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ATNOL Carrybacks under the CARES Act

April 16, 2020

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The CARES Act revived a five-year net operating loss carryback rule, but did not address the application of the rule when net operating losses are carried back to years before the corporate alternative minimum tax was repealed. Should corporations now compute alternative tax net operating loss carrybacks to offset alternative minimum taxable income? It seems that the answer is "yes."

On March 27, 2020, Congress passed, and the President signed into law, the Coronavirus Aid, Relief, and Economic Security Act (the "**CARES Act**")[1] to assist the immediate cash flow needs of many American businesses. Of relevance, the CARES Act resurrects a five-year net operating loss ("**NOL**") carryback rule, and accelerates the ability of corporations to utilize remaining minimum tax credits ("**MTCs**") generated under the former alternative minimum tax ("**AMT**") regime as refundable credits.

One issue raised by the CARES Act's five-year NOL carryback provision is whether taxpayers, following the repeal of the corporate AMT regime, can compute alternative tax net operating loss ("**ATNOLs**") carrybacks from 2018, 2019 or 2020 to offset alternative minimum taxable income ("**AMTI**") generated in years for which the corporate AMT still applied.

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1 Pub. L. No. 116-136 (enacted March 27, 2020).

In this article, we address the interaction between the CARES Act's five-year NOL carryback provisions and the retained AMT rules. We take the position that, notwithstanding the repeal of the corporate AMT, corporate taxpayers can still compute and carry back ATNOLs to offset AMTI generated in the year of carryback. We further take the position that the ATNOL should be computed using the items of tax preference and adjustment in effect in the tax year the loss is incurred (i.e., 2018 – 2020).

CARES Act—Five-Year NOL Carryback

As a result of the CARES Act, corporations that have incurred or will incur an NOL[2] in tax years beginning after December 31, 2017, and before January 1, 2021, generally are allowed to carry back these NOLs for five tax years.[3] Taxpayers may, however, elect to relinquish the five-year carryback period with respect to a particular year's NOL, with the election being irrevocable.[4] In addition, taxpayers are allowed to elect to exclude section 965 transition tax inclusion years from the carryback period.[5]

The Corporate AMT Regime – Historical Application and Repeal

General Framework

For tax years beginning before January 1, 2018, but after 1986, corporate taxpayers that were subject to regular tax[6] were also subject to the alternative minimum tax (i.e., AMT) regime.[7] As originally enacted by the Tax Reform Act of 1986,[8] the corporate AMT regime was designed to ensure that corporate taxpayers would not "avoid significant tax liability by using various exclusions, deductions and credits," to which they are entitled under the regular tax, but which are not viewed as accurately reflecting economic income.[9] To accomplish this objective, the corporate AMT regime was structured to operate as a separate corporate income tax (in that it has its own set of rules for calculating income and deductions and its own rate), but one that nonetheless "parallels" that of the regular tax system.[10]

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[2] For regular tax purposes, an NOL arises when the corporation's allowable deductions exceed its gross income. *See* section 172(c). Once an NOL is computed for a particular year, the loss is carried back or forward to offset income in previous or future tax years. *See* section 172(b). The NOL deduction for a given tax year is equal to the sum of these carrybacks and carryovers. *See* section 172(a)(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").

[3] CARES Act section 2303(b)(1), adding section 172(b)(1)(D)(i)(I) to the Code. . (For simplicity, we do not address the CARES Act's special NOL carryback rules for REITs and life insurance companies.)

[4] Section 172(b)(3). *See also* section 1.1502-21(b)(3)(i). For procedures regarding this carryback and election, see CARES Act section 2303(b)(1), adding section 172(b)(1)(D)(v)(II) to the Code; Notice 2020-26; Rev. Proc. 2020-24.

[5] CARES Act, section 2303(b)(1), adding section 172(b)(1)(D)(v)(I) to the Code.

[6] The term "regular tax" for AMT purposes means the regular tax liability for the tax year as defined in section 26(b) with certain specified modifications. *See* section 55(c)(1).

[7] *See generally* section 55.

[8] Pub. L. No. 99-514, 100 Stat. 2085, 2320-45 (1986).

[9] H.R. Rep. No. 99-426, at 326 (1985); S. Rep. No. 99-313, at 538 (1986); Joint Comm. on Tax'n, General Explanation of the Tax Reform Act of 1986, at 469.

[10] *See* Joint Comm. on Tax'n, General Explanation of the Tax Reform Act of 1986, at 469.

