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Does NOL Stand for Net Operating Loss or Non Obstante Lamentum? A Discussion of Amendments to Section 172 by H.R. 1

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Tax reform imposes a new 80 percent limitation on the use of net operating losses (“NOLs”) and eliminates the two-year carryback and 20-year carryforward periods. Change can spawn confusion. One glitch: Application of the new 80 percent limitation is unclear when losses generated both before and after the effective date of the new law are available in a single tax year. However, upon examination of three potential interpretations below, we believe that there is an answer in the absence of express guidance to the contrary. This article examines the new rules for the treatment of losses, analyzes alternative interpretations of how the new 80 percent limitation could apply when pre-effective-date and post-effective-date losses are in the mix, and identifies the interpretation of the 80 percent limitation that makes the most sense in light of the uncertainty.

The determination of a corporation’s NOL deduction (“NOLD”) in a given tax year—absent complications related to a section 382¹ limitation or the consolidated separate return limitation year

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¹ Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the “Code”) or the applicable regulations promulgated pursuant to the Code (the “regulations”).

(“SRLY”) rule—is relatively simple, right? Prior to the enactment of H.R. 1,² most readers would be nodding along with the understanding that a corporation’s NOLD was limited to its taxable income. However, as part of H.R. 1, Congress imposed new restrictions on the use of NOLs, including a reduction of the annual NOLD limitation from 100 percent to 80 percent of a corporation’s taxable income in a given tax year.³ This new 80 percent limitation is effective with respect to NOLs arising in tax years *beginning after* December 31, 2017 (“post-2017 NOLs”),⁴ and thus does not apply to NOLs arising in tax years *beginning on or before* December 31, 2017 (“pre-2018 NOLs”). Although this change seems straightforward, it appears that in its rush to pass the legislation Congress failed to anticipate foreseeable questions as to the mechanics of the 80 percent limitation to calculate the allowable NOLD in a tax year in which a taxpayer has both pre-2018 and post-2017 NOLs available. The IRS acknowledged that application of the 80 percent limitation to the combined use of pre-2018 and post-2017 NOLs to offset taxable income remains an open issue, along with the interplay and ordering between NOLs and other deductions.⁵ However, notwithstanding the IRS’s apparent view, a holistic reading of the statutory language suggests a likely result.

This article discusses the language used by Congress in section 13302 of H.R. 1; explores a number of logical outcomes permitted by the statutory language; and identifies a suggested path forward to apply the 80 percent limitation in instances when pre-2018 and post-2017 NOLs are both available, absent clear guidance from the IRS to the contrary.

NOL Limitation Rules Prior to the Enactment of H.R. 1

Former section 172⁶ permitted a taxpayer to claim a NOLD for a tax year equal to the lesser of (1) its taxable income determined without regard to its NOLs, or (2) the aggregate amount of its NOL carryovers, plus its NOL carrybacks, to a given tax year.⁷ Thus, a taxpayer could “zero out” its taxable income if it had sufficient NOL carryovers, but could not use loss carryovers to generate an NOL for the year.⁸ In the consolidated group context, the NOLD is determined on a consolidated basis,⁹ and the group’s NOL carryovers and carrybacks include (1) any NOLs generated by the consolidated group

² H.R. 1, an act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, was signed into law on December 22, 2017, as P.L. 115-95, 131 Stat. 2054 (2017) (“H.R. 1”).

³ H.R. 1, section 13302(a).

⁴ H.R. 1, section 13302(e).

⁵ Emily L. Foster, *Algebraic Solution May Be Required to Settle Pre-2018 NOL Issue*, Tax Notes Today (Mar. 13, 2018) (reporting the comments made by Kevin M. Jacobs, Senior Technician Reviewer, Branch 4, IRS Office of Associate Chief Counsel (Corporate), during the March 9, 2018 Federal Bar Association Section on Taxation conference in Washington, D.C.).

⁶ We use the term “former section 172(a)” to refer to the version of section 172(a) that was in effect immediately prior to the enactment of H.R. 1, and the term “amended section 172(a)” to refer to the statute immediately after its amendment by H.R. 1.

