Net Operating Losses

The CARES Act expands the value of NOLs for all taxpayers

BY JAMES R. SELSOR, JR., CPA

THE CORONAVIRUS CRISIS created unprecedented times and uncharted waters for all businesses. Many businesses are either closed or their operations limited. Congress reacted to the crisis by passing laws that created loan programs and lessened or delayed tax payments as aids for businesses. One of these tax law changes is the temporary modification of the use of net operating losses.

What is a net operating loss?

A net operating loss (NOL) occurs when a company or individual has less gross income than tax-deductible expenses during a tax year. The business or individual reports a business tax loss.

A net operating loss on its own means nothing in the year that the NOL arises. The benefit of an NOL is realized when it can be applied to years reporting taxable income.

What has changed in the CARES Act with net operating losses?

The use of NOLs, prior to the CARES Act, was codified in the 2017 Tax Cuts and Jobs Act (2017 Act). The 2017 Act limited NOLs arising after 2017 to carryforward only. The 2017 Act further limited the amount that could be applied in those future years to 80 percent of taxable income.

The CARES Act has temporary eliminated those two limitations contained in the 2017 Act. NOLs arising in the three tax years before 2021 (2018, 2019 and 2020) must be carried back to the prior five years unless a tax election is made to carry the loss forward. The CARES Act also eliminates the 80 percent of taxable income limitation.

These changes require all companies to look at their 2018 tax filing that had an NOL. If the company had a loss in 2018, it can now be carried back to the 5 prior years.

I have a client that benefits greatly from this rule change. The client realized a net operating loss of $335,000 in 2018. Under the 2017 Act, that loss was carried forward. With the changes in the CARES Act, we can now look back at the five prior years (2013 to 2017) to determine if carrying the loss back is more beneficial than carrying the loss forward to 2019. Carrying the loss forward to 2019 saved no federal taxes. Carrying the loss back to 2013 created an $80,000 federal tax refund! You must run the numbers and determine where an NOL is best utilized.

How can the carryback of the NOL be claimed?

For tax years 2019 and 2020, the loss carryback is claimed by filing either an amended return(s) for the year or years that the loss will be carried back or by filing an application for a tentative refund (Forms 1139 or 1045). The application for a tentative refund must be filed within 12 months after the end of the 2019 or 2020 tax year.

For calendar year 2018 tax filers, the loss carryback must be claimed by filing an amended return for the year(s) to which the loss is being carried back or by filing under extension procedures. The IRS has granted a 6-month extension of time to file Forms 1139 and 1045 for taxpayers that have an NOL that arose in a tax year that began during 2018 and ended on or before June 30, 2019. The 6-month extension of time to file for calendar year taxpayers expired on June 30, 2020.

Currently, Forms 1139 and 1045 can be filed with the IRS via fax or mail and the application will be processed within 60 days. Forms filed under the extension procedures must include on the top of the applicable form "Notice 2020-26, Extension of Time to File an Application for Tentative Carryback Adjustment."

If it will be more beneficial to carry the loss forward into future years for either 2018 or 2019, an election must be made, no later than the due date, including extensions, for filing the taxpayer's tax return for the first year after March 27, 2020 (the 2021 tax return for calendar year filers). Once made, the election is irrevocable.

It is important to look at your 2018 and 2019 tax filings with NOLs to determine how the change in the application of NOLs under the CARES Act will generate the largest federal tax refund. ■

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