any days spent in the UK on account of:

- Quarantine or self-isolation at the advice of a health professional or public health guidance;
- UK Government restrictions barring travel from the UK as a result of the virus;
- International border closures preventing departure from the UK; or
- An employer's request that an employee return to the UK temporarily as a result of the virus.

Given the fast-paced and ever-changing nature of the UK Government's COVID-19 related advice, non-UK tax residents are advised to keep detailed records and collect as much documentation as possible reflecting the reasons they needed to stay in the UK longer than normal. This will help alleviate disputes regarding tax residency, and tax liability, that might arise at a later time with HMRC.

Corporations
Corporate residency status for tax purposes is also an important issue that could be impacted by quarantines and border closures. In general, the UK uses the "central management and control concept" to determine tax residency of corporations. This means that corporate UK taxation is likely to follow when the top-level executive decision-making power of a company is exercised within the UK.

<u>Non-UK resident corporation</u>
Directors of non-UK resident corporations need to be mindful of the location where key management decisions are made, so as not to inadvertently expose non-UK resident companies to UK tax

obligations. This is particularly important given that HMRC has yet to issue formal guidance relating to the impact of the COVID-19 pandemic on corporate tax residency.

At this time, it is advisable for non-UK companies with corporate directors currently in the UK to consider taking measures to decrease the likelihood of inadvertently becoming a UK corporate tax resident during the pandemic. Such measures could include temporary resignation of board members located in the UK, the deferment of major board decisions, and/or the appointment of additional directors located outside of the UK.

UK resident corporation

For corporations already deemed to have UK residency, there may be good reasons to maintain that status, including a relatively low corporation tax rate, access to tax treaties, and an exemption from dividends received from overseas subsidiaries.

Ordinarily, a non-UK incorporated company is treated as a UK tax resident if it regularly holds board meetings in the UK where central management and control is exercised. However, if the directors are currently not located in the UK and cannot physically get to the UK to hold board meetings as a result of the pandemic, then UK tax residency may be lost. This could have significant tax implications for the company, including corporation tax exit charges. A corporation that loses its status as a UK resident may also risk becoming a tax resident in other jurisdictions that use a similar corporate residency test, potentially giving rise tax charges in that country. It should therefore be considered whether the powers of the board could be delegated to other individuals who are located in the UK for the duration of the health crisis to help ensure that central management and control is still being exercised in the UK.

Permanent establishment

In the UK, if a non-resident company is treated as trading in the UK through a permanent establishment, this brings the income, profits, and gains attributable to that permanent establishment within the charge of UK corporation tax. Further, a UK resident individual who is employed by the non-resident company may be treated as its UK representative and the corporation tax liabilities of the non-resident company could be recovered from the UK resident individual (Corporation Tax Act 2010, s. 970).

The significant increase in employees working from home could cause local tax authorities to consider whether a non-resident corporate employer has formed a permanent establishment in the UK. This could be of particular concern where a senior employee, based in the UK, enters into agreements on behalf of the non-resident corporate employer. In these circumstances, the individual may be treated as having created a permanent establishment for the employing company under most double tax treaties, which treats a person who 'habitually concludes contracts' on behalf of a company as a permanent establishment in the jurisdiction where the individual is based.. Therefore, companies should consider adopting protocols to allow for individuals who are resident in the same country as the company (rather than those who are now based in the UK under lockdown) to authorize and sign contracts during these uncertain times.

3. Extension of HMRC's Functions under the Coronavirus Act 2020

New legislation in the UK relating to the COVID-19 pandemic is still developing and therefore the full scope of such legislation remains to be seen. For example, part 1, paragraph 76, of the Coronavirus Act 2020 (the "**Act**") states that: '*Her Majesty's Revenue and Customs are to have <u>such functions as the Treasury may direct</u> in relation to coronavirus or coronavirus disease*." (emphasis added). However, no formal clarification has been provided yet as to what is meant by the term 'functions' as it relates to the HMRC's new powers under the Act.

As a counterbalance to any extraordinary measures the UK Government may need to take during the current health crisis, the Act is subject to review at six-month intervals, and any powers granted are limited to the Government's COVID-19 response. While HMRC will no doubt be curbed in pursuing routine audits and investigations, HMRC's powers remain intact and are likely to be strengthened as a result of its increased burden of managing the COVID-19 tax response programs. Therefore, it is imperative that taxpayers continue to retain sound financial records, even when working remotely, and maintain good communication channels with HMRC to the fullest extent possible.

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If you have any questions about the recent taxation developments addressed in this memorandum or otherwise, please do not hesitate to reach out to us.