⁷ Former section 172(a) generally allowed a taxpayer to carry back its NOLs two tax years and carry forward its NOLs 20 tax years.

⁸ This makes intuitive sense, in a context in which NOL carryovers were limited to 20 years. Taxpayers, if allowed to deduct NOL carryovers in an amount in excess of their taxable income for a given tax year, would have been able to use old NOLs to create new ones, and thus easily avoid the carryover limitation.

⁹ Section 1.1502-21(a).

(i.e., the excess of consolidated deductions over consolidated taxable income as determined under section 1.1502-11), and (2) any NOLs of the consolidated group members that arose in a separate return year during which the member generating the NOLs was not part of the consolidated group.¹⁰

In addition, prior to its repeal in H.R.1, taxpayers subject to the corporate alternative minimum tax (“AMT”) regime could claim a NOLD under the AMT, though the amount of the AMT NOLD that could be claimed in a tax year could not exceed 90 percent of a corporation’s pre-NOLD alternative minimum taxable income (“AMTI”).¹¹ As a result, the former 20 percent corporate AMT rate applied to the 10 percent of AMTI remaining after the AMT NOLD, guaranteeing Treasury a slice of the pie in a profitable year, regardless of the amount of AMT NOLs that were otherwise available.¹²

Overview of Amended Section 172

Following the enactment of H.R. 1, the general NOL landscape remains largely intact, even though Congress repealed most carrybacks.¹³ The remainder of the article will concentrate on the layers of complexity added by the new 80 percent limitation and the new bifurcated effective date language.

Amended section 172(a) reads as follows:

(a) DEDUCTION ALLOWED. – There shall be allowed as a deduction for the taxable year an amount equal to the lesser of— (1) the aggregate of the net operating loss carryovers to such year, plus the net operating loss carrybacks to such year, or (2) 80 percent of taxable income computed without regard to the deduction allowable under this section.¹⁴

H.R. 1 also amended section 172(b) to repeal the general two-year NOL carryback¹⁵ and to provide for an indefinite carryforward of NOLs.¹⁶ The amendments to section 172 did not alter the ordering rule for

¹⁰ *Id.*; section 1.1502-21(e). The SRLY rules operate to limit the use of SRLY-limited NOLs to offset items of income or gain of the SRLY-member, in a manner that prevents a SRLY-limited NOL from offsetting the income or gain of a non-SRLY member of the consolidated group. Section 1.1502-21(c)(2).

¹¹ In the former corporate AMT regime, a taxpayer was allowed to claim an AMT NOLD in lieu of the regular tax NOLD. Section 56(a)(4). The AMT NOLD is defined in section 56(d)(1)(A) to include, among other things, a provision that it generally cannot exceed 90 percent of AMTI determined without regard to the AMT NOLD.

¹² Taxpayers with significant foreign tax credits (“FTCs”) under the AMT regime could “zero out” in a tax year notwithstanding positive earnings for the year, if they were able to use a sufficient combination of AMT NOLs and AMT FTCs. Prior to 2004, the corporate AMT limited the use of AMT FTCs to 90 percent of the pre-credit tentative minimum tax, making it less likely in those years. Former section 59(a)(2), as in effect prior to its repeal in section 421(a) of the American Jobs Creation Act of 2004, P.L. 108-357, 118 Stat. 1418, 1514 (2004).

¹³ See *infra* note 15.

¹⁴ H.R. 1, section 13302(a)(1).

¹⁵ H.R. 1, section 13302(b)(1)(A), amending section 172(b)(1)(A)(i). Benjamin Franklin once said that there were only two things certain in life: death and taxes. Following the amendments to section 172(b) and the repeal of the carryback provision, we can now be certain of a third, the CERT rules don’t apply. H.R. 1 provided certain exceptions to the no-carryback rule, to permit a new two-year carryback for certain farming losses and to retain prior law for the NOLs of property and casualty insurance companies.

