

Covid-19 Tax Relief Makes Winners out of Losses (for some)

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The CARES Act, signed into law on March 27, 2020 in the wake of the onset of the Covid-19 pandemic, contained numerous changes to U.S. federal income tax law. One such change applied to the deductibility of net operating losses (“NOLs”).

Legislation enacted in December 2017 commonly known as the “Tax Cuts and Jobs Act” (the “TCJA”) prohibited the carrying back of NOLs to prior tax years and limited the amount of NOLs which could be deducted in any particular tax year to 80% of a corporate filer’s taxable income.

Reversing course, Section 2303 of the CARES Act delayed the effective date of certain limitations in the TCJA by allowing a corporate taxpayer’s NOLs arising in a taxable year beginning after December 31, 2017 and before January 1, 2021 to be carried back to the five years preceding the taxable year of such loss. In addition, the CARES Act eliminated the taxable income limitation applicable to the deductibility of NOLs for tax years beginning after December 31, 2017 and before January 1, 2021 (with additional rules applying to tax years beginning after January 1, 2021).

Recent SEC filings suggest that SEC-registered companies anticipate receiving refunds, in the aggregate, in excess of \$5 billion. Due to the reduction of the U.S. corporate tax rate from 35% to 21% as a result of the TCJA, some corporate taxpayers may benefit significantly more than others, due to the ability to carry NOLs back to tax years in which a higher U.S. federal income corporate tax rate applied. Other corporate taxpayers may be unable to fully, or even partially, utilize accumulated NOLs due to not having taxable income in the five tax years preceding the year of a particular loss.

NOL provisions in merger and acquisition agreements should be carefully analyzed in the wake of the CARES Act to ensure that the potentially significant benefits from the ability to carry back NOLs are appropriately negotiated.

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