Very generally, the AMT regime imposed upon corporations a specially computed tax liability during a given tax year to the extent that a corporation's tentative minimum tax ("**TMT**") exceeded its regular tax for the year.[11] The TMT was computed at the rate of 20 percent of a corporation's alternative minimum taxable income (i.e., AMTI) in excess of a $40,000 exemption that was subject to a phase out.[12] For this purpose, AMTI was calculated by adding certain preferences and making certain other adjustments to a corporation's regular taxable income.[13] As discussed further below, these preferences and adjustments are items a corporation may generally claim to reduce regular taxable income, but which were disallowed and/or modified under the AMT regime.[14]

If a corporation was required to pay AMT in any given tax year, section 53 allowed as a "minimum tax credit" (i.e., MTC) in a subsequent tax year for the amount of AMT previously paid.[15] The MTC for any given tax year was computed as the excess of (1) the adjusted net minimum tax imposed upon the corporation for all prior tax years beginning after 1986, over (2) the amount previously allowable as a credit under the general rule of section 53(a).[16] Under section 53(c), a corporation generally was permitted to utilize MTCs to the extent the corporation's regular tax liability exceeded its TMT in the later year.[17] Any unused MTCs could be carried forward for use by the corporation in a future year.[18]

Adjustments to AMTI—The ATNOL Deduction

As discussed above, the starting point for determining a taxpayer's AMTI was the taxpayer's regular taxable income.[19] Once a taxpayer computed its regular taxable income, the taxpayer was required to add back various tax "preferences" and "adjustments" to derive its AMTI. Among the adjustments used in computing a taxpayer's AMTI is the adjustment for the alternative tax net operating loss deduction (the "**ATNOL deduction**").

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11 Section 55(a).

12 Section 55(b)(1). This amount is then reduced by the "alternative minimum tax foreign tax credit" for the tax year determined under section 59(a). *Id*.

13 All of the rules generally applicable in determining a taxpayer's regular taxable income generally apply in determining a taxpayer's AMTI. *See* section 1.55-1(a) ("unless modified by the statute, regulations, or administrative pronouncement, all Internal Revenue Code (Code) provisions that apply in determining the regular taxable income of a taxpayer also apply in determining the taxpayer's alternative minimum taxable income."); *see also* H.R. Conf. Rep. No. 99-841, at II-283 ("…in light of the parallel nature of the regular and minimum tax systems, any limitations applying for regular tax purposes…apply for minimum tax purposes as well."); PLR 200044003 (Nov. 3, 2000) (limitations in the regular tax system apply to the minimum tax system whether or not Congress makes the application explicit).

14 *See* section 55(b)(2). Specifically, section 55(b)(2) defines AMTI as the taxable income of the taxpayer for the tax year, determined with the adjustments provided in sections 56 and 57, and increased by the amount of the items of tax preference described in section 57.

15 Section 53(a).

16 Section 53(b).

17 For this purpose, "regular tax liability" was reduced only by the sum of certain specified credits allowable as provided for in section 53(c)(1).

18 *See generally* section 53.

19 *See* section 172(c).

Pursuant to section 56(a)(4), a taxpayer was allowed to claim an ATNOL deduction in computing its AMTI *in lieu* of the NOL deduction allowed under section 172 for regular tax purposes. The ATNOL deduction is defined in section 56(d) as the "net operating loss deduction allowable for the taxable year under section 172," with certain modifications. First, section 56(d)(1)(B) requires that the amount of a taxpayer's NOL (as determined under section 172(c)) for the loss year to be computed by taking into account (i) all of the adjustments to taxable income set forth in sections 56 and 58 that apply in computing AMTI, and (ii) all of the tax preference items provided in section 57.[20] Second, section 56(d)(1)(A) limits the amount of the ATNOL deduction for any given year to 90 percent of the taxpayer's AMTI determined without regard to the ATNOL deduction (the "**90-Percent Limitation**").[21] This modification is designed to ensure that the ATNOL deduction does not completely eliminate all of a taxpayer's tax liability.

For purposes of the above computations, the amount of a taxpayer's NOL for a tax year is required to be computed *based on the law in effect in the tax year the NOL is incurred*.[22] Authorities apply this standard equally with respect to the computation of a taxpayer's ATNOLs.[23] For example, in Private Letter Ruling 9317002, the taxpayer had a 1989 regular tax NOL that was carried back to 1986. The taxpayer carried back the loss and applied the 1986 AMT provisions to the regular tax NOL to determine the ATNOL. The ruling held that the taxpayer must reduce its 1989 regular tax NOL by the amount of its 1989 preference and adjustment items, even though those items were not preferences in 1986 (*i.e.*, the year of carryback). Thus, in determining the ATNOL, a taxpayer is required to take into account the various items of tax preference and adjustment (as provided in sections 56 through 58) that exist in the year the loss was sustained.[24] Once the ATNOL is calculated for that year, it is then required to be carried back or forward in the same manner as NOLs under the regular tax system.[25]

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[20] *See* section 56(d)(2)(A).