¹⁶ H.R. 1, section 13302(b)(1)(B), amending section 172(b)(1)(A)(ii).

using NOLs, and accordingly, NOLs will continue to be used beginning with the loss from the earliest tax year (i.e., a first in, first out (“FIFO”) approach).¹⁷

H.R. 1 section 13302(e) contains a bifurcated effective date for the amendments to section 172:

- ♦ The amendments made to section 172(a) apply to losses arising in tax years *beginning after* December 31, 2017, and
- ♦ The amendments made to section 172(b) apply to losses arising in tax years *ending after* December 31, 2017.¹⁸

Perhaps this bifurcated approach was unintentional, as there appears to be a drafting error in the effective date language.¹⁹

Before addressing the crux of the matter at hand, a couple of items related to the effective date subsection are worth noting. First, the effective date subsection provides that the 80 percent limitation in amended section 172(a) does not apply to NOLs generated in tax years *beginning on or before* December 31, 2017 (i.e., pre-2018 NOLs)²⁰ and the carryback and carryforward amendments to section 172(b) do not apply to NOLs generated in tax years *ending on or before* December 31, 2017.²¹ As a result, former section 172 continues to apply to a corporation’s pre-2018 NOLs such that those losses are available to offset 100 percent of its pre-NOLD taxable income and are only permitted to be carried forward for 20 tax years.

Second, for a brief window of time, the bifurcated language of the effective date produces an unanticipated result for fiscal year taxpayers with losses generated in tax years that straddle December 31, 2017. Take for example a fiscal year taxpayer that generated an NOL in its 12-month tax year ending November 30, 2018. Because the tax year began December 1, 2017, which is before December 31, 2017, the NOL is not subject to amended section 172(a); however, because the tax year ended November 30, 2018, which is after December 31, 2017, the NOL is subject to amended section 172(b). Therefore, NOLs of a fiscal year taxpayer generated in the straddle year are not subject to the 80 percent limitation, can be used to offset 100 percent of taxable income, and are now permitted to be carried forward indefinitely. However, when there is an upside, there is also a downside: Amended section 172(b) applies to prevent the carryback of these straddle year NOLs, because they arise in tax years ending after December 31, 2017.²²

¹⁷ Sections 172(b)(2) and 1.172-4(b).

¹⁸ H.R. 1, section 13302(e).

¹⁹ There appears to be a drafting error in the effective date to the NOL carryback period. See Nathan J. Richman, Net Operating Loss Provision May Need Fix From Congress, 158 Tax Notes 587 (Jan. 29, 2018).

²⁰ H.R. 1, section 13302(e)(1).

²¹ H.R. 1, section 13302(e)(2).

²² *Id.*

The Lingering Questions

While the asymmetrical effective date language provides unanticipated, yet clear, results for fiscal year taxpayers, the interaction and applicability of the 80 percent limitation when a taxpayer has both pre-2018 and post-2017 NOLs provides unusual and unclear results for both fiscal and calendar year taxpayers. Is it a stretch to conclude that the 80 percent limitation applies in connection with the usage of pre-2018 NOLs, such that post-2017 NOLs may only be used to the extent their use would not result in a NOLD in excess of 80 percent of taxable income? Is it possible that the 80 percent limitation applies after the usage of pre-2018 NOLs, such that post-2017 NOLs may be used to the extent of 80 percent of the remaining portion of taxable income? Or is it apparent that the 80 percent limitation applies independent of the pre-2018 NOLs, such that post-2017 NOLs may be used to the extent of 80 percent of taxable income without reduction for the usage of pre-2018 NOLs? Or, alternatively, perhaps the 80 percent limitation applies in some other manner.

This issue could affect taxpayers in an NOL position for the next two decades (i.e., the duration of the pre-2018 NOL carryforward limitation under former section 172(b)). So, how does amended section 172(a)(2) operate when NOLs generated both before and after the effective date are available in a single tax year? Although we believe there is an answer to the application of the 80 percent limitation based on the statutory language, in the absence of clear guidance to the contrary, we will review two additional interpretations and explain why these both require a copious stretch of the statutory language and are therefore unlikely interpretations of the 80 percent limitation.

How Does the 80 Percent Limitation Apply If Both Pre-2018 and Post-2017 NOLs Are Available?

We will explore the incongruent application of a seemingly unambiguous statute through an illustrative example and a series of interpretations.

