TAX PLANNING OPPORTUNITIES FOR BUSINESSES: NET OPERATING LOSSES

The Tax Cuts and Jobs Act (TCJA) made significant changes to the net operating loss (NOL) rules for tax years beginning in 2018. Under the TCJA, the two-year NOL carryback provision was removed for most taxpayers, and instead NOLs may be carried forward indefinitely until the loss is fully recovered, but they are limited to offsetting 80 percent of the taxable income in any single tax period.

However, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) passed on March 27, 2020, suspends the 80 percent limitation for tax years beginning after December 31, 2017, and before January 1, 2021, i.e., 2018 through 2020, and NOLs generated in the same period may be carried back up to five tax years.

WHAT DOES THIS MEAN FOR YOUR BUSINESS?

- Consider amending past tax returns or filing a tentative refund claim to take advantage of the temporary rules under the CARES Act, potentially resulting in cash tax refunds.
- NOLs carried back to pre-2018 tax years may offset income taxed at higher pre-TCJA rates, making such NOLs even more valuable from a cash tax perspective.

PLANNING OPPORTUNITIES

There are several tax planning opportunities available to help generate or increase NOLs. Contact your BKD Trusted Advisor™ to review your 2018 and 2019 tax returns, and 2020 tax projections, to help your business take advantage of one or more of the following NOL tax planning opportunities.

Federal Tax Services

- **Accounting Method Changes.** Consider the following accounting method changes including, but not limited to:
  - **Accrued Bonuses.** Review your bonus plan to determine whether it meets the requirements to deduct bonuses in the year accrued. Consider filing an accounting method change to deduct qualifying bonuses.
  - **Prepaid Expenses.** Taxpayers may elect to deduct, rather than capitalize, qualifying prepaid expenses, such as certain insurance and maintenance contracts that do not extend beyond 12 months. The cumulative balance of qualifying prepaids may be deducted in the year of change.
  - **Accounting Methods Related to Inventory.** As a result of the TCJA, taxpayers with average gross receipts of less than $26 million may account for inventory using the cash method of accounting. In addition, all taxpayers with less than $26 million in gross receipts are no longer subject to the Section 263A uniform capitalization rules, which require certain additional costs to be capitalized into the basis of inventories. These accounting method changes can simplify the treatment of inventory for small business taxpayers and may result in a tax deduction in the year of change.

- **Cost Segregation Study.** A cost segregation study can help you accelerate depreciation tax deductions, enhancing your property’s financial return. BKD’s cost segregation professionals can identify portions of a building’s cost that can be allocated to shorter depreciable lives (generally five, seven or 15 years) as opposed to the standard 27.5- or 39-year life. This reclassification helps the building owner accelerate depreciation, defer income tax and increase cash flow.

- **Research & Development (R&D) Study.** An R&D study can help identify qualifying research expenditures under §41 that may be eligible for federal and state tax credits.

- **§179D Deduction.** Costs associated with energy-efficient improvements are eligible up to $1.80 per square foot for qualifying improvements to HVAC, lighting and building envelope. Note, engineering and architecture firms also may claim the §179D deduction for government projects.

- **Retail Glitch Fix.** Under the CARES Act, qualified improvement property has been assigned a 15-year MACRS recovery period (previously, 39-year MACRS recovery period) and is now eligible for bonus depreciation. As such, taxpayers may amend prior-year tax returns or file an accounting method change to be able to claim missed depreciation in 2018 and 2019.
• **Refundable Alternative Minimum Tax (AMT) Credits.** AMT credits from pre-2018 tax filings are recoverable immediately instead of over the four-year period through 2021. Any unused AMT credits are fully refundable, resulting in cash tax refunds.

• **§163(j) Planning.** The TCJA limits business interest expense to 30 percent of taxable income before interest expense, depreciation, amortization and depletion. After 2021, the limit is modified to 30 percent of taxable income before interest expense only. Businesses with average gross receipts of $26 million or less are exempt from the limit. Some businesses may qualify to elect to be treated as an electing real property trade or business, in which case they would not be subject to the limitation on business interest deductions.

Under the CARES Act, the business interest expense limitation is increased to 50 percent of adjusted taxable income (ATI) for 2019 and 2020 tax years for corporations and 2020 for partnerships. Corporations deducting more interest expense in 2019 due to the increased ATI limitation may increase or generate a NOL. The NOL may result in a cash refund if fully used in 2019 or carried back.

**State & Local Tax Services**

• **Return Filing Responsibilities.** States vary in terms of both their conformity to the Internal Revenue Code and the CARES Act. As a result, analysis must be completed to determine exactly which states conform and allow state NOL carryback refund claims. Additional complexity may occur if taxpayers include additional changes to federal taxable income beyond a NOL carryback claim.

Taxpayers could potentially have state amended return filing requirements to report the change to federal taxable income even in states that do not allow the NOL carryback claim. This is an area that can be complex depending on the taxpayer structure and in which state and local jurisdictions it has income tax nexus.

• **Return Filing Considerations.** Taxpayers contemplating a federal NOL carryback claim also should contemplate the state tax effect from both a refund and exposure perspective. For example, in a state that allows a state NOL carryback, the taxpayer may be able to identify additional refund opportunities related to apportionment positions, state modifications or credits if a thorough review of the return is completed.

On the other hand, a review of the originally filed state income tax return may uncover exposure items that may be easily identified by state DOR auditors if the state income tax return is amended to claim a state NOL carryback.

**International Tax Services**

• **Transfer Pricing.** U.S. companies with cross-border intercompany transactions should analyze whether their current intercompany pricing arrangements still reflect economic realities in a post-COVID-19 economy. In certain situations, the transfer prices may need to be adjusted so that a U.S. entity is no longer profitable or accrues less profit than in prior years. This could include the U.S. entity involved in sharing of losses, not earning a guaranteed fixed margin, selling goods at a lower price, not charging a markup on certain services, etc. The reduction in income in the current year would serve to augment the NOL, which would be carried back to prior tax years.

• **NOL Carrybacks.** Consider the effect of a NOL carryback on historical tax attributes such as foreign tax credits and other general business credits. The value of a NOL carryback will diminish as it reduces permanent tax attributes in carryback years such as the §199 DPAD, §250 GILTI/FDII deductions or GILTI foreign tax credits that may not be carried back or forward.

Note, a NOL carryback cannot be deducted against §965 deemed repatriation income. Consider the election to have a NOL carryback skip over a §965 income inclusion year if an eight-year installment election was made—the IRS will first apply an overpayment from a §965 income year to satisfy any outstanding §965(h) installments before refunding such overpayment.

**Transaction Services**

• **NOL Carrybacks.** Review purchase agreements for recently acquired or disposed companies to determine the ability to file amended tax returns and claim tax refunds.

• **Change of Control.** Review NOLs for companies that are preparing for a sales event to determine availability of NOLs that will be conveyed to a buyer.

This list is only a sample of the tax planning opportunities that may be available for your business. Consult your BKD Trusted Advisor to discuss what other opportunities may be available specific to your business and industry.