CARES ACT 2020
NET OPERATING LOSS CHANGES

The CARES Act amended §172(b)(1) to provide for a carryback of any net operating loss (NOL) arising in a taxable year beginning after 12/31/17, and before 1/1/21, to each of the five taxable years preceding the taxable year in which the loss arose (carryback period). See §172(b)(1)(D).

As a result of that amendment, taxpayers take into account such NOLs in the earliest taxable year in the carryback period, carrying forward unused amounts to each succeeding taxable year. Rev. Proc. 2020-24, §4.01(1) provides guidance as to when and how to file the irrevocable election under §172(b)(3) to waive the NOL carryback period for an NOL arising in a taxable year beginning after 12/31/17, and before 1/1/20.

To make the election to waive the carryback period for an NOL arising in a taxable year beginning in 2018 or 2019, the taxpayer must attach to its timely filed (including extensions) Federal income tax return for its first taxable year ending after 3/27/20, a separate statement for each taxable year for which the taxpayer intends to make the election that states the taxpayer is electing to apply §172(b)(3) under Rev. Proc. 2020-24 and the taxable year for which the statement applies. Once made, the election is irrevocable.

Additionally, under pre-CARES Act §172(a) the amount of the NOL deduction was equal to the lesser of (1) the aggregate of the NOL carryovers and NOL carrybacks to such year, or (2) 80% of taxable income computed without regard to the NOL deduction allowable under §172. Thus, NOLs were subject to a taxable-income limitation and could not fully offset income.

The CARES Act temporarily removes the taxable income limitation to allow an NOL to fully offset income. For taxable years beginning before 1/1/21, taxpayers can take an NOL deduction equal to 100% of taxable income (rather than the 80% limitation under prior law).

For taxable years beginning after 12/31/20, taxpayers will be able to deduct the sum of (1) the aggregate amount of NOLs arising in taxable years beginning before 1/1/18 that are carried to such taxable year, plus (2) the lesser of (a) the aggregate amount of NOLs arising in taxable years beginning after 12/31/17 that are carried to such taxable year, or (b) 80% of the excess (if any) of taxable income computed without regard to the deductions under §172, §199A, and §250, over the amount of NOLs deducted under (1) above.

Furthermore, under pre-CARES Act §461(l), for taxable years beginning after 12/31/17, and before 1/1/26, individuals (or estates or trusts) that own businesses directly or as partners in a partnership or shareholders in an S corporation, with net tax losses from active businesses in excess of an inflation-adjusted $500,000 for joint filers or an inflation-adjusted $250,000 for

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other covered taxpayers, were to treat the excess as a NOL for the taxable year for purposes of determining any NOL carryover under §172(b). However, the CARES Act retroactively postponed these limits so that they only apply to taxable years beginning after 12/31/20 and before 1/1/26, so taxpayers can now deduct what would otherwise have been excess business losses arising in 2018, 2019, and 2020.

Note: §461(l)(3)(A) provides that an “excess business loss” is the excess of the taxpayer's aggregate trade or business deductions for the taxable year over the sum of the taxpayer's aggregate trade or business gross income or gain plus $250,000 ($500,000 if filing a joint return).

To carry back an NOL arising in 2018, 2019, or 2020, individuals, estates, and trusts can either file amended returns for each carryback year, or they may file Form 1045 to apply for a tentative carryback adjustment of the tax liability for a prior taxable year affected by the NOL carryback. In addition to relieving the taxpayer (and their preparer) from the burden of filing multiple amended returns, the tentative carryback adjustment procedure allows the taxpayer to obtain a quick (within 90 days of the filing) tentative tax refund based on the NOL carryback.

Sec. 6411(a) requires a Form 1045 to be filed on or after the date of filing the return for the taxable year of the NOL from which the carryback results and within a period of 12 months after such taxable year. Therefore, for an NOL that arose in a taxable year beginning after 12/31/17 and ended before 3/27/19 (one year prior to the date of enactment for the CARES Act), the window to file Form 1045 had already expired by the time of the enactment of the new law. However, under Notice 2020-26, Treasury and the IRS have granted a 6-month extension of time to file Form 1045 to taxpayers that have an NOL that arose in a taxable year that began during calendar year 2018 and that ended on or before 6/30/19. Therefore, calendar year taxpayers with NOLs that arose during 2018 have until 6/30/20 to file Form 1045 to carryback the 2018 NOLs. Taxpayers filing Form 1045 within the 6-month extension must include the following statement on the top of the Form 1045: Notice 2020-26, Extension of Time to File Application for Tentative Carryback Adjustment. See also Rev. Proc. 2020-24, §4.04(2).

Finally, under Rev. Proc. 2020-24, §4.04(1) for an NOL arising in a taxable year that began before 1/1/18, and ended after 12/31/17, a taxpayer may file a Form 1045 NLT 7/27/20. Elections for such taxable years with an NOL to waive any carryback period, to reduce any carryback period, or to revoke any election made under §172(b) to waive any carryback period will be treated as timely filed if done so NLT 7/27/20. A taxpayer may file such elections where the taxpayer files its Federal income tax return by attaching the statement required to make the election, with "Filed pursuant to Rev. Proc. 2020-24" at the top, to an amended return, Form 1045, or Form 1139 containing only the taxpayer's name, address, and taxpayer identification

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number. The statement required to make the election must indicate the section under which the election is being made and shall set forth information to identify the election, the period for which it applies, and the taxpayer's basis and entitlement to make the election.

To further ease the administrative burden for taxpayers, the IRS has also implemented temporary procedures for digital transmission of Form 1045s filed to claim tentative refunds for NOL carrybacks. Starting on 4/17/20, and continuing until further notice, the IRS will accept eligible refund claims filed on Form 1045 that are submitted via fax to 844-249-6237. A maximum of 100 pages can be initially faxed. If additional documentation is required to be attached or deemed to be necessary, taxpayers will be notified during the processing of the Form 1045.

See https://www.irs.gov/newsroom/temporary-procedures-to-fax-certain-forms-1139-and-1045-due- to-covid-19

For taxpayers that previously mailed a hard copy Form 1045 after 3/27/20, the IRS will allow the taxpayer to submit the same claim using this procedure. To be processed, the Form 1045 must reflect the taxpayers originally filed or previously processed amended information (The information provided on the Form 1045 must match the information in the taxpayer's IRS account). Taxpayers that have electronically filed an amended return should note that on the fax cover page and the date that it was accepted. If a taxpayer needs to amend a previously filed return by filing a hard copy Form 1040-X, they should follow the normal filing procedures by timely filing a hard copy of Form 1139 containing only the taxpayer's name, address, and taxpayer identification number. The statement required to make the election must indicate the section under which the election is being made and shall set forth information to identify the election, the period for which it applies, and the taxpayer's basis and entitlement to make the election.1045 in order to adhere to any filing deadlines.

In these uncertain times, individuals and businesses need to retain cash, whether to offset lower revenues, negative cash flows, or to capitalize on buying/investing opportunities. Let Scarpello Consulting assist you in generating cash for your clients. While no one seems to be able to predict what the future will hold, it's a safe bet that incomes will be lower in 2020, so shift depreciation deductions to the 2018 and 2019 tax years where they will be more valuable.