Assume that Corporation X is a non-consolidated, calendar year, domestic subchapter C corporation with NOLs that are not subject to any limitation beyond section 172 (e.g., no section 382 or SRLY). Corporation X has \$90 of pre-2018 NOLs generated in tax years ending on or before December 31, 2017 and a \$30 post-2017 NOL generated in its tax year ending December 31, 2018. For its 2019 tax year, Corporation X's pre-NOLD taxable income was \$100. What is Corporation X's NOLD in 2019?

Sections 172(b)(2) and 1.172-4(b) require a corporation to absorb its NOLs chronologically, such that Corporation X's pre-2018 NOLs must be used to offset Corporation X's 2019 taxable income before Corporation X may use its post-2017 NOLs. The ability of Corporation X to include all \$90 of its pre-2018 NOLs in its NOLD for 2019 appears to be clear cut under former section 172(a). However, what has given tax professionals pause is whether Corporation X may also include any of its post-2017 NOL carryover in its NOLD for 2019 to offset the remaining \$10 of its 2019 taxable income and, if so, how much of Corporation X's post-2017 NOL carryover may be used.

Interpretation 1: Corporation X May Use a NOLD of \$90 in 2019

One interpretation is that Corporation X may use \$90 of its pre-2018 NOLs, but may not use any of its post-2017 NOLs to offset the remaining \$10 of its 2019 taxable income. To arrive at this conclusion, one must interpret amended section 172(a) as applying the 80 percent limitation with respect to the aggregate NOLD for the tax year, such that no use of the post-2017 NOLs could result in a NOLD greater than 80 percent of taxable income in a tax year. Applying this logic to Corporation X in the example above, none of its post-2017 NOLs are permitted to be used in 2019 because its NOLD, prior to using post-2017 NOLs, is \$90 (i.e., 90 percent of Corporation X's 2019 taxable income), and as a result Corporation X has surpassed the 80 percent limitation through use of its pre-2018 NOLs.

To apply amended section 172(a) in this manner, one must read section 172(a) as preventing post-2017 NOLs from being included in a NOLD greater than 80 percent of the corporation's taxable income. Support for this interpretation comes from a few different places. First, the language of amended section 172(a) provides that the permissible NOLD for a given tax year is an amount equal to the lesser of the NOLs available or "80 percent of taxable income computed without regard to the deduction allowable under this section."²³ The 80 percent limitation applies to taxable income and the effective date subsection provides that the limitation applies to post-2017 NOLs. Accordingly, this language could be interpreted, regardless of whether the deduction is composed of pre-2018 NOLs or post-2017 NOLs, to mean that no use of post-2017 NOLs may generate an NOLD in excess of 80 percent of taxable income.

Second, if "under this section" is intended to encompass both amended section 172(a) and former section 172(a), then the 80 percent limitation would be applied before the use of any pre-2018 NOLs. In this instance, the 80 percent limitation would apply to the full \$100 of taxable income before use of the pre-2018 NOLs. This rationale suggests that perhaps Congress intended for the 80 percent limitation to apply to prevent any use of the post-2017 NOLs from generating a deduction in excess of 80 percent of the corporation's taxable income. If this were to hold true, then the outcome described above that no post-2017 NOLs are permitted to be used in Interpretation 1 seems reasonable. Such interpretation can be read consistently with the effective date language of section 13302(e) of H.R. 1 if one presumes that although the 80 percent limitation applies only the post-2017 NOLs, a taxpayer's usage of its pre-2018 NOLs must still be taken into account in computing such limitation. As such, when using its post-2017 NOLs, a taxpayer is bound to the 80 percent of taxable income limitation, regardless of whether the NOLD is composed of pre-2018 NOLs or post-2017 NOLs.

