

Recent income tax changes may benefit equine industry



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As the COVID-19 pandemic continues to impact families and businesses across the country, government leaders have focused on helping Americans cope with the economic fallout of the virus. Over the past several weeks the Thoroughbred industry's focus has been on the various stimulus packages for which horse and farm owners may apply in order to help current cash flow.

In addition to these loan programs, the Coronavirus Aid, Relief, and Economic Security (CARES) Act, signed into law at the end of March, contains numerous income tax provisions benefiting taxpayers. Some of these provisions impact 2019 tax filings but might also provide amendment opportunities for 2018 tax filings. Other changes are effective for tax years beginning in 2020. The goal of all of these income tax provisions is to accelerate cash refunds or to keep cash with individuals and businesses.

Below, we break down some of the recent tax changes that might benefit individuals and businesses in the equine industry.

A note on income tax deadlines

Before diving into the CARES Act, it is important to note some changes to income tax deadlines. In response to COVID-19, the Department of Treasury has postponed to July 15 the deadline for most federal income tax returns and payments due on or after April 1 and before July 15, 2020. This extension applies to federal income tax returns and payments for the 2019 tax year that are normally due by April 15. It also applies to first and second quarter estimated income tax payments for tax year 2020, which would otherwise be due April 15 and June 15. For taxpayers struggling with cash flow in the wake of the pandemic, postponement of these tax payment deadlines allows them to retain cash a little longer.

Elimination of the excess business loss limitation for tax years 2018-20

In a big win for the equine industry, the CARES Act retroactively postpones implementation of the excess business loss (EBL) limitation until tax years beginning after Dec. 31, 2020. The Tax Cuts and Jobs Act (TCJA), passed at the end of 2017, introduced a limitation on business losses deductible by individuals and other non-corporate taxpayers (trusts and estates) against non-business income. This is calculated at the individual level and not at the pass-through entity level, as individuals combine all business activities when determining overall net business income or loss. Specifically, the TCJA disallowed net 2018 tax losses from active businesses in excess of \$250,000 (for individual taxpayers) and \$500,000 (for joint filers), adjusted annually for inflation. Disallowed losses are treated as net operating loss carryforwards to the following tax year. Under the TCJA, the EBL limitation was effective for tax years 2018 through 2025.

Many horse and farm owners who used income tax incentives—such as the 100% bonus depreciation—were subject to this EBL limitation beginning in 2018, which often resulted in a one-year deferral of this EBL.

The CARES Act retroactively postpones the effective date of the EBL limitation until tax years beginning in 2021. Taxpayers that filed a 2018 tax return reflecting a disallowed EBL or a 2019 tax return reflecting a disallowed EBL (or a carryover of a disallowed EBL from 2018) should consider amending those returns. On a less favorable note, once the EBL limitation returns in 2021, W-2 wages will no longer be included in the net business calculation.

Favorable changes to net operating losses

The CARES Act also makes taxpayer-friendly changes to the rules governing net operating losses (NOLs). The TCJA generally eliminated the ability of taxpayers to carry NOLs back to prior tax years, with the exception of farm losses, which could be carried back two years. This change was effective for tax years beginning after Dec. 31, 2017. Prior to the TCJA, taxpayers were permitted to carry NOLs back two years (or five years for farm losses) or forward 20 years.

The CARES Act reinstates carrybacks of NOLs arising in tax years beginning after Dec. 31, 2017 and before Jan. 1, 2021, allowing these losses to be carried back five years. This applies to both corporations and individuals, trusts and estates with net business losses. NOLs eligible for the five-year carryback period include farm losses, which would otherwise be subject to a carryback period of two years under the TCJA. Corporations that were subject to a 35% tax rate before the TCJA reduced the corporate rate to 21% as of Jan. 1, 2018, might particularly benefit from carrying back NOLs.

For NOLs arising in tax years beginning after Dec. 31, 2017, the TCJA also limited the NOL deduction to 80% of a taxpayer's taxable income.

The CARES Act suspends application of the 80% taxable income limitation for tax years beginning after Dec. 31, 2017, and before Jan. 1, 2021, allowing losses to offset 100% of taxable income.

These modifications to the NOL rules permit taxpayers to use NOLs to a greater extent to offset taxable income in prior or current tax years, providing taxpayers with liquidity in the form of tax refunds and reduced current tax liability. The IRS is temporarily accepting faxed refund claims for NOL carrybacks and the corporate AMT credit discussed below in order to expedite these refunds.

Acceleration of ability to claim corporate minimum tax credits

Before the TCJA, corporations were subject to an alternative minimum tax (AMT), which was imposed if the AMT calculation resulted in a greater tax liability than the liability computed under the regular income tax. If a corporation was subject to AMT, the amount of the AMT was allowed as a minimum tax credit in any later tax year to the extent the corporation's regular tax liability exceeded its tentative minimum tax in the later year.

The TCJA repealed the corporate AMT for tax years beginning after Dec. 31, 2017. It also established a method for taxpayers to use their AMT credit carryforwards fully by the end of tax year 2021.

The CARES Act accelerates the ability of corporations to claim AMT credits. Under the CARES Act, corporations can claim 100% of the credit by the end of either tax year 2018 or 2019. Corporations seeking to accelerate an AMT credit refund for tax year 2018 can utilize a "quick" refund procedure by filing Form 1139 with the Internal Revenue Service.

Increased tax benefits for charitable contributions during 2020

The CARES Act modifies certain rules governing charitable contributions, providing taxpayers with greater tax incentives to donate to charitable organizations. For individual taxpayers who do not itemize deductions, the CARES Act creates a \$300 above-the-line deduction for cash contributions to qualifying charitable organizations made during a tax year beginning in 2020. This change benefits taxpayers taking the standard deduction, who otherwise would not be able to deduct charitable contributions.

In addition, the CARES Act changes the limitations on individual and corporate cash contributions to charitable organizations during 2020. Generally, individuals are allowed a deduction for cash contributions to qualifying charitable

organizations of up to 60% of their adjusted gross income (AGI). The CARES Act removes this limitation for cash contributions made during 2020 only, allowing individuals to offset 100% of their AGI by making cash contributions to qualifying charitable organizations during the current year.

For corporations, charitable contribution deductions generally cannot exceed 10% of taxable income. This limitation is increased to 25% of taxable income for cash contributions made to qualifying charitable organizations during 2020.

The new rules do not apply to cash contributions made to donor-advised funds or to certain supporting organizations.

Like nearly every other industry in the country, the equine business has been tremendously impacted by the COVID-19 pandemic. With postponed or canceled racing and sales and the uncertainty for what will happen during the rest of the year, the need to maximize cash flow remains a top priority. The recent income tax changes in the CARES Act can provide some liquidity to industry participants and assist in weathering this storm.