

US Temporary Regulations on NOL carrybacks address new split-waiver elections

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On 2 July 2020, the United States (US) Treasury Department (Treasury) and the Internal Revenue Service (IRS) released two regulation packages, each under Internal Revenue Code¹ Section 1502: proposed regulations ([REG-125716-18](#)) (Proposed Regulations) and temporary regulations ([TD 9900](#)) (Temporary Regulations) (which also serve as part of the Proposed Regulations). The Proposed Regulations generally address the absorption of consolidated NOL (CNOL) carryovers and carrybacks applicable to consolidated groups under the *Tax Cuts and Jobs Act of 2017* (TCJA) and the *Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020*.

The Temporary Regulations specifically provide rules on a consolidated group's ability to make a "split-waiver election" for a corporation that had been a member of a prior consolidated group and has become a member of another consolidated group. The Temporary Regulations are effective as of 2 July 2020 but may be applied retroactively.

This Alert specifically addresses the new split-waiver elections introduced by the Temporary Regulations. A Tax Alert on the broader Proposed Regulations is forthcoming.

Background

Section 172(b)(1)(D), enacted under the CARES Act, allows NOLs arising in tax years beginning after 31 December 2017, and before 1 January 2021 (e.g., NOLs incurred in 2018, 2019 or 2020 by a calendar-year taxpayer) to

be carried back to each of the five tax years preceding the NOL's tax year. In doing so, it temporarily overrides the TCJA's repeal of the ability of most taxpayers to carry back NOLs.² This five-year carryback period applies to CNOLs as well. See Treas. Reg. Section 1.1502-21(b)(1).

Section 172(b)(3) permits a taxpayer entitled to a carryback period under Section 172(b)(1) to make an irrevocable election to relinquish the carryback period for an NOL for any tax year. Among other requirements, a taxpayer generally must make this election by the due date (including extensions) for filing the taxpayer's return for the tax year of the NOL for which the election is to be in effect. Solely for NOLs arising in a tax year beginning in 2018 or 2019, a taxpayer may elect to waive the carryback period for such NOLs by the due date (including extensions) for filing the taxpayer's federal income tax return for the first tax year ending after 27 March 2020. See Section 172(b)(1)(D)(v)(II).

Under Treas. Reg. Section 1.1502-21(b)(3)(i), a consolidated group may make an irrevocable election to relinquish the entire carryback period for a CNOL for any consolidated return year (a general waiver election). A general waiver election must be made for the consolidated return year in which the CNOL arises.

Separately, a partial or "split-waiver" election may be made under Treas. Reg. Section 1.1502-21(b)(3)(ii)(B) when a former member of one consolidated group becomes a member of another consolidated group. If a split-waiver election is made, the acquiring consolidated group irrevocably relinquishes, for all CNOLs attributable to the new member, the portion of the carryback period for which the new member was a member of a prior consolidated group; this allows the acquiring consolidated group to access its own carryback tax years while simultaneously preventing a carryback to taxpayer years of the new member (which, e.g., would generate a refund payable to the original consolidated group). A split-waiver election must be made in the year in which the new member becomes a member of the consolidated group.

Revenue Procedure 2020-24

Because the CARES Act retroactively enacted Section 172(b)(1)(D), some taxpayers had already missed the deadline for making an election under Section 172(b)(3) or Treas. Reg. Section 1.1502-21(b)(3)(i) for tax years beginning in 2018 or 2019. To provide relief to these taxpayers, the IRS issued Revenue Procedure 2020-24, which provided, among other guidance, special timing and method rules for taxpayers to elect to waive the carryback period for an NOL or a CNOL

arising in a tax year beginning in 2018 or 2019. Revenue Procedure 2020-24, however, did not provide relief for split-waiver elections or otherwise provide guidance specifically directed toward consolidated return groups.

For further detail on the procedures described in Revenue Procedure 2020-24, see EY Global Tax Alerts, [US: Taxpayers need to consider international tax implications of making certain net operating loss elections under Revenue Procedure 2020-24](#), dated 13 April 2020 and [US: Consolidated return considerations of NOL carrybacks under CARES Act](#), dated 17 April 2020.