Third, although Interpretation 1 is not stated in the statute itself or the congressional committee reports, it provides a result that generally appears consistent with H.R. 1's removal of corporate AMT. Corporate AMT previously ensured that a taxpayer could not fully offset its taxable income through the use of AMT NOLs, meaning that a corporate taxpayer was not allowed to "zero out" through the use of loss carryovers. From a policy perspective, perhaps this was Congress's intent for imposing the 80 percent limitation. Before the repeal of corporate AMT, the regime's 90 percent taxable income limitation on the

²³ H.R. 1, section 13302(a) (emphasis added).

use of NOLs could be viewed as imposing a two percent tax rate (i.e., 20 percent AMT rate multiplied by the 10 percent of income that could not be offset with a NOLD, at least for taxpayers without AMT foreign tax credits). Under the new law, the repeal of corporate AMT, coupled with the 80 percent limitation, could be viewed as imposing a 4.2 percent tax rate (i.e., 21 percent corporate tax rate multiplied by the 20 percent of income that cannot be offset with post-2017 NOLs). When examining this from a bird's eye view and a narrow policy perspective, perhaps Interpretation 1 is harmonized by the removal of corporate AMT. In fact, this rationale is consistent with the "Reasons for Change" portion of the Senate Report:

The Committee also believes that taxpayers should pay some income tax in years in which the taxpayer has taxable income (determined without regard to the NOL deduction). Therefore, the Committee believes that the NOL deduction should be limited to a certain percentage of taxable income (determined without regard to the deduction).²⁴

Despite this stated rationale, Interpretation 1 is certainly not aligned with the comprehensive congressional and presidential intent for enacting business tax reform in H.R. 1, namely to cut taxes.²⁵

More importantly, Interpretation 1 is inconsistent with the effective date language in H.R. 1 section 13302(e), which provides that amended section 172(a) only applies to NOLs arising in tax years beginning after December 31, 2017, or the post-2017 tax years. If we were to follow Interpretation 1, we would be turning a blind eye to the threshold question—to which NOLs does the 80 percent limitation apply? Because amended section 172(a) does not apply to NOLs generated on or before December 31, 2017, amended section 172(a) should be applied independent of former section 172(a).

In addition, Interpretation 1 is also seemingly contradictory to congressional intent as both the House and Senate expressly considered the condition of applying the 80 percent limitation to NOLs generated in specific years. The amendments to section 172 were initiated with the House Bill, which provided that a NOLD for a tax year would equal the lesser of "(1) the aggregate of the net operating loss carryovers to such year, plus the net operating loss carrybacks to such year, or (2) 90 percent of taxable income computed without regard to the deduction allowable under this section."²⁶ Notably, the House's proposed text of amended section 172(a) focused on the taxable year in which the NOLD was to be

²⁴ S. Print No. 115-20, at 176 (Comm. Print 2017).

²⁵ "It will bring down corporate tax rates, a goal long shared by Republicans and Democrats, and provide businesses with new opportunities for growth and expansion." Katie Niederee and Julia Lawless, Hatch, Senate Republicans Make the Case for Tax Reform (Nov. 10, 2017) <https://www.finance.senate.gov/chairemans-news/hatch-senate-republicans-make-the-case-for-tax-reform> (quoting Orrin Hatch); "[T]he *Tax Cuts and Jobs Act* will: Reduce the tax rate on the hard-earned business income of Main Street" Press Releases: What You've Been Waiting For: (November 2, 2017), <https://paulryan.house.gov/news/documentsingle.aspx?DocumentID=398771> (quoting Paul Ryan); "Today, it was my great honor to sign the largest TAX CUTS and reform in the history of our country." Donald J. Trump (@realDonaldTrump), Twitter (Dec. 22, 2017, 12:47 PM), <https://twitter.com/realDonaldTrump/status/944308491887316992>.

²⁶ H.R. 1, section 3302(c)(1) at 233-234 (engrossed in House Nov. 16, 2017).

claimed, not the taxable year(s) in which the underlying losses were generated.²⁷ The Senate's version followed the House bill with certain modifications, including a provision that would have limited the NOLD to "90 percent (80 percent in the case of taxable years beginning after December 31, 2022) of taxable income computed without regard to the deduction allowable under this section," demonstrating that the Senate intended to condition the 80 percent limitation on NOL usage to certain tax years following the enactment of the limitation.²⁸ Ultimately, "[t]he conference agreement follow[ed] the Senate amendment, except that the provision limits the NOL deduction to 80 percent of taxable income (determined without regard to the deduction) for *losses arising in taxable years beginning after December 31, 2017*."²⁹ Based on the congressional revisions to the limitation language during the drafting stages, it appears that Congress contemplated that the 80 percent limitation would apply only to post-2017 NOLs (i.e., prospectively, to losses generated in post-enactment years), without regard to the usage of pre-2018 NOLs. Thus, it seems unlikely that Interpretation 1 is consistent with congressional intent or the statutory language.