[21] Note, the 90-Percent Limitation must also be taken into account when the amount of carrybacks is determined under section 172(b). *See* sections 56(d)(1)(A) and (d)(1)(B)(ii).

[22] *See* section 1.172-1(e)(2) ("[t]he net operating loss for any tax year shall be determined under the law applicable to that year without regard to the year to which it is to be carried and in which, in effect, it is to be deducted as part of the net operating loss deduction"); Reo Motors v. Commissioner, 338 U.S. 442, 450 (1950) (an NOL must be computed solely on the basis of statutes in effect during the tax year in which the loss is incurred); American Bank & Trust v. United States, 333 F.2d 416 (5th Cir. 1964) (same)..

[23] *See, e.g.*, PLR 9317002 (Apr. 30, 1993); Adler v. United States, 32 Fed. Cl. 736 (1995) (taxpayer may not recompute pre-1986 AMT using post-1986 passive activity losses; there is "settled case law" that requires taxpayers to determine particular losses under law in effect during loss year); PLR 9152004 (Aug. 23, 1991) (same).

[24] PLR 9317002 (Apr. 30, 1993).

[25] *See* PLR 9317002 (Apr. 30, 1993) (ATNOLs carried back pursuant to section 172); Metro One Telecommunications v. Commissioner, 135 T.C. 573 (2010), *aff'd*, 704 F.3d 1057 (9th Cir. 2012) (section 56(d)(1), by reference to section 172, incorporates the same meaning for the terms "carryback" and "carryover"); Branum v. Commissioner, 17 F.3d 805 (5th Cir. 1994), *aff'g* T.C. Memo. 1993-8 (invalidating taxpayer's attempt to relinquish carryback period for regular NOLs, but not for ATNOLs; therefore, taxpayer must carry back or forward both regular tax NOLs and ATNOLs is the same fashion); Urbanek v. United States, 866 F. Supp. 1414 (S.D. Fla. 1994), *aff'd*, 71 F.3d 855 (11th Cir. 1996) (taxpayer was not allowed to compute AMTI using regular tax NOL carrybacks, but rather was required to compute AMTI using ATNOL carrybacks in lieu of regular tax NOLs).

Accordingly, when sections 56 and 172 are read together, it is evident that a taxpayer's ATNOL generally is required to be computed in the general same manner as the regular tax NOL (subject to the modifications noted above) and all the provisions of section 172 relating to carrybacks and carryforwards of NOLs apply equally to the ATNOL.

TCJA—Repeal of the Corporate AMT Regime

Congress, through the enactment of Public Law 115-97 (commonly referred to as the "Tax Cuts and Jobs Act of 2017") ("**TCJA**"),[26] repealed the corporate alternative minimum tax effective for tax years beginning after December 31, 2017, and adopted certain transition rules to address the treatment of any remaining MTCs.[27] Specifically, the TCJA amended section 55(a) by inserting "In the case of a taxpayer other than a corporation…," effectively excluding corporations from being subject to taxation under the AMT regime going forward. [28] In addition to the amendment to section 55(a), Congress also made certain additional amendments to other sections, including, as relevant here, section 56, which sets forth various adjustments that a taxpayer is required to make when computing its AMTI. Markedly, the only amendment made to section 56 was the elimination of subsections (c) and (g), which contained certain adjustments, such as the adjusted current earnings ("**ACE**") adjustment,[29] that were only applicable to corporations. Congress made no modifications, however, to subsections (a) or (d) of section 56 (dealing with the ATNOL deduction), or to sections 57 or 58.

The Issue

In light of the recent repeal of the corporate AMT, as well as the CARES Act's resurrection of the five-year NOL carryback provisions, uncertainty has arisen regarding whether corporate taxpayers can compute, and thus carry back, ATNOLs from 2018, 2019 or 2020 to offset AMTI generated in years for which the corporate AMT still applied.

Furthermore, if corporate taxpayers can compute ATNOL carrybacks from those years, which items of tax preference and adjustments should taxpayers use in determining ATNOLs? Specifically, should a

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[26] An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

[27] Pub. L. No. 116-136, § 2305.

