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Insights

Changes to Net Operating Loss Carryback Rules May Provide Opportunities

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[Updated April 17, 2020] The IRS posted updated FAQ's related to temporary procedures permitting refund claims, requested on Form 1045, Application for Tentative Refund, or Form 1139, Corporation Application for Tentative Refund, to be submitted via fax to 844-249-6237. Only claims allowed under the CARES Act, refund claims related to net operating losses, as described in this alert, are eligible refund claims under these temporary procedures.

The Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") provides a temporary option to carry back net operating losses ("NOLs") for five-years for most taxpayers.

Background

This provision is essentially a short-term reversal of the NOL carryback repeal enacted by the Tax Cuts and Jobs Act of 2017 ("TCJA"). Prior to the passage of the TCJA, taxpayers were able to carry back NOLs for two years and then carry forward any remaining NOLs for twenty years. These NOLs were available to offset up to one hundred percent of taxable income in each tax year. In addition to eliminating the ability to carry back NOLs, the TCJA imposed a limit on the deduction of NOL carryforwards to eighty percent of taxable income (the 80% limitation).

General Liquidity Opportunity from NOL Generated Refunds

Under the CARES Act, NOLs generated in tax years beginning after December 31, 2017 and before January 1, 2021 may now be carried back to offset taxable income earned during the five-year period prior to the year the NOL was generated. In addition, the CARES Act temporarily removes the 80% limitation on NOL carryforwards, permitting taxpayers to offset one hundred percent of taxable income in tax years 2018, 2019 and 2020.

These changes may provide additional liquidity opportunities for taxpayers that normally have taxable income but because of the current COVID-19 breakout are anticipating an NOL in the current tax year or that had NOLs in 2018 or 2019 that were previously subject to the 80% limitation. The ability to carry back NOLs generated in a year in which the corporate tax rate was 21% (as modified by the TCJA) to an earlier tax year where the tax rate was 35% may provide much needed liquidity. However, taxpayers are cautioned that there are numerous considerations to be worked through before deciding to utilize this temporary rule change, including various documentation requirements to support the NOLs and navigating the potentially negative impact of such carrybacks on other tax provisions (*e.g.*, tax credits).

Under the general rules of Section 172 of the Internal Revenue Code, NOLs allowed by the CARES Act must first be carried back to the tax year beginning five years before the year the loss was generated. Any unused NOL may then be applied to more recent years until fully utilized. Partnerships seeking to utilize this short-term NOL carryback option will need to utilize the temporary procedural relief provided to partnerships under recently released Re**venue Procedure 2020-23**. Corporate taxpayers seeking to utilize the NOL carryback rules will need to file IRS Form 1139, *Corporate Application for Tentative Refund*, or file an amended tax return for the year in which the NOL deduction is to be claimed.

Opportunity for a Fresh Look at Recent Acquisitions

The NOL changes summarized above may provide opportunities for tax savings arising from sales events occurring since January 1, 2018. Specifically, if a business was sold since the 2018 threshold for the NOL changes under the CARES Act, and was in a loss position during the year of the sale, it may that the seller is now entitled to unexpected tax refunds resulting from previously disallowed NOL carrybacks. Obviously, it will be necessary to review the terms of applicable transaction agreements in order to determine how such losses are allocated. However, taxpayers in such situations should consider undertaking such an analysis.

If you have any further questions, comments or concerns, please feel free to contact **Kendall A. Schnurpel** or a member of our **Business, Acquisitions & Securities team**.