While arguments can be made in support of Interpretation 1, we believe that the supportive arguments require an unnecessary level of manipulation of and departure from the statutory language and that the arguments require overlooking the threshold question of: to which NOLs does amended section 172(a) apply? For that reason, we do not think that Interpretation 1 is a permissible interpretation.

Interpretation 2: Corporation X May Use a NOLD of \$98 in 2019

A second interpretation of amended section 172 would permit Corporation X to offset \$98 of its 2019 taxable income with NOLs (i.e., \$90 of its pre-2018 NOLs and \$8 of its post-2017 NOLs). To arrive at this conclusion, one must interpret amended section 172(a) as applying the 80 percent limitation to the portion of 2019 taxable income remaining to be offset after use of any pre-2018 NOLs. Applying this logic to Corporation X, \$100 of its 2019 taxable income is first reduced by \$90 of its pre-2018 NOLs, resulting in \$10 of 2019 taxable income remaining and available to be offset by post-2017 NOLs. Then, the 80 percent limitation is applied to the remaining taxable income sought to be offset by post-2017 NOLs. Accordingly, Corporation X is able to use the lesser of: (1) \$30 (i.e., post-2017 NOLs), or (2) \$8 (i.e., 80 percent of the remaining \$10 of 2019 taxable income to be offset) of its post-2017 NOLs in 2019.

²⁷ *Id.* The House Committee on Ways and Means Report provides "the proposal limiting the NOL deduction applies to *taxable years* beginning after December 31, 2017." Staff of Joint Comm. on Taxation, 115th Cong., Description of H.R. 1, the "Tax Cuts and Jobs Act" at 135 (Comm. Print 2017) (emphasis added).

²⁸ H.R. 1, section 13302(a)(1) at 161 (engrossed amendment Senate Dec. 2, 2017). In the version of the bill passed by the House, the proposed NOL limitation was 90 percent of taxable income. However, Senate Finance Committee Chairman Hatch's mark reduced the NOL limitation to 80 percent for tax years beginning after December 31, 2023. Joint Committee on Taxation, Description of the Chairman's Modification to the Chairman's Mark of the "Tax Cuts and Jobs Act" (JCX-56-17) at 6 (Nov. 14, 2017). The date was then accelerated to December 31, 2022 during Senate floor proceedings. H.R. 1, section 13302(a)(1) at 161 (engrossed amendment Senate Dec. 2, 2017). Absent any explicit reasoning, we can deduce that this change was driven by revenue estimate considerations.

²⁹ Conference Report at 394 (emphasis added).

To apply amended section 172(a) in this way, one must read amended section 172(a) as bifurcating the NOLD between former and amended section 172(a), or in other words to apply section 172(a) in a kind of bifurcated, seriatim manner, first by fully applying former section 172(a) and then by applying amended section 172(a) with respect to the taxable income remaining after an application of former section 172(a). If we interpret “without regard to the deduction allowable under this section” to mean solely the deduction permitted under amended section 172(a), then the taxable limitation to which the 80 percent limitation applies must be computed only after we have accounted for the deduction permitted under former section 172(a). If so, the determination of taxable income under Interpretation 2 would be:

- ♦ Step 1: Reduce 2019 taxable income (and apply an initial NOLD for the year) by pre-2018 NOLs under former section 172(a)
- ♦ Step 2: Determine the amount of post-2017 NOLs under amended section 172(a) that may be included in an NOLD for the year

Applying this process to our example, Step 1, use the pre-2017 NOLs to offset 2019 taxable income (i.e., \$100 taxable income reduced by \$90 of pre-2018 NOLs). This yields an interim \$10 taxable income amount. Then, Step 2, apply the 80 percent limitation to the post-2017 NOLs, which results in permissible post-2017 NOLs being the lesser of: \$30 (i.e., post-2017 NOLs) or \$8 (i.e., 80 percent of an interim \$10 taxable income amount determined after the NOLD under former section 172(a) and prior to the NOLD under amended section 172(a)). The lesser of the two is \$8. As a result, a total of \$98 of taxable income is offset by NOLs.

