

DUGAN, SCOTTI & ZOCH, P.A.

Certified Public Accountants

161 MCKINLEY STREET • P.O. BOX 576 • CLOSTER, NJ 07624

PHONE: (201) 767-6270 • FAX: (201) 767-0920

www.dszcpa.com

Abstract: To provide businesses and their owners with some relief from the financial effects of the COVID-19 crisis, the CARES Act eases the rules for claiming certain tax losses. This article provides an overview of modifications, which are mostly temporary.

The ins and outs of the easing of loss limitation rules

To provide businesses and their owners with some relief from the financial effects of the COVID-19 crisis, the Coronavirus Aid, Relief, and Economic Security (CARES) Act eases the rules for claiming certain tax losses. Here's a look at the — mostly temporary — modifications.

Liberalized rules for NOL carryforwards

The CARES Act includes favorable changes to the rules for deducting net operating losses (NOLs). First, it eases the taxable income limitation on deducting NOLs.

Under an unfavorable provision included in the 2017 Tax Cuts and Jobs Act (TCJA), an NOL arising in a tax year beginning in 2018 or beyond and carried forward to a later tax year couldn't offset more than 80% of the taxable income for the carryforward year (the later tax year), calculated before the NOL deduction.

For tax years beginning *before 2021*, the CARES Act removes the TCJA taxable income limitation on deductions for prior-year NOLs carried forward into those years. So NOL carryforwards to tax years beginning before 2021 can be used to fully offset taxable income for those years.

For tax years beginning *after 2020*, the CARES Act allows NOL deductions equal to the sum of:

- 100% of NOL carryforwards from pre-2018 tax years, plus
- The lesser of 1) 100% of NOL carryforwards from post-2017 tax years, or 2) 80% of remaining taxable income (if any) after deducting NOL carryforwards from pre-2018 tax years.

As you can see, this is a complicated rule. But it's more taxpayer-friendly than what the TCJA allowed. This favorable change is permanent.

Carrybacks allowed for certain NOLs

Under another unfavorable TCJA provision, NOLs arising in tax years ending after 2017 generally couldn't be carried back to earlier tax years and used to offset taxable income in those earlier years. Instead, NOLs arising in tax years ending after 2017 could only be carried forward to later years. But they could be carried forward for an unlimited number of years.

Under the CARES Act, NOLs that arise in tax years beginning in 2018 through 2020 can be carried back for five years. For example, a taxpayer could carry back an NOL arising in 2020 to 2015 and recover federal income tax paid for that year. That could be very beneficial, because the federal income tax rates for both individuals and corporations were higher before the TCJA rate cuts took effect in 2018.

When advantageous, taxpayers can elect to waive the carryback privilege for an NOL and, instead, carry the NOL *forward* to future tax years. In addition, barring a further tax-law change, the no-carryback rule will come back into play for NOLs that arise in tax years beginning after 2020.

Excess business loss rules postponed

Another unfavorable TCJA provision disallowed current deductions for so-called “excess business losses” incurred by individuals and other noncorporate taxpayers in tax years beginning in 2018 through 2025.

An excess business loss is one that exceeds \$250,000 (\$500,000 for a married joint-filing couple). These limits are adjusted annually for inflation.

The CARES Act removes the excess business loss disallowance rule for losses arising in tax years beginning in 2018 through 2020.

Barring a further tax-law change, the excess business loss disallowance rule will come back into play for losses that arise in tax years beginning in 2021 through 2025. Any disallowed excess business loss for one of those years will be carried forward to the following year and can be deducted under the rules for NOL carryforwards.

Amended return opportunities

These taxpayer-friendly CARES Act changes can affect prior tax years for which you’ve already filed returns. Amended returns may be needed to benefit from the changes. Contact your tax professional for more information.