[28] The original version of the House Bill would have abolished AMT for both individual and corporate taxpayers. *See* H.R. 1, 115th Cong. § 2001 (Nov. 2, 2017). The TCJA Conference Report, explaining the House Bill, states that, "[i]n determining the alternative minimum taxable income for taxable years beginning before January 1, 2018, the net operating loss deduction carryback from taxable years beginning after December 31, 2017, are determined without regard to any AMT adjustments or preferences." Conf. Rep. 115–466 at 322. While this provision made sense when the entire AMT regime was to be repealed, it does not appear applicable to the iteration of the law that ultimately passed. However, this does further support our position, explained below, that the ATNOL should be computed based on law in effect in the tax year the loss is incurred. Had the entire AMT regime been repealed, there would have been no AMT adjustments or preferences in effect in the years losses were incurred.

[29] Very generally, under the ACE adjustment, a corporation's AMTI was increased by 75 percent of the excess of the corporation's ACE over its AMTI (computed without regard to the ACE adjustment or the ATNOL deduction). Likewise, a corporation's AMTI was decreased by 75 percent of the excess of the AMTI over the ACE. *See* former section 56(c) and (g).

taxpayer's computation take into account the items of tax preference and adjustment that are currently included in sections 56 through 58 (*i.e.*, determined without regard to the ACE adjustment), or rather, should taxpayers compute the ATNOLs using the items of tax preference and adjustment that existed in the year to which the ATNOL is carried?

Treasury and the IRS have not, as of yet, issued any guidance addressing either of the above mentioned issues.

Analysis

As discussed above, for purposes of computing AMTI, a taxpayer must use the ATNOL deduction in lieu of the NOL deduction allowed for regular tax purposes. A taxpayer is, therefore, required to make two parallel but distinct sets of NOL computations: (1) a regular NOL computation to be used in computing taxpayer's regular tax liability, and (2) an ATNOL computation to be used in computing a taxpayer's AMT liability. Although these computations are separate and distinct, they are nonetheless inextricably linked. This connection can be seen not only in the various cross-references made to section 172 in sections 56(a)(4) and (d), but also in judicial and administrative authorities. For example, in *Plumb v. Commissioner*[30] the court held that the waiver-of-carryback provision contemplates a single election that applies to both the regular tax NOL and the ATNOL. As such, the court required that a regular NOL and an ATNOL be treated consistently with respect to such an election.[31] Moreover, in *Sequa Corp. v. United States*,[32] the taxpayer had ATNOLs in post-1986 years that were carried back to 1986. The taxpayer, arguing against the carryback of its ATNOLs, reasoned that such a carryback was not permitted as the corporate AMT regime was not effective in 1986 (i.e., the corporate AMT was not effective until 1987). In holding against the taxpayer, the court reasoned that "[t]aking all of the indicators together—the statutory language, the interaction of the various provisions, the purpose of Congress, and the teaching of the Blue Book—and giving each its proper weight, the Court cannot concluded that the IRS erred in carrying Sequa's [ATNOLs] back to 1986 and offsetting them against Sequa's regular taxable income."[33]

Even though the Code no longer imposes AMT on corporations for tax years beginning after December 31, 2017, we believe that unless and until Treasury and the IRS release guidance indicating otherwise,[34] the best read of the authorities, when "taking all of the indicators together," appears to be that corporate taxpayers can compute ATNOL carrybacks from 2018, 2019, and 2020 to offset AMTI generated in years for which the corporate AMT still applied. First, the operative statutory provisions that define and govern the ATNOL deduction (i.e., sections 56(a)(4) and (d)) remain intact and entirely

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30 97 T.C. 632 (1991).

31 *See also* Rev. Rul. 87-44, 1987-1 C.B. 3 (IRS requires that a regular tax NOL and an ATNOL to be treated consistently with respect to the section 172(b)(3)(C) election); *Branum*, 17 F.3d at 805 (invalidating taxpayer's attempt to relinquish carryback period for regular NOLs, but not for ATNOLs).

32 Sequa Corp. & Affiliates v. United States, 350 F. Supp. 2d 447 (S.D.N.Y. 2004), *aff'd*, 437 F.3d 236 (2d Cir. 2006).

33 *Sequa Corp.*, 350 F. Supp. 2d at 454.