In order to logically lead to this position, the statutory language “80 percent of taxable income [is] computed *without regard* to the deduction allowable *under this section*” must be understood to exclude an NOLD generated by pre-2018 NOLs. If “under this section” is merely intended to encompass deductions pursuant to amended section 172(a) (and *not* to former section 172(a)), then Interpretation 2 seems reasonable, as the 80 percent limitation would be applied after the use of any pre-2018 NOLs (i.e., a deduction under *former* 172(a)). However, similar to Interpretation 1, Interpretation 2 requires a strained reading of the statutory language. Reverting, again, to the effective date language, amended section 172(a) only applies to losses arising in post-2017 tax years. Additionally, in writing amended section 172(a), Congress employed the phrase “taxable income computed without regard to the deduction allowable under this section;” Congress did not write “taxable income computed after reduction for pre-effective date NOLs.” By carving-out the use of pre-2018 NOLs before determining the taxable income to which the 80 percent limitation applies, Interpretation 2 distorts the statutory language in section 172(a) and the effective date language that limits the application of amended section 172(a) to post-2017 NOLs, and requires the application of a bifurcated approach to the NOLD determination and computing an interim amount of taxable income. For that reason, we do not think that Interpretation 2 is particularly persuasive or yields a likely outcome.

Interpretation 3: Corporation X May Use a NOLD of \$100 in 2019

Another interpretation is that Corporation X may fully offset its 2019 taxable income and use \$100 of its NOL carryforwards (i.e., \$90 of its unlimited, pre-2018 NOLs and \$10 of its limited, post-2017 NOLs) as a NOLD for the 2019 tax year. To arrive at this conclusion, one must interpret amended section 172(a) as testing the 80 percent limitation exclusively with respect to Corporation X's taxable income for its 2019 tax year without any intermediate reduction with respect to pre-2018 NOLs, and then applying that limitation solely to the use of post-2017 NOLs. If we apply amended section 172(a) to Corporation X's post-2017 NOLs of \$30, independent of Corporation X's pre-2018 NOLs, then its post-2017 NOLs are limited to the lesser of: \$30 (i.e., post-2017 NOLs) or \$80 (i.e., 80 percent of its \$100 taxable income for the year without regard to the NOLD under former or amended section 172(a)). Following the use of \$90 pre-2018 NOLs, only \$10 of taxable income remains to be offset, and therefore Corporation X ought to include in its 2019 NOLD \$10 of its post-2017 NOLs.

To apply amended section 172(a) in this manner, one must read the effective date subsection to mean that the 80 percent limitation must be applied independent of the use of any pre-2018 NOLs. Support for this interpretation comes from a few places. First, the straightforward application of the effective date subsection, which provides that amended section 172(a) only applies to losses arising in tax years *beginning after* December 31, 2017, which simply suggests that amended section 172(a) ought to be applied independent of former section 172(a), such that pre-2018 NOLs may continue to fully offset taxable income.

Second, the statutory language in amended section 172(a) provides that the 80 percent limitation is determined "without regard to a deduction under this section." If "without regard to a deduction under this section" is read to mean without regard to a deduction under amended and former section 172(a), then the 80 percent limitation is established before reducing taxable income for the use of pre-2018 NOLs.³⁰

