Net Operating Losses

Old Law	Current Law
A corporation has a NOL if its deductions exceed its gross income. A NOL can be used to offset taxable income in the prior 2 years (or "carried back") or the following 20 years ("carried forward")	Starting in 2018, the deduction for net operating losses (NOLs) is limited to 80% of a corporation's income. The current law repeals existing NOL carryback rules. Disallowed losses may be carried forward indefinitely.

- Tax Cuts and Jobs Acts (the "Act") provides major changes to the utilization of net operating losses (NOLs) for corporate taxpayers.
- For NOLs, the carryover and carryback rules change and a new limitation on NOL utilization is added.
- Under prior section 172, NOLs were generally eligible for a **two-year carryback and twenty year carryforward**. NOL carryovers and carrybacks could fully offset taxable income of the taxpayer if not otherwise limited under the Internal Revenue Code (e.g., section 382 limitations). Both of those rules have now changed.
- The amendments to section 172 disallow the carryback of NOLs but allow for the indefinite carryforward of those NOLs. Pursuant to section 172(e)(2) of the statute, the amended carryback and carryover rules apply to any NOL arising in a taxable year ending after Dec. 31, 2017.
- For fiscal year corporations reporting an NOL for a tax year that includes Dec. 31, 2107 and ends after Dec. 31, 2017, under a plain reading of the statute, a corporate taxpayer projecting an NOL for a fiscal year ending March 31, 2018 is subject to the NOL carryback disallowance because the tax year ends after Dec. 31, 2017.

NOL income limitation

- In addition to the carryover and carryback changes, the Act also introduces a limitation on the amount of NOLs that a corporation may deduct in a single tax year under section 172(a) equal to the lesser of the available NOL carryover or 80 percent of a taxpayer's pre-NOL deduction taxable income (the "80-percent limitation"). This limitation applies only to losses arising in tax years that begin after Dec. 31, 2017 based upon section 172(e)(1) of the amended statute.

<u>Practical effects</u>

- Manufacturers suffering from the "Retail Flu" with significant operating losses may not be able to receive tax refunds (CASH) and therefore may need to layoff workers or make other operational cutbacks.

- The carry back law was enacted in 1910 to stimulate the manufacturing industry. In a 1957 Supreme Ct. decision, the Ct said carrybacks and carryforward benefits "were designed to permit a taxpayer to set off its lean years against its lush years."

- Companies with pre 1/1/18 losses, can carry their losses forward forever (not 20 years) and therefore may be more valuable.

Example. JOE Corp has a $2 million cumulative NOL from 2017 and prior tax years. JOE generated a $15 million NOL in 2018. 2019 taxable income is forecast to be $15 million. JOE can use its entire $2 million pre-2018 NOL and $12 million of the 2018 NOL (80 percent multiplied by pre-NOL income of $15 million). As a result, 2019 taxable income would be $1 million with a $3 million NOL carryforward.