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Congress and IRS Virus Relief Allow Loss Carrybacks, Tax Refund Claims

In response to the coronavirus pandemic, the IRS is updating some important guidelines and procedures to make them easier.

EXPERT TAKE

Many investments these days seem volatile, but there are few asset classes that have been as volatile as crypto. If you have losses, you might have trouble claiming them, offsetting gains or reducing your income. In fact, asking if you have tax losses or even expecting some sounds like a silly question. How losses are treated under the tax law is an important and complex question.

In general, our tax system requires you to treat each tax year separately. You tally up your income, deductions and other items, and you figure your tax bill for the tax year based on that. However, the rules for claiming net operating losses, or NOLs, essentially operate as an exception. Subject to a number of details, you can sometimes apply a loss in one year to reduce your tax in another year.

There were always limits, but under the tax bill Congress passed in late 2017, claiming net operating losses became much tougher, starting in 2018. The big tax bill passed at Christmas 2017 was called the Tax Cuts and Jobs Act, and it slashed the ability to claim NOLs after 2017 to 80% of taxable income. As a reminder, that big 2017 tax law was also the law that removed the ability to exchange one crypto for another crypto tax-free.

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What's more, the 2017 law took away the ability to carry NOLs back to prior tax years. Both of those changes hurt, especially the rule killing carrybacks. But as part of the COVID-19 response, the new CARES Act helps in a big way. For tax years starting after Dec. 31, 2017, and before Jan. 1, 2021 — that's three calendar years of losses that you incurred in 2018, 2019 or 2020 — the new law allows you to carryback 100% of these NOLs to the prior five tax years.

You first have to carry losses back to the earliest year, five years back, then the fourth, then third, and so on. You have to work out the mechanics of claiming these, but it's a sweet deal if you are in the sour position of having losses. Due to the COVID-19 pandemic, there will be lots of business with losses for 2020. How about NOL carryforwards?

The CARES Act liberalizes the treatment of those, too, at least for some time. If you want, you can waive the carryback and can elect to carry NOLs forward to subsequent tax years. Run some numbers to see what makes sense for you. Furthermore, for 2018, 2019 and 2020, corporate taxpayers can use NOLs to fully offset their taxable income — rather than only 80% of taxable income.

For tax years beginning before 2021, taxpayers can take an NOL deduction equal to 100% of taxable income — rather than the present 80% limit. What will happen in 2021? For tax years beginning after 2021, taxpayers will be eligible for: (1) a 100% deduction of NOLs arising in tax years before 2018, and (2) a deduction limited to 80% of taxable income for NOLs arising in tax years after 2017. Under the changes of the CARES Act, corporate taxpayers with eligible NOLs are now able to claim a refund for tax returns from prior tax years.

For corporate taxpayers, NOLs carried back to pre-2018 years — when corporate tax rates were a whopping 35% — are more valuable than losses used to offset income that is taxable at the current 21% rate. Thus, a corporation can carry back its 2018, 2019 and

2020 NOLs to offset pre-2018 ordinary income or capital gains that were taxed at rates of up to 35%. Think of it as a kind of tax-rate arbitrage, so you can get a tax refund based on the old higher tax rate.

The United States Internal Revenue Service has already announced the implementation of rules for these important changes. Revenue Procedure 2020-24 provides guidance to taxpayers with net operating losses that are carried back under the CARES Act. There are details about waiving the carryback period in the case of a net operating loss arising in a taxable year beginning after Dec. 31, 2017, and before Jan. 1, 2021, disregarding certain amounts of foreign income subject to transition tax that would normally have been included as income during the five-year carryback period, and waiving a carryback period, reducing a carryback period or revoking an election to waive a carryback period for a taxable year that began before Jan. 1, 2018, and ended after Dec. 31, 2017.

What's more, the IRS is also giving you more time to file, allowing an extra six months. In Notice 2020-26, the IRS grants a six-month extension of time to file IRS Form 1045 or Form 1139 with respect to the carryback of an NOL that arose in any taxable year that began during the calendar year of 2018 and that ended on or before June 30, 2019. Individuals, trusts and estates should file Form 1045; corporations should file Form 1139.

Are partnerships with losses left out? Not hardly. The IRS issued Revenue Procedure 2020-23, which allows eligible partnerships to file amended partnership returns using Form 1065. They are supposed to check the "Amended Return" box and issue amended Schedules K-1 to the partners. Partnerships filing these amended returns should write "FILED PURSUANT TO REV PROC 2020-23" at the top of the amended return.

Finally, the IRS is doing its best to adopt special procedures designed to help people get these tax refunds quickly. The IRS announced temporary procedures in updated FAQs for filing IRS Forms 1139 or 1045 that claim these tax refunds by fax. Tax returns by fax are unusual, and the IRS is clear that this is not a blanket rule that will apply to other tax returns and other tax refund claims. However, in the case of these particular refund claims, the IRS is making an exception.

The IRS has announced two dedicated fax lines, one for eligible refund claims on Form 1139, which can go by fax to 844-249-6236. The other is for eligible refund claims on Form 1045, which can go by fax to 844-249-6237. The IRS is quick to note that these numbers will not work until April 17, so don't fax before then.

Should you mail the old-fashioned way? No. The IRS is encouraging taxpayers to wait until April 17 and file by fax, rather than mailing in Forms 1139 and 1045, since mail processing is being impacted by the emergency. A maximum of 100 pages can be initially faxed, but the IRS says that if additional documentation is required to be attached or needed, the IRS will follow up and ask.

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