

DOWNTURN TAX PLANNING

CASE FOR LOSSES: NET OPERATING AND EXCESS LOSSES

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May 28, 2020



Realizing and using losses plays a significant role in tax planning. The recent CARES Act enacted on March 27, 2020 creates opportunities to use losses.

In particular, the CARES Act enables taxpayers to carry back net operating losses (losses from business activities known as NOLs) back five years and temporarily eliminates until 2021 a restriction that limits the use of NOLs to 80%. President Trump's 2017 tax reform legislation, 2017 TCJA, had eliminated NOL carrybacks in most instances and imposed the 80% limitation. For example, as currently allowed, a taxpayer can carry back 100% of an NOL incurred in 2020 to 2015 and later years. Such a carryback essentially enables a taxpayer to obtain a tax refund from earlier profitable years, including years for which the statute of limitations would have barred a refund. Additionally, top federal income tax rates dropped from 35% to 21% for corporations and from 39.6% to 37% (or less with the 20% qualified business income deduction)

beginning in 2018. Therefore, losses in 2020 carried back to 2015 through 2017 could recover taxes paid at significantly higher rates (although a myriad of related adjustments to other tax items could reduce the actual tax savings).

The US House of Representatives has come to this realization and has proposed in its latest round of Covid-19 relief legislation, passed on May 15, 2020 as the HEROES Act, provisions to prevent NOL carrybacks from 2019 and 2020 to years beginning earlier than Jan. 1, 2018. Although the package as a whole could face significant hurdles to passage, the NOL portion may have bipartisan support as reported in the May 13, 2020 issue of Tax Notes Today.

The CARES Act also suspended until 2021 the 2017 TCJA enacted limit on excess business losses for individuals and other non-corporate taxpayers. That limit had prevented a taxpayer in 2018, 2019 or 2020 from using business losses in excess of \$250,000 (\$500,000 for joint returns)

to offset other income. The disallowed excess loss added to NOL carryforwards to later years.

The HEROES Act proposes to reinstate the excess business loss limitation effective as of December 31, 2017, undoing the CARES Act suspension. Taxpayers with disallowed excess losses from 2018 or 2019 may wish to wait until the fate of HEROES Act provisions becomes clearer, before seeking refunds or filing or amending tax returns to use those losses.

California, on the other hand, does not conform to the CARES Act provisions. In fact, as indicated in the Gov. Newsom's budget plan posted on May 15, 2020, California may suspend NOLs for larger businesses. Proposed legislation would apply the NOL suspension to taxpayers with net business incomes of \$1,000,000 or more.

The preceding discussion is not and should not be construed as legal or tax advice or representation on specific legal matters for any client or jurisdiction, but rather as a general commentary. The information provided should not be acted upon without specific legal advice based on particular situations.