

IRS FAQs on NOLs for those with Section 965 inclusions

The Coronavirus Aid, Relief, and Economic Security (CARES) Act changed the rules for net operating losses (NOLs), including allowing taxpayers with NOLs arising in the 2018, 2019 or 2020 tax year to carry back losses to each of the five preceding years. Meanwhile, under Internal Revenue Code Section 965, certain U.S. shareholders must pay a transition tax on the untaxed foreign earnings of certain specified foreign corporations as if those earnings had been repatriated to the United States.

The IRS recently provided answers to frequently asked questions (FAQs) about NOL carrybacks for taxpayers with outstanding Sec. 965 net tax liabilities. Here are 10 pertinent FAQs:

Question No. 1: A taxpayer has an NOL arising in a tax year beginning in 2018, 2019 or 2020, and one or more of the tax years in the carryback period for that NOL is a Sec. 965 year. May the taxpayer make an election either under Sec. 172(b)(3) to waive the entire carryback period (that is, for both Sec. 965 years and non-Sec. 965 years) or under Sec. 172(b)(1)(D)(v)(I) to waive the carryback for only Sec. 965 years?

Answer: Yes. The taxpayer may file an election to either 1) waive the entire five-year carryback period or 2) exclude all Sec. 965 years from the carryback period. Guidance regarding when and how to file these elections is provided in IRS Revenue Procedure 2020-24, and in FAQ No. 2 below.

Question No. 2: A taxpayer has an NOL arising in a tax year beginning in 2018, 2019 or 2020, and has one or more Sec. 965 years in the carryback period. How does the taxpayer elect to exclude only the Sec. 965 years from the carryback period?

Answer: A taxpayer may elect to exclude all Sec. 965 years from the carryback period by attaching an election statement to the earliest filed of the following:

- The federal income tax return for the tax year in which the NOL arises,
- A Form 1139 or Form 1045, as applicable, applying the NOL to a tax year in the carryback period, or
- An amended federal income tax return applying the NOL to the earliest tax year in the carryback period that isn't a Sec. 965 year.

This election statement must include the following:

- A statement that the taxpayer is electing to apply Sec. 172(b)(1)(D)(v)(I) under Revenue Procedure 2020-24,
- The tax year in which the NOL arose, and
- The taxpayer's Sec. 965 years.

If a taxpayer claims a refund or credit as a result of the carryback of the NOL by filing amended federal income tax returns for tax years in the carryback period, the taxpayer must also attach the election statement to each amended return.

Question No. 3: A taxpayer is carrying back an NOL to a Sec. 965 year and is now entitled to a refund for that year because the income tax liability for that Sec. 965 year (including all installment payments) is fully paid. May the taxpayer use Form 1139 or Form 1045, as applicable, to apply for a refund for the Sec. 965 year?

Answer: Yes. Taxpayers can disregard the portion of the instructions for Forms 1139 and 1045 that prohibit taxpayers from using these forms to apply for refunds for Sec. 965 years. However, the CARES Act provides that a taxpayer who has a carryback to a Sec. 965 year is deemed to have made a Sec. 965(n) election that limits the loss that can be carried back to each Sec. 965 year. Because of this, an NOL can be carried back only to reduce income in excess of the amount of the Sec. 965(a) inclusion net of the Sec. 965(c) deduction.

Question No. 4: A taxpayer files a Form 1139 or Form 1045 to request a refund resulting from a five-year carryback of an NOL arising in a tax year beginning in 2018, 2019 or 2020, and the carryback period includes Sec. 965 years. Will the taxpayer receive the full carryback refund amount?

Answer: For a taxpayer who has made a Sec. 965(h) election, a refund will be generated only if the excess credit generated by the NOL deduction in the Sec. 965 year exceeds the entire unpaid income tax liability for the Sec. 965 year.

Question No. 5: Has the IRS extended the due date for filing Forms 1139 and 1045 to apply for a tentative refund based on the carryback of NOLs arising in tax years beginning on or after January 1, 2018, and ending before June 30, 2019?

Answer: Yes. The IRS has granted a six-month extension of time for taxpayers to file Form 1139 or Form 1045, as applicable, to apply for a tentative refund from the carryback of an NOL that arose in a tax year that began during calendar year 2018 and that ended on or before June 30, 2019. This extension of time is limited to requesting a tentative refund to carry back an NOL and doesn't extend the time to carry back any other item.

