

CARES Act Lifts NOL Restrictions Imposed by Tax Reform

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On March 27, 2020, the Coronavirus, Aid, Relief and Economic Security Act (the “CARES Act”) was signed into law; it is an approximately \$2 trillion relief package for businesses and individuals impacted by the coronavirus outbreak.

The CARES Act provides that net operating losses (“NOLs”) arising in tax years beginning after December 31, 2017 and before January 1, 2020 may be carried back to five years preceding the year of such loss.^[1] The CARES Act reverses restrictions put in place under the Tax Cuts and Jobs Act (“TCJA”), which denied NOL carrybacks but allowed indefinite carryforwards. Pursuant to such changes, corporate taxpayers that have incurred losses in the last two tax years or in the current tax year may obtain a refund of taxes paid in the five preceding years of the loss. Such carrybacks are particularly valuable to corporate taxpayers that have income that may be offset in 2017 and prior years, during which time corporations were subject to a 35% federal income tax rate rather than the current 21% corporate tax rate. Corporations that were profitable in 2018 and 2019 and are only in a loss position for the current taxable year generally must wait until after the end of year to claim refunds attributable to NOL carrybacks.

Additionally, the CARES Act temporarily removes another restriction under the TCJA, which limits the use of NOLs to 80% of taxable income computed without regard to NOLs.^[2] This 80% restriction is reinstated for tax years beginning after December 31, 2020.³ Taxpayers may still waive carrybacks and elect to carry NOLs forward to subsequent tax years.^[4]

Under general timing rules of section 172 and applicable Treasury Regulations, losses that are carried back are carried to the earliest tax year to which the loss may be carried.^[5] Taxpayers may claim refunds under the carryback provisions by filing IRS Form 1045 (for individuals, estates, and trusts) or IRS Form 1139 (for corporations). Refunds are generally processed within 90 days (or the last day of the month in which the tax return reflecting the NOL is due, including extensions, if later).

Special rules apply for REITs. Under the CARES Act, a taxpayer may not carry back NOLs to a year when the taxpayer was a REIT and NOLs of a REIT may not be carried back to any tax year, regardless of whether the taxpayer was a REIT or not.^[6]

Further, the new carryback rules under the CARES Act prevent NOL carrybacks from being used to offset prior income inclusions under section 965. A taxpayer with section 965 income inclusions is deemed to have made an election under that section not to use NOLs to offset the section 965 amount.^[7]

Taxpayers should consider the use of such NOL carrybacks and how it may affect other tax attributes, such as foreign tax credits and any impact it may have on the taxpayer's AMT liability in such prior years. Further, with respect to any carrybacks into 2018 or 2019, taxpayers should consider how such carrybacks will affect calculations related to a section 163(j) interest deduction limitation or a section 250(a)(2) limitation on global intangible low-taxed income ("GILTI") and foreign-derived intangible income ("FDII").

Additionally, taxpayers that have engaged in acquisitions occurring during the 2018 through 2020 tax periods should analyze any tax refund provisions in their purchase agreements, as many provisions specify whether sellers or buyers are entitled to refunds arising from NOL carrybacks.

¹¹ CARES Act Section 2303(b)(1), Code Section 172(b)(1)(D)(i).

¹² CARES Act Section 2303(a)(1); Code Section 172(a).

¹³ CARES Act Section 2303(a)(2); Code Section 172(a).

¹⁴ Code Section 172(b)(3).

¹⁵ Code Section 172(b)(2); Treas. Reg. § 1.172-4(b)(1).

¹⁶ CARES Act Section 2303(b)(1)(ii); Code Section 172(b)(1).

¹⁷ CARES Act Section 2303(b)(1)(iv); Code Section 172(b)(1).

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