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CARES Act Update: IRS and Treasury Department Release Net Operating Loss Guidance

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On April 9, 2020, the IRS and Treasury Department released ***Revenue Procedure 2020-24*** (the Revenue Procedure) and ***Notice 2020-26*** (the Notice). The Revenue Procedure provides technical guidance for corporations with respect to the net operating loss (NOL) provisions of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), including the procedures for waiving the new five-year carryback period and excluding from such carryback period any taxable year for which the corporation has an inclusion (a Section 965 Inclusion) under Section 965 of the Internal Revenue Code of 1986, as amended (the Code). The Notice extends the deadline for filing a Refund Claim (as defined below) with respect to an NOL that arose in a taxable year beginning during 2018 and ending on or before June 30, 2019.

Background

The CARES Act made ***several amendments*** to the Code related to the utilization of NOLs. Among them, the CARES Act allows corporations to carry back NOLs arising in taxable years beginning after 2017 and before 2021 (Eligible NOLs) to the five previous taxable years. The amendment is similar to the carryback rules that were in place prior to the Tax Cuts and Jobs Act (TCJA), which generally gave corporate taxpayers the ability to carry back an NOL to the two previous taxable years in order to offset taxable income in those years. The CARES Act amendments provide corporate taxpayers the flexibility to waive the carryback of Eligible NOLs (the General Waiver Election), which is consistent with the NOL carryback rules prior to the TCJA.

The CARES Act also included changes to the Code that impact the application of the five-year carryback period to the one-time transition tax under Code Section 965 (the Transition Tax). The Transition Tax, originally imposed by the TCJA, required a U.S. shareholder to include in taxable income, as of the end of 2017, its share of a specified 10 percent-owned foreign corporation's untaxed foreign earnings as if such earnings had been repatriated to the United States. Under the CARES Act, a corporate taxpayer can elect to exclude from its NOL carryback period any taxable year with a Section 965 Inclusion (the Section 965 Waiver Election). Alternatively, if the corporation does not make a General Waiver Election or Section 965 Waiver Election with respect to a taxable year with a Section 965 Inclusion, the corporation will be deemed to make an election under Code Section 965(n) (the Section 965(n) Election) with respect to the carryback of an Eligible NOL to a taxable year with a Section 965 Inclusion, in which case such Eligible NOL would be eligible to offset only non-Section 965 income for such taxable year.[1]

The Revenue Procedure

The Revenue Procedure provides guidance regarding the time and manner for making the General Waiver Election. A corporate taxpayer may make a General Waiver Election for an Eligible NOL arising in a taxable year beginning in 2018 or 2019 by attaching an election statement to its federal income tax return for the first taxable year ending after March 27, 2020. Such election must be made no later than the due date, including extensions, for filing such federal income tax return. The corporation must attach a separate election statement with respect to Eligible NOLs arising in each of 2018 and 2019. The election statement must state that the corporation is making the General Waiver Election pursuant to the Revenue Procedure and the taxable year for which the election applies. Once made, the General Waiver Election is irrevocable.

The Revenue Procedure also provides guidance regarding the time and manner for making the Section 965 Waiver Election. A corporate taxpayer may make a Section 965 Waiver Election for an Eligible NOL arising in a taxable year beginning in 2018, 2019 or 2020 by attaching an election statement to the earliest filed, after April 8, 2020 (the effective date of the Revenue Procedure), of:

- the corporation's federal income tax return for the taxable year in which the Eligible NOL arises,

- the corporation's refund claim on IRS Form 1045 (Application for Tentative Refund) or IRS Form 1139 (Corporation Application for Tentative Refund) (each, a Refund Claim), in each case, carrying back the Eligible NOL to a taxable year in the five-year carryback period, or

- the corporation's amended federal income tax return carrying back the Eligible NOL to the earliest taxable year in the five-year carryback period that does not have a Section 965 Inclusion.

The election statement must be made (a) in the case of an Eligible NOL arising in a taxable year beginning in 2018 or 2019, no later than the due date, including extensions, for filing the corporation's federal income tax return for the first taxable year ending after March 27, 2020, and (b) in the case of an Eligible NOL arising in a taxable year beginning after 2019 and before 2021, no later than the due date, including extensions, for filing the corporation's federal income tax return for the taxable year in which such Eligible NOL arises. The election statement must state that the taxpayer is making the Section 965 Waiver Election pursuant to the Revenue Procedure, the taxable year in which the Eligible NOL arose, and each taxable year that the corporation had a Section 965 Inclusion. Once made, the Section 965 Waiver Election is irrevocable.

Finally, the Revenue Procedure provides guidance with respect to NOLs arising in taxable years beginning before January 1, 2018 and ending after December 31, 2017 (a 2017-2018 Fiscal Year), which may be relevant for corporate taxpayers with a taxable year that is different from the calendar year. The TCJA prohibited such a corporation from carrying back NOLs from a 2017-2018 Fiscal Year, which generally was viewed as an unintended result of the legislation. The CARES Act retroactively corrected this issue by permitting a corporate taxpayer to carry back an NOL incurred during a 2017-2018 Fiscal Year by filing a Refund Claim. The Revenue Procedure provides that, solely with respect to NOLs arising in a 2017-2018 Fiscal Year, the taxpayer's Refund Claim will be timely if filed no later than July 27, 2020. Similarly, the Revenue Procedure provides that certain elections with respect to NOLs arising in a 2017-2018 Fiscal

Year, including the General Carryback Waiver, will be treated as timely filed if filed no later than July 27, 2020. The corporation may file such elections by attaching an election statement to an amended federal income tax return or Refund Claim, which identifies the relevant election, the period for which it applies, and the taxpayer's basis and entitlement to make the election, and states that the taxpayer is making such election pursuant to the Revenue Procedure.

The Notice

The Notice grants a six-month extension to file a Refund Claim with respect to an Eligible NOL that arose in a taxable year beginning in 2018 and ending on or before June 30, 2019. Without the extension, the deadline for such a Refund Claim would be 12 months of the close of the taxable year in which the Eligible NOL arose. Accordingly, as a result of the extension, corporate taxpayers have the opportunity to file such a Refund Claim up to 18 months after the close of the taxable year in which the Eligible NOL arose. The corporation must indicate on the applicable Refund Claim that such claim being made pursuant to the six-month extension permitted under the Notice.

The six-month extension is available only to those corporations requesting a tentative refund to carry back an Eligible NOL that arose in a taxable year beginning in 2018 and ending on or before June 30, 2019, and does not extend the time to carry back any other item (including, for example, a tentative refund claim for an alternative minimum tax credit).

Frequently Asked Questions

The IRS has provided further guidance clarifying certain topics in the Revenue Procedure and the Notice in a series of publicly-available ***frequently asked questions***.

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[1] Under the TCJA, a corporate taxpayer could make a voluntary Section 965(n) Election in order to prevent NOL carryforwards from offsetting a Section 965 Inclusion. Such an election could prove beneficial for a corporation with a Section 965 Inclusion in a carryforward year, for example, by permitting such corporation to preserve its NOLs and use other tax attributes, including foreign tax credits, to offset the Section 965 Inclusion.