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Struggling Businesses Get Some Relief From Net Operating Loss Provisions in the CARES Act

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In an effort to provide additional liquidity for struggling businesses, the federal Coronavirus Aid, Relief and Economic Security Act ("**CARES Act**") has loosened the restrictions on the use of net operating loss carryovers. These provisions are intended to provide businesses with needed liquidity in a time of crisis and constrained cash flow.

When a company's allowable deductions exceed its taxable income, it results in a net operating loss ("**NOL**"). The Tax Cuts and Jobs Act ("**TCJA**"), which was enacted at the end of 2017, imposed additional restrictions on the ability to use NOLs to reduce taxable income. As a result of the TCJA (1) NOLs could generally no longer be carried back to prior tax years, (2) NOLs could be carried forward and used in subsequent tax years, but were limited to 80 percent of the each subsequent year's taxable net income, and (3) individuals, trusts and estates who conducted business through a pass-through entity (such as a partnership or S corporation) were not permitted to use business losses in excess of $250,000 (or $500,000 if married filing jointly) to offset their non-business income.

The CARES Act made three changes to NOLs that improve cash flow for struggling businesses:

1. NOLs generated in 2018, 2019, or 2020 may now be carried back for up to five tax years prior to the year the NOL was incurred. Corporations that had NOLs in 2018 or 2019 can file refund claims if they paid federal income tax in the prior five tax years.

2. The CARES Act suspends the NOL limit of 80 percent of taxable income. This means that businesses can deduct their NOLs to eliminate up to 100 percent of their taxable income in a given year, instead of having to carry forward any NOL beyond 80 percent of taxable income.

3. Individuals (and trusts and estates) that conduct business through pass-through entities can now use their business losses to offset their non-business income above the previous limit of $250,000 (single) or $500,000 (married filing jointly) for 2018, 2019, and 2020.

The IRS has issued guidance intended to help taxpayers take advantage of the new rules. Notice 2020-26 (PDF) grants a six-month extension of time to file the required NOL Form 1045 or 1139, as applicable, for the carryback of a NOL that arose in a taxable year that began during calendar year 2018 and ended on or before June 30, 2019. Revenue Procedure 2020-24 (PDF) provides guidance to taxpayers who want to waive the carryback of NOLs permitted under the CARES Act.

The IRS also issued Revenue Procedure 2020-23 (PDF), allowing eligible partnerships to file amended partnership returns using Form 1065 by checking the "Amended Return" box and issuing amended Schedules K-1s to each of its partners. Partnerships filing these amended returns should write "FILED PURSUANT TO REV PROC 2020-23" at the top of the amended return. This relief is very important because, due to recent changes in the way that partnerships are audited, partnerships are generally prohibited from filing amended partnership tax returns.

The CARES Act made a number of additional tax changes intended to provide tax relief to struggling businesses:

· *Retail Glitch Fixed*. The CARES Act retroactively fixed an error in the TCJA that limited the ability of taxpayers to expense qualified improvement property (leasehold improvements constructed by a tenant on nonresidential property). The fix applies to qualified improvement property place in service in 2018 and following years. This is very important for restaurants and retail businesses.

· *Deductibility of Business Interest Expense*. The TCJA limited the deduction for business interest expense to 30 percent of the taxpayer's "adjusted taxable income." This percentage limitation has been increased to 50 percent for 2019 and 2020. Moreover, the business interest expense limitation for 2020 may be based on the taxpayer's 2019 adjusted taxable income.

· *Alternative Minimum Tax*. The corporate alternative minimum tax was repealed by the TCJA, which left some corporate taxpayers with AMT credit carryforwards. The CARES Act accelerates any remaining credit carryforwards.

These changes may permit businesses to file refund claims. Contact Saul Ewing Arnstein & Lehr to discuss how to apply these tax law changes for the benefit of your business.

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