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A Taxpayer's Ability to Use Net Operating Losses Was Significantly Restricted by the TCJA, but the CARES Act Temporarily Loosens Things up – The Proper Use of NOLs Could Prove To Be an Important Strategy in Your Game Plan During These Challenging Times

By Larry Brant and Steven Nofziger and Peter Evalds on 4.16.20 | Posted in Federal Law, Legislation, Tax Laws

Like other commentators, we have been writing extensively about the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), the historic \$2.2 trillion relief package enacted last month by lawmakers in the wake of the COVID-19 pandemic.

In a [prior post](#), we provided a summary and analysis of numerous tax provisions of the CARES Act.

In this post, we expand on our previous coverage of the CARES Act relative to net operating losses (“NOLs”), and provide an overview of new guidance issued by the IRS.

Background

Before 2018, taxpayers could carry back NOLs from a current taxable year to the two preceding taxable years (receiving a tax refund if the NOL could be used against income on which tax had already been paid) in addition to carrying NOLs forward up to 20 years.

The Tax Cuts and Jobs Act (“TCJA”), signed into law on December 22, 2017, dramatically changed the NOL landscape. One of the TCJA’s many provisions eliminated a taxpayer’s ability to carry back NOLs (except for farm losses). After the TCJA, NOLs could only be carried forward. The 20-year limitation, however, was removed from the law. So, NOLs could be carried forward indefinitely.

The TCJA further limited the use of NOLs. Beginning in 2018, NOLs could only be used in another taxable year to offset 80 percent of the amount of taxable income in that taxable year (ignoring the NOL itself).

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Practice Alert: It is important to note that NOLs arising prior to 2018 are still governed by the old law. So, these NOLs may be used to offset income in the manner provided under pre-TCJA law (i.e., they may be carried back two years or carried forward up to 20 years, and they may be used to offset 100 percent of taxable income).

CARES Act

The CARES Act temporarily changes the treatment of NOLs. In essence, it temporarily suspends the TCJA provisions relative to NOLs.

1. The CARES Act provides (except for REITs) that NOLs arising in taxable years ending after December 31, 2017, and before January 1, 2021, shall be carried back to each of the five taxable years preceding the taxable year of the loss. So, 2018, 2019 and 2020 NOLs are to be carried back five years.
2. The CARES Act also amends the NOL provisions to remove the limitation that NOLs could be used to offset no more than 80 percent of taxable income (ignoring the NOL itself). So, 2018, 2019 and 2020 NOLs are not subject to the 80 percent limitation.
3. These two changes are temporary. They only apply to taxable years beginning before January 1, 2021. In 2022, the TCJA's NOL provisions spring back into life.

Practice Alert: Now more than ever, it is important that taxpayers keep good records relative to NOLs. There now exist at least three categories of NOLs that have to be tracked and accounted for separately: (i) pre-2018 NOLs, which are governed by pre-TCJA law; (ii) 2018, 2019 and 2020 NOLs, which are governed by the CARES Act; and (iii) 2021 and beyond NOLs, which are governed by the TCJA.

Waiver of NOL Carryback Period; Revenue Procedure 2020-24

As a general rule, a taxpayer with NOLs is required to carry back the NOLs to prior taxable years before the taxpayer may carry any remaining NOLs forward. In accordance with Code Section 172(b)(3), however, taxpayers may elect to irrevocably waive the carryback requirement in a manner prescribed by the U.S. Secretary of the Treasury.

Revenue Procedure 2020-24 provides that guidance with respect to waiving the carryback of NOLs arising from tax years beginning in 2018 or 2019:

1. The taxpayer must make an election to waive the NOL carryback period no later than the due date (including extensions) for filing the taxpayer's federal income tax return for the first taxable year ending after March 27, 2020;

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2. The election must be made by attaching to such return a separate statement for each tax year (2018 and/or 2019) for which the taxpayer intends to make the election; and
3. Each statement must state: (a) that the taxpayer is electing to apply Code Section 172(b)(3) under Revenue Procedure 2020-24; and (b) the tax year for which the statement applies.

