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Congress Expands Favorable Tax Treatment of 2008 and 2009 Net Operating Losses

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On November 6, 2009, President Obama signed into law the Worker, Homeownership, and Business Assistance Act of 2009 (the "Act"), a piece of legislation widely known for extending unemployment benefits as well as the first-time homebuyer tax credit.[1] No less important, however, the Act contains an enhanced and expanded net operating loss ("NOL") carryback election that makes available to all businesses (with few exceptions) a five-year NOL carryback period for losses incurred in 2008 or 2009.[2] A similar provision had been contemplated earlier this year for inclusion in the American Recovery and Reinvestment Act of 2009 ("ARRA 2009"), but was watered down prior to passage.

Pursuant to changes made by the Act, taxpayers may make an irrevocable election to carry back an "applicable NOL" for 2008 or 2009 (but not both) up to five years.[3] An applicable NOL is one for a taxable year beginning or ending in 2008 or 2009.[4] A similar provision had been contemplated in early 2009 for inclusion in ARRA 2009, but was watered down just prior to passage to apply only to "small businesses," defined to include those with average gross receipts of no more than $15 million. For most other businesses, the carryback period prior to the Act was two years.

If an election is made under the Act to carry back an NOL for the full five-year period, the offset amount for the fifth year is limited to 50 percent of taxable income in that year.[5] The amount of the NOL otherwise carried to tax years after such fifth preceding year is adjusted to take this limitation into account. For example, where a large business has an NOL of $5 million in 2009 and $3 million of taxable income for 2004, only $1.5 million of 2004 taxable income may be offset by the current NOL. The remaining $3.5 million NOL would be applied against income from 2005 and each subsequent year until it is extinguished or expired.

The Act also modifies the NOL carryback framework in the context of the alternative minimum tax (the "AMT"). Under pre-Act law, for purposes of computing the AMT, a taxpayer's NOL deduction could not reduce its alternative minimum taxable income ("AMTI") by more than 90 percent of AMTI. Pursuant to the Act, however, this limitation is suspended for applicable NOLs for which the extended carryback period is elected. Also, in applying the 50 percent limitation (described above) with respect to the AMT, the limitation is applied separately based on AMTI.[6]

The enhanced carryback election is generally not available for companies in which the federal government has received an equity interest (or warrants or rights to acquire such an interest) pursuant to the Emergency Economic Stabilization Act of 2008. This includes companies that have received TARP assistance. Fannie Mae and Freddie Mac are also excluded. These exclusions also apply to any entity that in 2008 or 2009 is a member of an affiliated group that includes an excluded company. Note that if an otherwise eligible company previously elected not to carry back an NOL from a tax year ending before the Act was passed, it may revoke such election before the due date (with extensions) for filing its 2009 return.

Notwithstanding these exceptions, an eligible company may elect an extended carryback period under the Act any time before the due date (with extensions) for filing the return for its last taxable year beginning in 2009. It should be noted that the twenty-year NOL carryforward provision remains in place, as does the option to forego any carryback and instead carry an NOL forward.[7] The Joint Committee on Taxation estimates that the changes described above will provide more than $33 billion of immediate tax relief at a cost of $10.4 billion over the course of 10 years.[8]

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1 In addition to extending the $8,000 tax credit for first-time homebuyers, Sec. 11 of the Act adds a new $6,500 tax credit for homebuyers who are currently homeowners.

2 The Worker, Homeownership, and Business Assistance Act of 2009, H.R. 3548, 111th Cong. Sec. 13, amending Section 172(b)(1)(H) of the Internal Revenue Code of 1986, as amended (the “Code”).

3 Note, however, that an eligible small business that timely elected (or timely elects) to carry back a 2008 NOL pursuant to ARRA 2009 can make the election under the Act for an additional year, thus carrying back, for up to five years, NOLs from both 2008 and 2009.

4 Thus, a fiscal year taxpayer may be able to choose from three different tax years in electing the extended carryback period under the Act.

5 The limitation does not apply to a 2008 NOL of an eligible small business with respect to which an election is made pursuant to ARRA 2009, even if such election is made after Nov. 6, 2009.

6 See Joint Committee on Taxation, Technical Explanation of Certain Revenue Provisions of the Worker, Homeownership, and Business Assistance Act of 2009, JCX-44-09, fn. 18 (Nov. 3, 2009).

7 See Code Sections 172(b)(1) and (3).

8 Joint Committee on Taxation, Estimated Revenue Effects of Certain Revenue Provisions Contained in the “Worker, Homeownership, and Business Assistance Act of 2009,” JCX-45-09 (Nov. 3, 2009).