34 Given the continuing uncertainty and administrative complexity this application is likely to cause corporate taxpayers, we believe that providing certainty in this area is a priority.

unchanged following the TCJA, thereby continuing to provide a mechanism for corporate taxpayers to compute ATNOLs. Second, the explicit cross-reference and interaction between sections 56 and 172 provide further support for computing and carrying back ATNOLs from 2018, 2019, and 2020. Finally, failure to require an ATNOL carryback would frustrate the policy of the corporate AMT regime as in existence in those prior years, because the AMT regime was only intended to provide a 10 percent haircut on the use of NOLs. If there is no ATNOL carryback, AMT could function like a 100 percent haircut.[35]

With respect to the second issue raised above, authorities indicate that a taxpayer is required to compute its NOL and ATNOL for a given tax year based on the law in effect in the tax year the ATNOL is incurred (i.e., 2018 – 2020). Accordingly, it is our view that taxpayers should compute ATNOL carrybacks taking into account only the items of tax preference and adjustment that are currently included in sections 56 through 58, which, notably, no longer includes the ACE adjustment. Computing the ATNOL in this manner generally is expected to maximize the total amount of ATNOLs available for carryback to a prior year.[36]

The application of these rules may have a variety of outcomes and impacts depending on the unique facts and circumstances of each taxpayer. Generally, we would expect that the CARES Act's five-year NOL carryback provision would increase the number of taxpayers that previously were in a regular tax position who flip to an AMT position. Because ATNOLs are not able to fully offset a taxpayer's AMT liability in the carryback year, due to the application of the 90-Percent Limitation, many taxpayers may generate MTC carryforwards, which could be used against regular tax paid in subsequent years or, if unable to be used in such carryforward years, claimed as a refund in 2018 or 2019.[37] Conversely, if

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[35] For example, assume a taxpayer had 200 of AMTI and 100 of regular taxable income in a prior year to which 100 of NOL is carried back. If no ATNOL is carried back along with the regular tax NOL, AMTI would now exceed regular taxable income by 200 in that year. Thus, the NOL carryback creates an additional 100 of excess AMTI over regular taxable income, which is subject to taxation under the AMT regime. Contrast that with the situation where a 90 ATNOL is also carried back and allowed, where there is only 10 additional excess AMTI over regular taxable income. The latter is more consistent with the intended function of the AMT regime. However, as reflected in footnote 36 and the accompanying text, the repeal of the ACE adjustment could have unintended mechanical effects on the implementation of this policy.

[36] The ATNOL for a loss year is the excess of the deductions allowed in figuring AMTI (excluding the ATNOL deduction) over a taxpayer's income included in AMTI. In applying this formula, AMTI should no longer take into account the 75 percent ACE adjustment. Specifically, pre-TCJA, a corporation would compute its ACE for a tax year and compare that amount with its pre-ACE AMTI. If ACE exceeded pre-ACE AMTI, the corporation would increase its AMTI by 75 percent of the excess of its ACE over its pre-ACE AMTI (without regard to ATNOL). Of note, in determining whether there is an excess of ACE over AMTI, a positive amount exceeds a negative by the sum of the absolute numbers. See section 1.56(g)-1(a)(3). Thus, for example, if a taxpayer had ACE of negative $2 million and pre-ACE AMTI of negative $3 million, the negative amount of ACE (-$2 million) exceeds the negative amount of pre-ACE AMTI (-$3 million) by $1 million. Because ACE exceeds pre-AMTI by $1 million, the corporation would increase its AMTI by $750,000; thereby, decreasing the potential ATNOL for the given year. The ACE adjustment can also operate to decrease AMTI; however, such negative ACE adjustments are generally subject to further limitation. *See* former section 56(g)(2)(B) and section 1.56(g)-1(a)(2)(ii). While the regulations implementing the ACE regime remain outstanding, the operative language was removed from the Code by the TCJA and, therefore, we believe the regulations have no effect in post-TCJA years.

[37] *But see, e.g.*, Mark Hoffenberg and Stephen Marencik, *Are AMT Credit Refunds Subject to Limitation?*, 158 Tax Notes 1177 (Feb. 26, 2018) (discussing potential issues with the ability to fully claim MTCs that are subject to limitation under section

taxpayers previously were in an AMT position, ATNOL carrybacks may serve to reduce a taxpayer's AMT liability in the carryback year (thereby, entitling it to a refund), while reducing such taxpayer's available MTC carryforwards.

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383); Amy Chapman and Bela Unell, *SRLY Not a Bar to MTC Refunds*, What's News in Tax (April 6, 2020) (discussing potential issues with the ability to fully claim MTCs that are subject to limitation under the separate return year limitation ("**SRLY**") regime).

