Attribute planning

In this episode, Deloitte's Steve Harrison and Ken Gerstel provide a snapshot of the CARES Act net operating loss (NOL) tax provisions and the opportunity for businesses to monetize. Steve and Ken highlight some of the limitations of NOL carrybacks and how to determine the best approach for your company.

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IAN: Steve, Ken, welcome to the podcast. Great to have you on today. Thanks very much for being here.

STEVE: Thanks for having us.

KEN: Thank you.

IAN: So, Steve, let's start with the CARES Act. Obviously, that created a number of opportunities for taxpayers to monetize losses that may have been generated during 2018 and 2020. Can you take us through the details there a bit?

STEVE: Happy to do that. So a couple of things to look at with the CARES Act that came out specific to net operating losses and the ability to carry back. You know, the exciting thing for taxpayers here experiencing these difficulties with losses is that, as a result of this of this new act, it basically undid what happened at the end of '17, where losses were unable to be carried back any longer. And so now, for losses that have been generated from 2018 through the 2020 period, those losses can be carried back up to a maximum of five years.

So that means we've now . . . Looking at all of our taxpayers and situations, we really have the opportunity to access any taxes paid all the way back to our 2013 years for calendar-year taxpayers and recover those taxes, which is really significant for us because, as most of our listeners will know, that in addition to the change to the NOL rules, there was also a change to the underlying tax rate. And so today, our corporate tax rate is 21 percent, where prior to that, in 2017 and earlier, we had a 35 percent tax rate. And so the ability to carry back those losses today to those '13–'17 tax years really provides a bit of a permanent opportunity to take a 21 percent deduction and really recover it at a 35 percent rate. So that's really huge for a lot of our clients and for companies out there to consider.

The other thing that's important to just recognize is that when they did these carryback rules, there was a bit of a disconnect about how the NOL carryback and carryforward rules worked with the last tax reform, the tax reform act that occurred in '17.

And so for fiscal year taxpayers whose year straddled the '17–'18 tax year, those losses were not available for carryback under the old rules. And so they fixed that glitch as part of the CARES Act. And so now those taxpayers who have that fiscal-year loss that ends in 2018, that loss is now eligible to carry back. It's eligible under the old rules. So that loss can be carried back two years, to the extent there is one, as opposed to five. But it has at least created a complete period, an unbroken period of carryback for fiscal-year taxpayers, as well as our calendar-year taxpayers.

KEN: I think one of the one of the things we saw there because of that is, we had folks that had that fiscal crossover law of December '17, and our clients, too, had losses in their '18 year. Those returns are already filed, and they're rushing for the cash. And I think our tax executives are under some pressure from a treasury and finance perspective to get those through, which procedurally may be easy, but in terms of actually figuring out the amount is a little bit harder. And so there's a little bit of a caution there. We're seeing with some of our clients, you know, that the procedure may be simple, but the effort is a decent lift.

IAN: Thanks, Ken. And, Steve, what about from a planning perspective? What are some of the opportunities there, and also some of the issues?

STEVE: Yes, so I think, when you think about the issues and opportunities to think about . . . I mean, clearly, we're sitting here and recording this in May of 2020, and so at this point, a lot of companies have not gone and filed those 2019 returns. And so you have people who are looking at the 2019 tax profile, as well as the 2020 tax profile, and really trying to evaluate, how do we maximize the ability to carry back these losses?

And so there's a number of things around accounting methods, deduction items, are there bad debts or things like that that could be taken into consideration, and sort of modeling out consequences related to '19 and '20, as well as part of the rule change around qualified improvement property and the ability to—and this is . . . If you've been watching this in the past, this has kind of been the retail glitch that has been talked about in the press, where those type of leasehold improvements are now, instead of being recovered over 39 years—which is what's happened since the last law change—they've now got an accelerated deduction to 15 years, which importantly also makes them eligible for bonus depreciation. So there's quite a bit of flexibility that's allowed in and around those that are things to be thoughtful about, considering it really gets into, ultimately . . . This is a big modeling exercise for companies to think about as far as, do I try to maximize a '19 loss? Do I try to maximize a '20 loss? Are there things I can do between '19 and '20? Because when I look at a loss from 2019, I can immediately go and carry back that loss.

KEN: And, Steve, I think it's fair to say we're seeing a lot of our clients projecting or forecasting a loss for the first time in 2020 over the last several years. And that, kind of to your point, in terms of 2019 planning, some of those clients may look at a highly profitable 2019. And in thinking about that return, because they are in a position where a tax loss may arise operationally or otherwise in'20, they . . . Some clients are actually taking the option to decrease deductions under permitted tax accounting methods in 2019 or increase or accelerate income recognition where a method may permit that, so that, although they pay higher taxes in '19 at 21 percent, they might drive a greater loss in 2020. But to your point, you can't really do that without running the model and getting forecast visibility, which I know is the challenge in the current environment.

IAN: NOLs can now be carried back to as early as potentially 2013. And I'm guessing that means a lot of complexity in the decision-making process. So, Steve, what should taxpayers be considering as they evaluate their strategies, what's right for them and their company?

STEVE: So I think there's a number of things when you're looking at this wide band of years for companies to really be thinking about what income can they go access on what taxes that they're going to be able to carry back and do. And so I think it really drives off of, you know, you're looking at a period of 2013 all the way to 2020, right? And so we've got an eight-year period, and so for a lot of companies during this time, I think there is a lot of transactional activity that's occurred that's really driven either through acquisitions, divestitures, mergers, even consolidation or restructuring within the company and its corporate structure.