The Temporary Regulations

In response to past economic downturns, the US has enacted legislation allowing each permitted taxpayer to carry back specified NOLs for up to five years (rather than the usual two years). See the *Job Creation and Worker Assistance Act of 2002* and the *Worker, Homeownership, and Business Assistance Act of 2009*. More recently, in response to the 2008–2009 financial crisis, Congress amended Section 172 in November 2009, generally permitting taxpayers to elect to extend the then-applicable two-year NOL carryback period by up to three additional years for NOLs arising in 2008 or 2009. Through now-expired Temp. Reg. Section 1.1502-21T(b)(3)(ii)(C), issued in 2010, Treasury extended the due date for consolidated groups filing the election, thereby allowing those groups to make a split-waiver election that might have been otherwise time-barred. The now-expired temporary regulations allowed a consolidated group, solely for its CNOL subject to the extended carryback period, to make a split-waiver election either for the entire pre-acquisition carryback period or only for the extended carryback period.

Consistent with previous (but now-expired) split-waiver regulations, the Temporary Regulations permit an acquiring consolidated group to waive, on a tax-year-by-tax-year basis, all or a portion of the carryback period for CNOLs attributable to an acquired member for pre-acquisition years during which the acquired member was a member of a former consolidated group.

The Temporary Regulations provide two types of split-waiver elections: (1) an "amended statute split-waiver election" and (2) an "extended split-waiver election." The amended statute split-waiver election and the extended split-waiver election are each subject to the same conditions and procedures, and provide similar relief, except that the extended split-waiver election waives only the extended carryback period (if any).

Generally, the split-waiver elections under the Temporary Regulations permit an acquiring group to make either an amended statute split-waiver election or an extended split-waiver election for a portion of a CNOL that is attributable to an acquired member and arises in a tax year to which an amended carryback rule applies (an “amended carryback CNOL”). These split-waiver elections are available to consolidated groups with an acquired member and attributable CNOLs that become eligible for carryback for more years than under the statutory law in effect at the time of the member’s acquisition (the “default carryback period”). Such eligibility for additional carryback years would arise via a subsequent statutory amendment to the carryback period under Section 172 (the “amended carryback rules”). The additional years added to the default carryback period under the amended carryback rules constitute the “extended carryback period.”

As an illustration, prior to the CARES Act changes, NOLs for certain farming losses and losses incurred by non-life insurance companies³ were eligible for a two-year carryback, the default carryback period in place in 2018. Such losses became eligible for five-year carryback under the CARES Act. Thus, the extended carryback period under the Temporary Regulations would be three years for farming losses and losses incurred by non-life insurance companies arising in a tax year beginning after 31 December 2017, and before 1 January 2021.

Amended statute split-waiver election

For an amended carryback CNOL, the amended statute split-waiver election allows an acquiring group to make an irrevocable election to relinquish the portion of the carryback period (including the default carryback period and the extended carryback period) for the loss during which an acquired member was a member of any former group. In other words, an amended statute split-waiver election applies only to the portion of a CNOL that is attributable to an acquired member for the portion of the carryback period (including the default carryback period and the extended carryback period) during which the acquired member was a member of a former group.

Extended split-waiver election

To provide acquiring groups with additional flexibility for making split-waiver elections, the extended split-waiver election allows, for an amended carryback CNOL, an acquiring group to make an irrevocable election to relinquish solely

the portion of the extended carryback period (and no part of the default carryback period) for that loss during which an acquired member was a member of any former group. In other words, this election affects only the extended carryback period for an acquired member’s attributable loss. As an extended carryback period currently arises only in the context of farming losses and losses incurred by non-life insurance companies, the extended split-waiver election has no practical applicability if the particular consolidated group’s CNOL is not attributable to farming or non-life insurance companies.

Conditions for making a split-waiver election

Temp. Reg. Section 1.1502-21(b)(3)(ii)(C)(3) sets forth various conditions for making either an amended statute split-waiver election or extended split-waiver election. Specifically, an acquiring group may make a split-waiver election for an amended carryback CNOL unless the former group files a return or other filing claiming a carryback to a tax year included in the extended carryback period on or before the date the acquiring group files its split-waiver election. An acquiring group may not make such split-waiver election for an acquired member if the acquiring group filed (1) a valid split-waiver election for that acquired member on or before the effective date of the relevant amended carryback rules or (2) a general waiver election for a CNOL of the acquiring group from which the amended carryback CNOL is attributed to the acquired member.

