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Managers with Operating Losses Get a Boost from CARES Act Tax Changes

By Lisa FuApril 22, 2020

Asset managers that experience net operating losses this year may qualify for some additional tax relief under the newly enacted CARES Act.

A change to the net operating loss (NOL) carry back rule embedded in a stimulus package is generating interest among asset managers, according to **PWC** partner **Tom Holly**. Asset managers are eager to participate in the CARES Act programs, but some are excluded from provisions such as the SBA loan or payroll tax credit because of their larger headcounts, he says.

Those that do not want to apply to the government programs or do not qualify for certain provisions may still be able to benefit from the net operating loss tax change included in the legislation. The rule change allows some companies to receive a bigger tax refund by carrying back today's losses to a prior year, Holly explains.

The net operating loss carry back rule is probably the most significant tax change included in the CARES Act for asset managers, according to **Erik Corwin**, principal in the corporate group of **KPMG**'s Washington national tax practice. The rule change allows firms that experience net operating losses today to claim money back from taxes paid in prior years. An asset manager with a net operating loss in 2020 can now claim money back from up to five years ago. This is significant because the tax rate in years prior was higher than it is today, and thus, a firm can get more money back by claiming the loss in 2016, when the tax rate was 35%, than in 2019, when the tax rate was just 21%.

The rule change also increases the amount of net operating loss that a firm can deduct in a single tax year from 80% of adjustable taxable income to 100% of adjustable taxable income for years 2018 to 2020.

For example, an asset management firm organized as a C-corporation can take a $100 loss from 2020 and carry it back to 2016, a year where the firm made $100 and paid a 35% tax rate. Even though the firm incurred the loss in 2020, when the corporate tax rate was just 21%, the rule change would allow the firm

to claim a refund from a year where the tax rate was 35%. Thus, the firm would recover $35, instead of the lower amount it would receive if getting a refund based on 2019 tax rates.

"All of these things add up to greater liquidity, more ability to have cash in hand," Corwin says. "I would expect to the extent that they are available to particular taxpayers to improve [their] liquidity position, [asset managers are] going to take advantage of it."

Asset managers, like other companies, are experiencing business disruptions during this time, and some of them may be in need of liquidity, Corwin says. This can be due to potential declines in assets under management, clients pulling out money because they no longer want to be in the market, or because the work-from-home environment has increased costs for the firm, he explains.

Asset managers organized as partnerships or S-corporations will feel the impact of the NOL and other tax changes at the partner level or S-corporation shareholder level because they are flow-through entities, according to Corwin. Because the partnership itself would not have a net operating loss that it could carry back, everything would have to flow through the individual partners. Small asset management firms organized as C-corporations will benefit from these changes more directly.

To take advantage of these CARES Act-related tax changes, managers do not need to apply for an SBA loan, register with the government, or publicly disclose additional information, Corwin adds.

Asset managers interested in receiving the tax refund should consider the potential benefits in balance with other factors such as international income tax regulations as there can be some complexities, PwC's Holly says.

Corporate taxpayers will be some of the biggest beneficiaries of the NOL rule changes, says **Marcum** tax and business services partner **Martin Martinez.**

The CARES Act works by first, keeping small firms in business by offering SBA loans and tax credits and second, monetizing some of the net operating losses, he explains.

"[The government's] trying to infuse liquidity in the market. That's the whole purpose of the CARES Act," Martinez says.

Fund managers in the private equity and real estate space will get even greater benefits from the CARES Act tax changes because of their flow through structure, Martinez says. These firms should look into the new qualified improvement property (QIP) rules, which accelerate the depreciation for certain qualified improvements on a property, according to Martinez. The bonus depreciation may create additional net operating losses, allowing firms to claim a greater refund.

Fund managers that are highly leveraged will also benefit from the adjustment to the 163 J interest expense limitation, he says. The change will allow firms to apply business interest deductions on up to half of their adjustable taxable income instead of 30% previously, according to Martinez. That means a

highly leveraged firm will get a higher deduction with respect to the interest expense, and the firm will likely fall into a lower taxable income base in 2020, he explains.

The 163 J limitation rules really apply to firms that are not structured as C-corporations, says **Seth Lebowitz**, a tax group partner at **Sadis**.

The increase on business interest deductions will likely benefit larger managers, he says.

Generally, the industry will have to wait until the end-of-year results come in to see how much asset managers will benefit from these CARES Act tax changes, according to Lebowitz. It is still early days and a lot of the tax benefits will depend on the results because the net operating loss changes are only beneficial if an asset management firm has a net operating loss to begin with, he says.