¶515 Net Operating Losses

NEW LAW EXPLAINED

Net operating loss carryback eliminated and unlimited carryforwward period provided; 80 percent taxable income limit.— Net operating loss deductions in carryback and carryforward years are limited to 80 percent of taxable income. The generally applicable two-year carryback period, as well as the longer carryback periods for special types of losses, are eliminated. NOLs, however, may be carried forward indefinitely. Exceptions described below apply to farming losses and losses of casualty and property insurance companies.

Net operating loss deduction limited to 80 percent of taxable income. Effective for net operating losses that arise in tax years beginning after December 31, 2017, the net operating loss deduction for a tax year is limited to the lesser of:

1) the aggregate of net operating loss carryovers (i.e., carryforwards) to the tax year, plus net operating loss carrybacks to the tax year, or
2) 80 percent of taxable income computed for the tax year without regard to the net operating loss deduction allowed for the tax year (Code Sec. 172(a), as amended by the Tax Cuts and Jobs Act of 2017)

COMMENT

Since the 80 percent taxable income limit applies to losses arising in tax year beginning after December 31, 2017, net operating loss carrybacks and carryforwards attributable to losses that arose in tax years beginning before January 1, 2018, are not subject to the 80 percent limitation (Act Sec. 13302(e)(1) of the 2017 Tax Cuts Act).

In determining the amount of a net operating loss that remains available for carryback or carryforward, the taxable income for any prior tax year to which the net operating loss was carried is not treated as exceeding 80 percent (Code Sec. 172(b)(2), as amended by the 2017 Tax Cuts Act).

Taxable income of REIT. In the case of a real estate investment trust, the 80 percent taxable income limitation is determined by reference to "real estate investment trust taxable income" as defined in Code Sec. 857(b)(2) but without regard to the dividends paid deduction (Code Sec. 172(d)(6), as amended by 2017 Tax Cuts Act).

Most net operating loss carrybacks eliminated and carryforwards allowed indefinitely. The new law eliminates the carryback of all NOLs except for NOLs attributable to farm losses and certain insurance companies, as described below. However, the 20-year limitation on carryforwards is also eliminated (Code Sec. 172(b)(1)(A), as amended by 2017 Tax Cuts Act). This provision is effective for net operating losses arising in tax years ending after December 31, 2017 (Act Sec. 13302(c)(2) of the 2017 Tax Cuts Act).

A conforming amendment strikes special carryback rules that apply to:

- Real estate investment trusts (Code Sec. 179(b)(1)(B), stricken by the 2017 Tax Cuts Act)
- Specified liability losses (Code Sec. 179(b)(1)(C), stricken by the 2017 Tax Cuts Act)
- Excess interest loss in a corporate equity reduction transaction (CERT) (Code Sec. 179(b)(1)(D), stricken by the 2017 Tax Cuts Act)
- Casualty losses (Code Sec. 179(b)(1)(E), stricken by the 2017 Tax Cuts Act)
- Farming losses (Code Sec. 179(b)(1)(F), stricken by the 2017 Tax Cuts Act)

Two-year carryback for farming losses. The five-year carryback period for farming losses is replaced with a two-year carryback period (Code Sec. 172(b)(1)(B), as added by the 2017 Tax Cuts Act). This provision is effective for net operating losses arising in tax years ending after December 31, 2017 (Act Sec. 13302(e)(2) of the 2017 Tax Cuts Act).

COMMENT

The definition of a farming loss remains unchanged and taxpayers may continue to waive the carryback period (Code Sec. 172(b)(1)(B)(ii) and (iv), as added by the 2017 Tax Cuts Act). Also, as under prior law, where a NOL for a tax year consists of both a farming loss and a non-farming loss, the two losses are treated separately and the farming loss is taken into account in carryback and carryforward years after the non-farming loss (Code Sec. 172(b)(1)(B)(iii), as added by the 2017 Tax Cuts Act). This rule was previously provided by a cross-reference to a similar rule for specified liability losses (Code Sec. 172(f)(5), stricken by the 2017 Tax Cuts Act).

Two-year carryback and 20-year carryforward for casualty and property insurance company losses. The net operating loss of an insurance company other than a life insurance company (e.g., a property and casualty insurance company) may continue to be carried back two years and forward twenty years (Code Sec. 172(b)(1)(C), as added by the 2017 Tax Cuts Act).

In addition, the 80 percent taxable income limitation does not apply to a non-life insurance company. Accordingly, the deductible amount of a non-life insurance company's net operating loss for a tax year is the sum of the net operating loss carryovers to the tax year plus the net operating loss carrybacks to the tax year (Code Sec. 172(f), as added by the 2017 Tax Cuts Act).

COMMENT

The two-carryback and 20-year carryforward period are retained for insurance companies other than life insurance companies. In addition, the 80 percent of taxable income limitation does not apply to these companies. The operations loss deduction for life insurance companies is repealed and life insurance companies will claim NOLs in a manner similar to other corporations under Code Sec. 172 (i.e., no carryback, indefinite carryforward, and 80 percent taxable income limitation on deduction). The NOL deduction of a life insurance company is determined by treating the NOL for any tax year generally as the excess of the life insurance deductions for such taxable year, over the life insurance gross income for such taxable year. See ¶905 for the treatment of life insurance companies.

Determination of remaining carryback or carryforward. In determining the portion of a net operating loss that remains for carryback or carryforward, the new 80 percent taxable income limitation applies. Consequently, the portion of a net operating loss that remains available for carryback or carryforward to another tax year is the excess, if any, of the amount of the loss over the sum of 80 percent of the taxable income (computed with certain of the modifications described in Code Sec. 172(d)) for each of the tax years to which the loss was previously carried (Code Sec. 172(b)(2), as amended by 2017 Tax Cuts Act).

Modifications to taxable income in computing NOL for loss year. The Code Sec. 199 manufacturing deduction is removed from the list of deductions that may not be claimed in computing the net operating loss for a loss year (Code Sec. 172(d)(7), stricken by the 2017 Tax Cuts Act).

COMMENT

This amendment is made because the Act repeals the manufacturing deduction (Act Sec. 13305(a) of the 2017 Tax Cuts Act).

The new deduction for foreign-derived intangible income (Code Sec. 250) is added to the list of deductions that may not be claimed in computing the net operating loss for the loss year (Code Secs. 172(d)(9) , as added by the 2017 Tax Cuts Act).

The qualified business income deduction allowed by new Code Sec. 199A for noncorporate taxpayers is also added to the list of deductions that may not be claimed (Code Sec. 172(d)(8), as added by the 2017 Tax Cuts Act) (see ¶330).

These modifications apply to tax years beginning after December 31, 2017 (Act Secs. 11011(e), 13305(c), 14202c) of the 2017 Tax Cuts Act).

Effective date. The amendments made by this section limiting net operating losses (NOLs) to 80 percent of taxable income, determining the amount of remaining carryback or carryforward, and exempting life insurance companies from the 80 percent of taxable income limitation apply to losses arising in tax years beginning after December 31, 2017 (Act Sec. 13302(e)(1) of the Tax Cuts and Jobs Act). The amendments eliminating the carryback periods, making the carryforward period indefinite, reducing the farming loss carryback period from five years to two years, and allowing a two-year carryback and twenty-year carryforward for the net operating loss of an insurance company apply to net operating losses arising in tax years ending after December 31, 2017 (Act Sec. 13302(e)(2) of the 2017 Tax Cuts Act).