And so one thing that companies have to be mindful about as they're evaluating their ability to carry back is, you know, what groups or periods or separate companies these losses are actually carried back to, back in their past. And so part of what needs to happen is really evaluating, what was the corporate history that I've built up from 2013 to today? And so in determining, how do I have losses that can be carried back and accessed, really we have to look at not just my current group today—to the extent I've got a consolidated group, or if I'm a separate, stand-alone corporate taxpayer—but we also have to then turn around and look and say, have I been in a steady state for that eight-year period or not? And to the extent you're not, there's a number of rules that really deal with your ability to carry back losses from one group to another. And depending on it, entities have combined or restructured. There's a limitation about to what year or which entities' history you can actually carry back.

So you acquired a company that had pay tax in the past, and that company then gets merged into another entity in your group, and you generate a loss. That loss can't be carried back to those prior tax years from the acquired company's years.

Further, there's losses under our separate return limitation year rules, which are referred to by the acronym SRLY. And so whenever you have a loss that you have that, first you have to take that loss and allocate it to members of your consolidated group. And then, once you do that, you carry back that loss to each of those entities' prior years, and so it's in your consolidated group. That all can work really well and relatively easily. But to the extent it's allocated to a loss that belongs to a company that had a prior tax period or year other than in the consolidated group, there are these separate return limitation year rules, which I think most taxpayers exempt, they've dealt with consolidated returns, I've heard about and at least have some working knowledge of from a carryforward perspective. But in a carryback perspective, they apply as well. And there is an aggregate income limitation that you have to manage on a separate carryback basis as well.

The last thing that I'll at least raise on this to at least think about—as well as to the extent that you've got a loss that can be carried back for a company that's been acquired during this time period—you really have to also give some consideration to the fact that those losses being carried back are going to be paid to the parent, to that former group. And so the result, depending on the way that your transaction agreements were structured around that acquisition, you may not have any type of tax sharing agreement with that company to work out how refunds that belong to the acquired company get paid to the acquiring group.

KEN: I think your point is a good one. And we've seen a lot of those issues for people that are rushing to get their refund and the refunds filed in the carryback to prepared. But it's hard to evaluate this in an international setting, in a post–tax reform world. And I think the surprise that's hitting some companies when they're doing their carryback of losses is the fact that when you do that, you free up credit, if credits have previously been taken against income, and sometimes those credits are foreign tax credits, and you may not be getting the benefit that you think you are, because there was already a shelter against prior income. And then you have to kind of model out how those credits would otherwise be recovered, because the way the rules work, you carry everything back, you apply the loss, then you have to deal with all related consequences. So that ends up really driving towards some modeling decisions.

The other surprise when you go into a domestic loss situation from an international perspective is, if you know this was your first experience recently over the past several years that you have a loss, your offshore income is now included in income under the GILTI regime. And to the extent you're still operating at a profitable level offshore, but you're creating domestic losses, you may be in for a bit of an unpleasant surprise in that the deduction you normally get to reduce the tax effect of that offshore income can be haircut or entirely eliminated.

And so effectively, it may very well cut against the planning or the optimization that one thinks exists when forecasting a domestic US loss prior to actually getting to the point where there's a loss to be carried back—in other words, including all that income offshore as an offset of the domestic losses before getting to the carryback, given the possible limitation on the GILTI deduction.

IAN: And finally, Steve, what about taxpayers who might be building tax attributes today that can't be immediately monetized? What are some of the thoughts there?

STEVE: Yeah. And so once we've looked at monetized as much as we can in the most effective and efficient way possible, then to the extent we've got a lot of deductions left over that are being carried forward, this is where really watching out for the specter of what we refer to as Section 382 or change of control rules can really come into play. And so what we're seeing a lot in in this type of environment, where the equity markets have been in such disarray and so much activity, is that it puts more companies in the danger zone, if you will, around having a risk of a ownership change.

And so our 382 rules apply when you have a greater than 50 percent change in control of the ownership of the company. And that test is not just as a point in time, but it's really comparing the ownership at a point in time to all of the activity it's had over the prior three years. And so, while there are a number of people who've probably dealt with these rules when they've had the acquisition of a company or the disposition of a company where there's a 100 percent change of control, there's also the concept, if you will, of a creeping change of control that companies need to be mindful of and really be aware of when they're trying to manage and maximize sort of that future value of their losses, if you will.

And so one thing we're seeing a lot of companies talk about—and this is really coming from a board perspective, and management and some of the equity holders are having conversations, and so our tax folks need to make sure that they're out there talking about it to their companies—is a rights plan to help manage it solely from a from a change of control perspective. And really, from a tax perspective, it really elevates you from a board discussion perspective and really thinking about creating and maintaining value overall for the company.

KEN: Yes, Steve, I think that's right. You know, the 5 percent shareholder activity is really the threshold component that can contribute to an ownership change. And in the 382 world, a lot of times, people think about this as the hindsight analysis. And it seems like our clients, particularly those that are going to have significant attributes, are really needing to move those analysis forward, and the burden that's imposed on the tax function when there's a potential board action to limit trading in shares is quite expensive, and a lot of times a lot of forecasting and anticipation.

IAN: Steve and Ken, great information. Thanks again for coming on the podcast today.

STEVE: Thanks for having us on.