A third piece of support comes from an unlikely place, a mismatched use of terms within two parts of the statute. The language of the operative rule of amended section 172(a) and the effective date provision in H.R. 1 section 13302(e) are not parallel. Specifically, the language in the effective date subsection applies to *NOLs generated*, but the language in amended section 172(a) applies to *taxable income*. Congress's use of uncoordinated language is confusing. However, this inconsistency can be resolved by examining the rule in light of the restrictions provided in the statute. Despite the use of varying terms, the statutory language in the effective date subsection provides that amended section 172(a) applies to losses generated in post-2017 tax years. Stated inversely, the 80 percent limitation in amended section 172(a) does not apply to losses generated in pre-2018 tax years. The legislative history further supports this conclusion, as the limited drafting revisions in the Senate include applying of the 80 percent limitation to a select number of years generating NOLs.³¹ Because the effective date

³⁰ Unlike the FIFO NOL usage rule in section 172(b), there is no parallel ordering requirement for determining the 80 percent limitation. See generally H.R. 1, section 13302.

³¹ H.R. Conf. Rep. No. 115-97, at p. 394. See *supra* notes 26 - 29 and accompanying text.

language provides a cut-off, a beginning of the application of amended section 172(a), former section 172(a) must continue to apply to pre-2018 NOLs and the amended section 172(a) must apply to post-2017 NOLs, independently. The applicable limitation provided by the statute is the lesser of: (1) the NOLs to which section 172(a) applies (i.e., post-2017 NOLs, which in our example is \$30); or (2) 80 percent of taxable income without regard to the NOLD, which in our example is \$80.

If we interpret “without regard to the deduction allowable under this section” to mean deductions permitted under section 172, including both former and amended section 172(a), then the taxable limitation to which the 80 percent limitation applies must be computed before any NOLD usage. If so, the determination of taxable income under Interpretation 3 would be:

- ♦ Step 1: Determine the permissible amount of post-2017 NOLs under section 172(a)
- ♦ Step 2: Use the ordering rule under section 172(b)(2) to determine how much pre-2018 and post-2017 NOLs (as determined in Step 1) are necessary and permitted to offset 2019 taxable income

Applying this process to our example, Step 1, the application of the 80 percent limitation to the post-2017 NOLs would result in permissible post-2017 NOLs being the lesser of: \$30 (i.e., post-2017 NOLs) or \$80 (i.e., 80 percent of \$100 taxable income without regard to the NOLD). The lesser of the two is \$30. Step 2, the application of the ordering requirement in section 172(b)(2) to the available NOLs would result in \$100 of taxable income first being offset by \$90 of pre-2018 NOLs and the remaining \$10 taxable income being offset by \$10 of post-2017 NOLs, which is within the prescribed limitation of \$30, determined above.

A potential counterargument to Interpretation 3 may be result-oriented. If Interpretation 3 is applied and Corporation X were to include \$10 of its post-2017 NOLs in its 2019 NOLD, the result superficially could seem inconsistent with the statutory language of section 172(a) because post-2017 NOLs are being used to generate a NOLD in excess of 80 percent of taxable income. However, this counterargument is not persuasive given that the new 80 percent limitation is explicitly tied to taxable income determined without regard to the NOLD and is explicitly limited to post-2017 NOLs.

Based on the above, Interpretation 3 appears consistent with the dual reading and application of amended section 172(a) and the effective date language in section 13302(e) of H.R. 1. In addition, Interpretation 3 appears to require less manipulation of the statutory language than Interpretation 1, which requires that the statutory language of the effective date subsection be disregarded, by ignoring that amended section 172(a) only applies to post-2017 NOLs to arrive at such application. Further, Interpretation 1 requires less creative analysis than Interpretation 2, which requires that the FIFO ordering of NOLs be applied prior to the application of the 80 percent limitation to the post-2017 NOLs and includes an inconsistent view of the amount of taxable income for purposes of applying section 172(a) in a bifurcated, seriatim manner.

Conclusion

While the language provided by Congress is unambiguous in the abstract, its application is not luminous. We think that Interpretation 3, which applies amended section 172(a) independent of former section 172(a), follows naturally from the effective date provisions in H.R. 1 and is the most appropriate interpretation of the three described above. Interpretation 3 is consistent with the plain language of the statute and requires the least amount of interpretational creativity. Additionally, of the three interpretations, Interpretation 3 is the most consistent with congressional intent demonstrated by revisions made through the drafting process and the deliberate choice of an effective date for the imposition of the 80 percent limitation.

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