Practice Alert: A taxpayer may want to waive the carryback of NOLs. For example, assume a taxpayer had a \$4.7 million NOL arising from tax year 2018, and it has a 2019 income tax return to be filed on or before July 15, 2020 with \$4 million in income taxes owing. In this case, the taxpayer would likely want to carry the NOL forward from 2018 to 2019 to currently apply it against the 2019 tax bill, greatly reducing its out-of-pocket payment of taxes this year. The alternative would be for the taxpayer to carry the NOL back five prior tax years and wait patiently for the IRS to issue refunds for those tax years. Even if a taxpayer is eligible to obtain a fast track carryback adjustment (discussed below), time is of the essence for most American businesses these days. The delay in obtaining a much needed refund could be devastating to the business. In these turbulent economic times, the former approach will likely be a better approach for most taxpayers.

Practice Alert: The CARES Act provides special rules with respect to the intersection of NOL carrybacks and Code Section 965 (the transition tax for certain foreign corporations). Revenue Procedure 2020-24 also provides guidance with respect to making an election to exclude from the NOL carryback period for an NOL arising in a taxable year beginning after December 31, 2017, and before January 1, 2021, any taxable year in which the taxpayer has a Code Section 965(a) inclusion. Taxpayers for whom Code Section 965 applies should review Section 4.01(2) of Revenue Procedure 2020-24.

Application for Tentative Carryback Adjustment; Notice 2020-26 and FAQs

Code Section 6411 allows a taxpayer to file an application for a tentative carryback adjustment of the tax liability with respect to a prior tax year. Under Treasury Regulations Section 1.6411-1, corporations make the application on Form 1139 and other taxpayers make the application on Form 1045.

Taxpayers must file the application within 12 months of the close of the taxable year in which the NOL arose. The tentative carryback adjustment procedure allows a taxpayer to obtain a relatively fast tentative tax refund based on an NOL carryback. In accordance with Code Section 6411(b), the IRS will, within **90 days** of the taxpayer's filing of the application, conduct a limited examination of the application and make the appropriate credit or refund. Keep in mind, for many businesses today, 90 days may be too long to wait. So, carrying a 2017 or 2018 NOL forward to cover a 2019 tax liability may be preferable.

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Practice Alert: Notice 2020-26 gives taxpayers an automatic six-month extension to file Form 1045 or Form 1139, provided the NOLs arose in a taxable year that began during 2018 and ended on or before June 30, 2019.

Practice Alert: Even with the extension of time granted by Notice 2020-26, applications for a tentative carryback adjustment have to be filed within a specific timeframe (i.e., within 12 months of the close of the taxable year in which the NOL arose, or with respect to NOLs arising in a taxable year that began during 2018 and ended before June 30, 2019, within 18 months of the close of the taxable year in which the NOL arose).

Under FAQs posted on the [IRS website](#), the IRS is allowing taxpayers to file Forms 1139 and 1045 by fax. See the FAQs for fax numbers. **Note that the fax numbers will not be operational until April 17, 2020.**

Practice Alert: Taxpayers who already mailed in a Form 1139 or 1045 may also fax in a copy of the form using the procedures under the FAQs.

Practice Alert: Section 4.04 of Revenue Procedure 2020-24 provides guidance regarding applications under Code Section 6411(a) for tax years that began in 2017 and ended in 2018.

The temporary allowance of NOL carrybacks could prove to be an important tax planning tool for many taxpayers. Today, with the expectation of 2020 operating losses for many U.S. businesses, the ability to carry back a NOL to a prior year and obtain a refund may serve to help finance a business during these horrific times. Of course, do not forget the ability to waive the carryback requirement in situations where carrying the NOL forward would better serve the taxpayer. Keep in mind, the TCJA limitations on NOLs spring back into life in 2022.

With all of the COVID-19 related legislation and guidance from the IRS and Treasury coming at us daily, it is quite difficult for tax advisers to keep track of all of the moving pieces. Nevertheless, it is likely more important than ever that tax advisers understand the new legislation and IRS/Treasury guidance so that they can assist taxpayers in navigating the challenges they face today. We have to weather this storm!

Tags: CARES Act, Carryback Adjustment, Carryback Period, Coronavirus, COVID-19, IRS, net operating losses, Tax Cuts and Jobs Act, Taxpayer, Treasury