IRS Guidance On Farm NOLs

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Overview

The IRS has finally issued guidance on how farm taxpayers are to handle carryback elections related to farm net operating losses (NOLs) in light of all of the legislative rule changes in recent years.

Handling farm NOLs – it's the topic of today's post

Background

The Tax Cuts and Jobs Act (TCJA) limited the deductibility of an NOL arising in a tax year beginning after 2017 to 80 percent of taxable income (computed without the NOL deduction). Under the TCJA, no NOL carryback was allowed unless the NOL related to the taxpayer's farming business. A farming NOL could be carried back two years, but a taxpayer could make an irrevocable election to waive the carryback. The 80 percent provision also applied to farm NOLs that were carried back for NOLs generated in years beginning after 2017. Under the TCJA, post-2017 NOLs do not expire.

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) suspended the 80 percent limitation for NOLs through the 2020 tax year. The suspension applies to all NOLs, farm or non-farm, arising in tax years beginning in 2018-2020. The CARES Act also removed the two-year carryback option for farm NOLs and replaced it with a five-year carryback for all NOLs arising in a tax year beginning after 2017 and before 2021. Under the carryback provision, an NOL could be carried back to each of the five tax years preceding the tax year of the loss (unless the taxpayer elected to waive the carryback). That created an issue – some farmers had already carried back an NOL for the two-year period that the TCJA allowed.

The COVID-Related Tax Relief Act (CTRA) of 2020 amended the CARES Act to allow taxpayers to elect to disregard the CARES Act provisions for farming NOLs. This is commonly referred to as the "CTRA election." Under the CTRA election, farmers that had elected the two-year carryback under the TCJA can elect to retain that carryback (limited to 80 percent of the pre-NOL taxable income of the carryback year) rather than claim the five-year carryback under the CARES Act. In addition, farmers that previously waived an election to carryback an NOL can revoke the waiver.

The CTRA also specifies that if a taxpayer with a farm NOL filed a federal *income tax return* before December 27, 2020, that disregards the CARES Act amendments to the TCJA, the taxpayer is treated as having made a "deemed election" unless the taxpayer amended the return to reflect the CARES Act amendments by the due date (including extensions of time) for filing the return for the first tax year ending after December 27, 2020. This means that the taxpayer is deemed to have elected to utilize the two-year carryback provision of the TCJA.

IRS Guidance

On June 30, 2021, the IRS issued Rev. Proc. 2021-14, 2021-29 I.R.B. to provide guidance for taxpayers with an NOL for a tax year beginning in 2018-2020, all or a portion of which consists of a farming loss. The guidance details how the taxpayer can elect to not apply certain NOL rules of the CARES Act, and how the CTRA election can be revoked. Rev. Proc. 2021-14 is effective June 30, 2021.

Affirmative election. The Rev. Proc. specifies that a taxpayer with a farming NOL, other than a taxpayer making a deemed election, may make an "affirmative CTRA election" to disregard the CARES Act NOL amendments if the farming NOL arose in any tax year beginning in 2018-2020. An affirmative election allows the farm taxpayer to carryback a 2018-2020 farm NOL two years instead of five years. To make an affirmative election, the taxpayer must satisfy all of the following conditions:

- The taxpayer must make the election on a statement by the due date, including extensions of time, for filing the taxpayer's Federal income tax return for the taxpayer's first tax year ending after December 27, 2020. This means that for calendar year individuals and C corporations, the date is October 15, 2021.
- The top of the statement must state: "The taxpayer elects under § 2303(e)(1) of the CARES Act and Revenue Procedure 2021-14 to disregard the amendments made by § 2303(a) of the CARES Act for taxable years beginning in 2018, 2019, and 2020, and the amendments made by § 2303(b) of the CARES Act that would otherwise apply to any net operating loss arising in any taxable year beginning in 2018, 2019, or 2020. The taxpayer incurred a Farming Loss NOL, as defined in section 1.01 of Rev. Proc. 2021-14 in [list each applicable taxable year beginning in 2018, 2019, or 2020]."

Note. The election is all-or-nothing. The taxpayer must choose either the two-year farm NOL carryback provision for all loss years within 2018-2020, or not.

- The taxpayer attaches a copy of the statement to any original or amended federal income tax return or application for tentative refund on which the taxpayer claims a deduction attributable to a two-year NOL carryback pursuant to the affirmative election.

For taxpayers that follow the Rev. Proc. and make an affirmative election, the Rev. Proc. specifies that the 80 percent limitation on NOLs will apply to determine the amount of an NOL deduction for tax years beginning in 2018-2020, to the extent the deduction is attributable to NOLs arising in tax years beginning after 2017. In addition, the CARES Act carryback provisions will not apply for NOLs arising in tax years beginning in 2018-2020.

