

US IRS issues FAQs on interaction of NOL carrybacks and Section 965 inclusions

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On 23 April 2020, the United States (US) Internal Revenue Service (IRS) issued instructions and other clarifying guidance in the form of Frequently Asked Questions ([FAQs](#)) for taxpayers that are claiming refunds under the new net operating loss (NOL) carryback provisions and have Internal Revenue Code¹ Section 965 transition tax liabilities during the carryback period.

Background

In an effort to boost taxpayer's liquidity, the *Coronavirus Aid, Relief, and Economic Security Act*, P.L. 116-136 (CARES Act) allows taxpayers to carry back NOLs arising in tax years beginning after 31 December 2017, and before 1 January 2021. Under Section 172(b)(3), taxpayers may also elect to waive the carryback period for NOLs arising in those years and carry them forward instead. Alternatively, Section 172(b)(1)(D)(v) allows taxpayers with one or more Section 965 inclusion years to elect to exclude all Section 965 inclusion years from the NOL carryback period. [Revenue Procedure 2020-24](#) establishes the timing and methods for making these elections (see EY Global Tax Alert, [US: Taxpayers need to consider international tax implications of making certain net operating loss elections under Revenue Procedure 2020-24](#), dated 13 April 2020).

Under Section 172(b)(1)(D)(iv), a taxpayer that carries an NOL back to a Section 965 inclusion year is treated as having made a Section 965(n) election for each such year. The Section 965(n) election allows an NOL to be carried back to a Section 965 inclusion year only to reduce income exceeding the net Section 965(a) inclusion.

Following enactment of the CARES Act, the IRS issued guidance on filing Form 1139, *Corporation Application for Tentative Refund*, and Form 1045, *Application for Tentative Refund*, to claim refunds under the new NOL carryback provisions, including the ability to fax eligible forms to the IRS in lieu of mailing paper forms, which are not currently being processed (see EY Global Tax Alerts, [US IRS announces taxpayers can temporarily fax Forms 1139 and 1045 to claim NOL carrybacks and AMT credits under CARES Act](#), dated 16 April 2020 and [US IRS issues additional FAQs on faxing Form 1139 with NOL and AMT claims under CARES Act](#), dated 23 April 2020). FAQ 5 of that guidance noted that the IRS would be issuing “additional instructions ... for taxpayers with outstanding [Section] 965(h) net tax liabilities, so that these requests and liabilities can be identified, routed, and tracked appropriately, and so that payment schedules can be adjusted to avoid unintentional or erroneous acceleration of deferred [Section] 965(h) installment payments, delays in refunds, or other processing complications.”

The recently released FAQs provide the promised additional guidance and reiterate that taxpayers can use Form 1139 and Form 1045 to apply for a tentative refund for a Section 965 inclusion year, contrary to the form instructions.

Election due dates

A taxpayer that wishes to waive the entire carryback period or to exclude its Section 965 inclusion years from the carryback period must elect to do so by:

- ▶ The due date (including extensions) for filing its return for its first tax year ending after 27 March 2020, for an NOL arising in a tax year beginning in 2018 or 2019
- ▶ The due date (including extensions) for filing its return for that tax year, for an NOL arising in a tax year beginning in 2020

Both elections are irrevocable.

Election to exclude Section 965 inclusion years

To elect to exclude *only* Section 965 inclusion years from the five-year NOL carryback period, taxpayers must attach an election statement to the first of the following three forms to be filed after 9 April 2020:

- ▶ The federal income tax return for the tax year in which the NOL arises
- ▶ A Form 1139 or Form 1045 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 is not a Section 965 year

The election statement must state: (1) that the taxpayer is electing to apply Section 172(b)(1)(D)(v)(I) under Revenue Procedure 2020-24, (2) the tax year in which the NOL arose, and (3) the taxpayer's Section 965 years. If a taxpayer files amended federal income tax returns to claim refunds or credits from carrying back NOLs, the election statement must also be attached to each amended return.

NOLs that are carried back to pre-Section 965 inclusion years may change the tax attributes (such as a foreign tax credit carryover or charitable contribution carryover) of a Section 965 inclusion year that was excluded from the carryback period. If this occurs, the taxpayer should make sure to file an amended return for the Section 965 inclusion year to reflect the change in either the total tax liability or the Section 965(h) net tax liability due to the change in tax attributes. If an amended return is not filed, the IRS system will not reflect the correct, updated Section 965(h) installment payment amount, and future installment payments made by the taxpayer may appear to be incorrect, triggering penalties, interest and/or the unintentional acceleration of installment payments.

Refunds for Section 965 inclusion years

When requesting a refund resulting from the carryback of NOLs to a Section 965 inclusion year, taxpayers must attach the following information:

- ▶ 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 Section 965 net tax liability, if any, caused by the NOL carryback
- ▶ A statement explaining the change in the Section 965 net tax liability

Importantly, the IRS noted in FAQ 4 that taxpayers may not receive a refund or credit of tax payments for a Section 965 inclusion year until the entire income tax liability for the Section 965 year, including any outstanding Section 965(h) installments, has been paid. Thus, a taxpayer that has made a Section 965(h) election will only receive a refund if the excess credit generated by the NOL carryback exceeds the entire unpaid income tax liability for the Section 965 inclusion year.

Filing extensions

Taxpayers normally have one year from the close of the tax year in which an NOL arose to file a claim for refund on Form 1139 or Form 1045. Notice 2020-26 grants a six-month extension of time for taxpayers to file such forms to claim a refund from the carryback of an NOL that arose in a tax year that began during calendar-year 2018 and ended on or before 30 June 2019. Taxpayers that file after the extended due date may not file Form 1139 or Form 1045 and must instead file an amended return for each applicable tax year in the five-year carryback period.

Fiscal-year taxpayers with an NOL arising in a 2017 fiscal year can file Form 1139 or Form 1045 until 27 July 2020, to apply for a refund on Form 1139 or Form 1045. These taxpayers also have until 27 July 2020, to elect to waive or reduce any carryback period, or to revoke an election made under Section 172(b) to waive any carryback period.

Implications

Taxpayers wishing to avail themselves of the “quick” refunds available for NOL carrybacks via Forms 1139 and 1045 should be mindful to meet the due dates for those forms and the related elections. The sole option of claiming a refund for a taxpayer that misses the filing deadline is to file an amended return for the carryback year, a process that requires Joint Committee on Taxation (JCT) review before a refund over US\$2 million (or US\$5 million for C corporations) may be issued. Refunds requested through Forms 1139 and 1045 are only subject to JCT review after the refund has been issued. Further, the IRS has issued temporary procedures for faxing Forms 1139 and 1045 to expedite the processing of these forms while IRS service centers remain closed. Amended returns that are mailed to the IRS will only be processed once the IRS re-opens and begins the daunting task of sorting through trailers full of accumulated mail.

Endnote

1. All “Section” references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

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