

Client Alert

April 2020

Utilizing Tax Refunds Available to Commercial Borrowers Under the CARES Act

The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) provides banks, like other taxable entities, with an opportunity to take advantage of tax refunds from net operating losses (“NOLs”) and accelerated alternative minimum tax (“AMT”) credits. In addition, banks should consider obtaining the right to the tax refunds associated with NOLs from commercial borrowers, particularly where banks are entering into forbearances or other concessions with the borrower. Neither of these accelerated tax benefits were budgeted by borrowers in 2020 and could serve as support for credit extensions and forbearances made by banks to borrowers suffering during the downturn. However, to maximize the credit support available from the CARES Act tax provisions, lenders will need covenants requiring that borrowers promptly take advantage of certain provisions outlined below, and borrowers must also agree not to waive the NOL carrybacks.

The CARES Act provides that NOLs may offset 100% of taxable income in 2018, 2019, and 2020 tax years and allows a taxpayer to carry back NOLs arising in such tax years to any of the five years preceding the tax year when the NOL arose. Prior to the CARES Act, NOLs arising in tax years beginning after December 31, 2017 could be carried forward indefinitely to offset 80% of taxable income for a given tax year but could not be carried back to any prior tax year. The CARES Act also allows an immediate full refund of excess AMT tax credits in 2018 or 2019 (rather than 2021).

The Internal Revenue Service (“IRS”) issued Notice 2020-26 (the “Notice”) and Revenue Procedure 2020-24 (the “Rev. Proc.”) to provide technical guidance implementing the CARES Act NOL provisions. The Notice extends the deadlines applicable to expedited tax refunds for certain 2018 NOLs and provides that a taxpayer must file the applicable IRS form no later than 18 months after the close of the year in which the NOL arose. The Rev. Proc. provides guidance regarding certain NOL elections and refund requests.

Notice 2020-26

- *Extends deadline to file tax refund application for 2018 NOLs.* The Notice extends the deadline for taxpayers to file an expedited tax refund application for an NOL arising in a tax year that began during 2018 and ended on or before June 30, 2019 (including an NOL that arose in a tax year ending on December 31, 2018) (“2018 NOLs”). An expedited tax refund application entitles a taxpayer to a 90-day refund process, which is much faster than the available relief if the taxpayer were to amend its tax return for the applicable year.

The Notice provides that taxpayers must file the expedited refund application within 18 months after the close of the tax year when the 2018 NOL arose. Without the Notice, a taxpayer typically would have 12 months after the close of a tax year to file the application. In effect, the Notice provides a six-month extension of the time to file. For example, if a taxpayer has a 2018 NOL for a tax year ending on December 31, 2018 and wants to carry that NOL back to a prior tax year, the taxpayer must file an expedited tax refund application for that NOL by June 30, 2020 (rather than December 31, 2019).

The extended deadline for expedited tax refund applications will allow a taxpayer to obtain a quick refund for 2018 NOLs carried back to a prior tax year. This Notice only applies to expedited tax refund applications for 2018 NOLs – it does not apply to 2019 or 2020 NOLs because an extension of the time to file is not necessary. To use the expedited tax refund process for a 2018 NOL that is carried back to a prior tax year, a taxpayer should file IRS Form 1139 (corporations) or IRS Form 1045 (taxpayers other than corporations) no later than 18 months after the close of the year when the NOL arose. Include on the top of the Form: “Notice 2020-26, Extension of Time to File Application for Tentative Carryback Adjustment.”

- *Clarifies deadline to file single tax refund application for a taxpayer with a 2018 NOL and a 2018 AMT credit.* If a corporate taxpayer wishes to file an expedited tax refund application for both a 2018 NOL and any remaining AMT credits, the Notice provides that a taxpayer must file the application by June 30, 2020. Prior to the CARES Act, excess tax credits for corporate AMT paid in prior tax years were partially refundable starting in the 2018 tax year and were fully refundable in 2021. Typically, a corporate taxpayer may file an expedited tax refund application by December 30, 2020 to claim these AMT credits for a 2018 tax year. However, if a corporate taxpayer prefers to use a single expedited refund application for both a 2018 NOL and its AMT credits, it must file the application by June 30, 2020 (rather than December 30th).

Revenue Procedure 2020-24

As mentioned above, under the CARES Act, NOLs may offset 100% of taxable income in 2018, 2019, and 2020 tax years and a taxpayer may carry back NOLs arising in such tax year to any of the five years preceding the tax year when the NOL arose. The Rev. Proc. provides certain elections that a taxpayer may make with respect to NOLs impacted by the CARES Act.

- *Allows waiver of carryback of 2018 or 2019 NOLs.* Despite the fact that the CARES Act permits the carryback of certain NOLs, the Rev. Proc. allows a taxpayer to irrevocably waive this carryback for an NOL arising in a tax year beginning in 2018 or 2019. To waive an NOL carryback, the taxpayer must attach a statement to its timely filed (including extensions) federal income tax return for its first taxable period ending after March 27, 2020.
- *Permits exclusion of years from NOL carryback period if the years included a repatriation of foreign earnings toll charge.* If a taxpayer included an amount in income in a prior tax year (or years) due to the repatriation of foreign earnings toll charge (a “Repatriation Year”), the Rev. Proc. permits the taxpayer to exclude those years from the five-year carryback period for a 2018, 2019, or 2020 NOL. A taxpayer may wish to exclude a Repatriation Year to avoid complexities when carrying an NOL to a Repatriation Year. The taxpayer can use an NOL to offset income in other prior tax years while avoiding Repatriation Year complications. To make this election, the taxpayer must attach a statement to the earliest filed of: (1) its federal income tax return for the year when the NOL arose, (2) its expedited refund claim for the NOL, or (3) if it carries back the NOL, its amended federal income tax return applying the NOL to the earliest year that is not a Repatriation Year.

If a taxpayer carries an NOL to a Repatriation Year (*i.e.*, the taxpayer does not elect to exclude such year from the carryback period), the repatriation tax for that year (and certain other amounts) will not be included when calculating the NOL.

- *Extends deadline to file tax refund application for 2017 NOLs.* The Rev. Proc. clarifies that a taxpayer may file an expedited tax refund application (as discussed in the Notice) for a NOL arising in a tax year that began in 2017 (even if the tax year ends in 2018). To use the expedited tax refund process for a 2017 NOL that is carried back to a prior tax year, a taxpayer should file IRS Form 1139 (corporations) or IRS Form 1045 (taxpayers other than corporations) by July 27, 2020. A taxpayer also may use this process to waive or reduce a carryback period or revoke a waiver election for a 2017 NOL. Include on the top of the Form: “Filed pursuant to Rev. Proc. 2020-24” with certain information about the taxpayer and the applicable request or election.

To maximize the ability to benefit from tax refunds of commercial borrowers under the CARES Act, lenders should consider incorporating covenants into loan agreements requiring borrowers to promptly assess their ability to carry back any NOLs, obtain expedited AMT credits, and seek applicable tax refunds based on the procedures outlined above. The covenant should require the borrower to remit proceeds from those refunds to lender as cash collateral or payments if the borrower is not current on the forbearance terms or the underlying credit agreement. The covenant should also be forward-looking, requiring commercial borrowers with 2020 NOLs to promptly do the same. Corporate borrowers expecting a 2020 NOL should analyze the possibility of accelerating deductions into 2020 to permit those borrowers to carry back deductions as part of its 2020 NOL and increase any prior year tax refund. Lastly, borrowers should covenant that they will not waive the carryback of 2018 or 2019 NOLs.

Please reach out to us with any questions about the CARES Act and its implications for borrowers.

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