Question No. 6: What's the due date for filing a Form 1139 or Form 1045 to request a tentative refund from the carryback of an NOL arising in a tax year beginning before January 1, 2018, and ending after December 31, 2017 (that is, a 2017 fiscal tax year)? Also, what's the due date to make or revoke an election with respect to an NOL arising in a 2017 fiscal tax year?

Answer: Taxpayers with an NOL arising in a 2017 fiscal tax year who make an application for a tentative refund on Form 1139 or Form 1045 (as applicable) with respect to a carryback of such an NOL will be treated as having timely filed if Form 1139 or 1045 with respect to such carryback is filed no later than July 27, 2020. Similarly, elections for a 2017 fiscal tax year with an NOL to waive any carryback period, to reduce any carryback period or to revoke any election made under Sec. 172(b) to waive any carryback period will be treated as timely filed if filed no later than July 27, 2020.

A taxpayer can file the above elections by attaching a statement containing the taxpayer's name, address and taxpayer identification number — with "Filed pursuant to Rev. Proc. 2020-24" at the top — to Form 1045 or Form 1139. This statement must indicate the section under which the election is being made, and it needs to identify the election, the period for which it applies, and the taxpayer's basis and entitlement to make the election.

Question No. 7: May a taxpayer with a farming business or insurance company that previously filed elections to forgo the carryback period for NOLs arising in tax years 2018 and 2019 revoke those elections and claim the five-year carryback period with respect to such NOLs?

Answer: No. The CARES Act doesn't provide for an election to revoke previous elections to forgo the carryback period for NOLs arising in these years. A taxpayer may, however, revoke a prior election to relinquish the carryback period with respect to an NOL arising in a 2017 fiscal tax year.

Question No. 8: What's the due date for filing an election to forgo the entire carryback period or forgo only Sec. 965 years?

Answer: A taxpayer must elect to either 1) exclude Sec. 965 years from the carryback period for an NOL arising in a tax year beginning in 2018 or 2019, or 2) waive the carryback period for such an NOL by the due date (including extensions) for filing its return for the first tax year ending after March 27, 2020.

For an NOL arising in a tax year beginning in 2020, these elections must be made by the due date (including extensions) for filing the federal income tax return for that tax year. Once made, both elections are irrevocable.

Question No. 9: What supporting documentation is required to be attached to a request for refund resulting from the carryback of NOLs to Sec. 965 years?

Answer: The following documentation must be attached to a refund request:

- All supporting documentation for the NOL carryback as described in the Form 1139 or Form 1045 instructions,
- An amended Form 965-A or Form 965-B (as applicable) to record the amount of the change in the Sec. 965 net tax liability, if any, caused by the NOL carryback, and
- A statement of explanation about the change in Sec. 965 net tax liability.

Question No. 10: As a result of an NOL carryback to pre-Sec. 965 years (2014, 2015 and 2016) and exclusion of 2017 (a Sec. 965 year), there's a change in a foreign tax credit carryover or charitable contribution carryover (tax attributes) for 2017. This change reduces — but doesn't eliminate — the taxpayer's Sec. 965 net tax liability for 2017. Should the taxpayer file an amended return for 2017 to reflect this?

Answer: Yes. If the taxpayer doesn't file an amended return, the IRS's records won't reflect the change in either the total tax liability or the Sec. 965(h) net tax liability for the Sec. 965 year because of the change in tax attributes. Consequently, the taxpayer's Sec. 965(h) net tax liability and associated installment payments due in the future may not be accurately reflected in IRS systems. This, in turn, could lead to unintentional or erroneous accelerations of Sec. 965(h) installment payments if the taxpayer doesn't pay the pre-change installment amounts, as well as potential interest and penalty charges, delays in refunds, or other processing complications.

Taxpayers shouldn't use the temporary procedures reserved for submission of certain claims on Form 1139 or Form 1045 to fax an amended return, as such faxed amended returns won't be processed.

The interaction between the CARES Act and Sec. 965 warrants careful examination. Work closely with your CPA to determine how your situation has been affected. •