Deemed election procedure. In §3.02 of the Rev. Proc., the IRS sets forth the procedure for a taxpayer to follow to not be treated as having made a deemed election. For taxpayers that made a deemed election under the CARES Act, the election applies unless the taxpayer amends the return the deemed election applies to reflecting the CARES Act amendments by due date specified in the Rev. Proc. Also, for taxpayers that made a deemed election under the CARES Act and IRS rejected the two-year carryback claims, Rev. Proc. 2021-014 establishes the steps the taxpayer may take to pursue those claims. Those steps require the taxpayer to submit complete copies of the rejected applications or claims, together with income tax returns for the loss year(s). The top margin of the first page of a complete copy of each application or claim should include, "Deemed Election under Section 3.02(2) of Rev. Proc. 2021-14." The Rev. Proc. states that resubmission of previously rejected claims should be sent by the Rev. Proc. due date.

Note. The taxpayer is not treated as having made a deemed election if the taxpayer subsequently files an amended return or an application for tentative refund by the due date of the Rev. Proc.

For a taxpayer that elected not to have the two-year carryback period apply to a farming NOL incurred in a tax year beginning in 2018 or 2019, the Rev. Proc. specifies that the taxpayer may revoke the election if the taxpayer made the election before December 27, 2020, and makes the revocation on an amended return by the date that is three years after the due date, including extensions of time, for filing the return for the tax year the farming NOL was incurred. If the NOL is not fully absorbed in the five-year earlier carryback year, the balance carries forward to the fourth year back and subsequent years in the carryback period until it is fully absorbed. The taxpayer may also amend the returns for the years in the five-year carryback period, if needed, to utilize the benefits of I.R.C. §1301 (farm income averaging).

Note. A statement must be attached to the return to revoke the prior election to waive the carryback period. The statement must read as follows: "Pursuant to section 4.01 of Rev. Proc. 2021-14 the taxpayer is revoking a prior I.R.C. §172(b)(1)(B)(iv) or I.R.C. §172(b)(3) election to not have the two-year carryback period provided by I.R.C. §172(b)(1)(B)(i) apply to the farm NOL, as defined in section 1.01 of Rev. Proc. 2021-14, incurred in the taxable year."

Area of uncertainty. What remains unclear after the issuance of Rev. Proc. 2021-14 is whether the affirmative CTRA election can be made to use the two-year carryback if a farmer had previously waived the five-year carryback. The Rev. Proc. is not clear on this point.

Example. Hamilton Beech is a calendar year farmer. He sustained a farming NOL in 2019. 2017, however, was a good year financially and Hamilton wanted to use the TCJA two-year carryback provision so that he could use the 2019 NOL to offset the impact of the higher tax brackets on his taxable income for 2017. Unfortunately, the CARES Act (enacted into law on March 27, 2020) eliminated the two-year carryback provision leaving Hamilton with the choice of either carrying the 2019 NOL to 2014 or forgoing the five-year carryback. 2014 was a low-income year for Hamilton. Thus, Hamilton elected to waive the five-year NOL carryback provision on his 2019 return that he filed after March 27, 2020 (but before December 27, 2020) and the attached statement made reference to I.R.C. §172(b)(3) and not I.R.C. §172(b)(1)(B)(iv).

Because Hamilton filed his 2019 return after March 27, 2020, and before December 27, 2020, uncertainty exists concerning his ability to make an affirmative election under the Rev. Proc. to disregard the CARES Act five-year NOL carryback provision. If he can, he would be able to use the two-year carryback rule to offset his higher income in 2017. One approach for Hamilton would be for him to amend his 2019 return, citing Rev. Proc. 2021-14, Section 3.01 and state that he has met the conditions of Section 3.01(2).

Note. The taxpayer must also attach a statement to an amended return for the loss year, that states at its top: "Pursuant to section 4.01 of Rev. Proc. 2021-14, the taxpayer is revoking a prior I.R.C. §172(b)(1)(B)(iv) or I.R.C. §172(b)(3) election not to have the two-year carryback period provided by I.R.C. §172(b)(1)(B)(i) apply to the Farming Loss NOL, as defined in section 1.01 of Rev. Proc. 2021-14, incurred in the taxable year."

Mixed NOLs. If a taxpayer has an NOL that is a mixture of farm and non-farm activities, the portion of the NOL that is attributable to the farming activity may be carried back either two or five years consistent with the guidance of the Rev. Proc. The non-farm portion of the NOL may not be carried back two years. Also, the election to waive the carryback period is all-or-nothing. It is not possible to separately waive a farm NOL carryback from a non-farm NOL.

Conclusion

The Congress has made tax planning with farm NOLs difficult in recent years with numerous rule changes. The recent guidance from the IRS, though issued late, is helpful on several points.