Finally, the split-waiver election must include all corporations joining the acquiring group that were affiliated immediately before joining the acquiring group (e.g., if a parent’s subsidiary corporations are acquired, each of them must join in the split-waiver election).

Timing

Under Temp. Reg. Section 1.1502-21(b)(3)(ii)(C)(6)(i), either an amended statute split-waiver election or extended split-waiver election must generally be filed with the acquiring group’s timely filed consolidated return (including extensions) for the year during which the amended carryback CNOL is incurred.

If the required filing date of the consolidated return is not at least 150 days after the date of the statutory amendment to the carryback period, however, Temp. Reg. Section 1.1502-21(b)(3)(ii)(C)(6)(ii), permits the split-waiver election statement to be attached to an amended return filed by the date that is 150 days after the date of the statutory amendment. For tax years beginning before 1 January 2021,

for which the required filing date of the consolidated return precedes 30 November 2020, Temp. Reg. Section 1.1502-21(b)(3)(ii)(C)(6)(iii) allows the split-waiver election statement to be attached to an amended return filed by 30 November 2020.

Applicability

The Temporary Regulations generally apply to any CNOL arising in a tax year ending after 2 July 2020. Consistent with the applicability date for the CARES Act amendments to Section 172(b), however, taxpayers may apply these temporary regulations to any CNOLs arising in a tax year beginning after 31 December 2017. The Temporary Regulations' applicability will expire on 3 July 2023.

Implications

Following the TCJA's repeal of the ability to carry back NOLs, consolidated groups generally would not have had reason to make a general waiver election or a split-waiver election on a return for a tax year beginning in 2018 or 2019 because no NOL carryback was otherwise possible. The Temporary Regulations enable consolidated groups to make more refined NOL carryback modeling to account for acquisitions of new members when the statutory loss carryback rules subsequently change.

Most consolidated groups will welcome the loss carryback flexibility offered by the Temporary Regulations. The Temporary Regulations do not solve every NOL carryback issue, of course, particularly carryback issues that require cooperation among selling and acquiring parties (e.g., a consolidated group that acquired a target in 2018 may have expected to inherit the target's allocable NOLs but may be contractually prohibited from electing a split-waiver for those allocable losses absent a new agreement with the selling group). The Temporary Regulations allow more nuanced

planning than before because the current regulations depart from prior versions in at least three important ways, each of which appears to provide consolidated groups with more flexibility than prior versions.

First, the Temporary Regulations permit acquiring consolidated groups to make a split-waiver election on a tax-year-by-tax-year basis; it is not an all-or-nothing election. Acquiring consolidated groups should confirm, however, that they meet the conditions of Temp. Reg. Section 1.1502-21(b)(3)(ii)(C)(3) to make such an election. Moreover, a split-waiver election may only be made for an acquired member that was a former member of a consolidated group (i.e., a split-waiver election is not available to an acquired member that was previously a standalone corporation). Likewise, a split-waiver election is not available to a corporation that is acquired from a consolidated group but does not join in filing a consolidated return with the acquirer following the acquisition.

Second, the availability of the extended split-waiver election recognizes that the general loss carryback regime under Section 172 in a particular year, when a target company is acquired from another group, may only focus on particular industries (e.g., farming or property and casualty insurance companies).

Finally, the Temporary Regulations include a new anticipatory mechanism, by which Treasury aims to have a split-waiver election mechanism in place if the general NOL carryback regime is amended again. The Temporary Regulations are clearly a response to the CARES Act, but Treasury apparently desires to "get ahead of the curve," administratively speaking. The Temporary Regulations could be seen as a tacit acknowledgement by Treasury of the transitory nature of any changes to the NOL carryback regime.

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. NOL carrybacks remain available for certain types of taxpayers (i.e., non-life insurance companies) and certain types of businesses (i.e., farming businesses). These carryback opportunities are reflected in the Proposed Regulations, which will be the subject of a forthcoming Alert.
3. References herein to "non-life insurance companies" are to insurance companies that are other than life insurance companies (such as property & casualty insurance companies) and do not include non-insurance companies.

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