

Client Alert

Latham & Watkins
Tax Department

President Signs Legislation Extending NOL Carryback Period and Delaying Implementation of Worldwide Interest Allocation Rules

On November 6, 2009, President Obama signed into law the Worker, Homeownership, and Business Assistance Act of 2009 (the Act). This *Client Alert* addresses two tax-related provisions of the Act of particular interest to businesses. First, the Act generally allows taxpayers to elect to extend the carryback period for net operating losses (NOLs) arising in 2008 or 2009 from the generally applicable two years to up to five years. The election, however, is not available to taxpayers in which the federal government has acquired equity interests under the Troubled Asset Relief Program (TARP).

Second, the Act delays by seven years (until taxable years beginning after December 31, 2017) the effective date of the worldwide interest allocation rules that had been due to become available to multinational companies after 2010. The delay in the effective date of these rules is apparently intended to offset anticipated revenue losses from other provisions of the Act, such as the NOL carryback extension.

The Act's other provisions:

- extend the first-time homebuyer tax credit for purchases of principal residences from the current deadline of November 30, 2009 to purchases

by April 30, 2010 (or by June 30, 2010, as long as the buyer entered into a binding contract by April 30, 2010 to close on the purchase by June 30, 2010) and make other modifications, including special rules for certain members of the uniformed services, the Foreign Service and the intelligence services;

- extend unemployment benefits to certain recipients, the cost of which is intended to be offset by an extension of the 0.2 percent surtax on employers under the Federal Unemployment Tax Act from the end of 2009 through June 2011;
- increase the amount of third quarter 2014 corporate estimated taxes due from corporations with assets worth at least \$1 billion;
- increase the penalty for failure to file a partnership or S corporation return; and
- expand the electronic return filing requirements for tax return preparers.

Election to Extend NOL Carryback Period for Up to Five Years

Background

A net operating loss refers to the amount by which a taxpayer's business

"The Act permits taxpayers to carry back 2008 or 2009 NOLs up to five years instead of two years, and it delays until 2018 the effective date of rules permitting the worldwide allocation of interest expense."

deductions exceed its gross income. In general, under current law, a taxpayer is permitted to carry back NOLs to the two taxable years preceding the year of the loss in order to offset income in those years. If the loss is not fully utilized in those two years, the taxpayer generally may carry the remaining NOLs forward for up to 20 years after the year of the loss to offset income in such years (the taxpayer can also choose to forgo the carryback and deduct the loss just in the carryover period).

Extended NOL Carryback Election

To provide relief to taxpayers whose NOLs arising in any taxable year beginning or ending in 2008 and 2009 exceed their income during the two-year carryback period, the Act allows taxpayers to elect to carry back such NOLs for three, four or five years. The Act also permits life insurance companies to elect to carry back operations losses (similar to NOLs) for four or five years instead of the maximum three years permitted absent the election.

The economic stimulus legislation enacted in February 2009 previously permitted eligible small businesses (whose annual gross receipts generally do not exceed \$15 million) to elect to carry back NOLs arising in 2008 for up to five years instead of two years.¹ The Act now enables businesses of all sizes to enjoy an extended NOL carryback period.

Finally, for alternative minimum tax purposes, an NOL deduction cannot reduce the taxpayer's alternative minimum taxable income (AMTI) by more than 90 percent of the AMTI. The Act suspends this 90 percent limitation on the use of any alternative minimum tax NOL deduction attributable to an NOL carryback made pursuant to an extended carryback election.

Limitations

The election permitted under the Act is subject to several limitations. It can be made only with respect to a single taxable year (except an eligible small business that elected to carry back 2008 NOLs for three or more years may also make the new carryback election with respect to 2009 NOLs). Further, if a taxpayer elects the full five-year carryback period, only 50 percent of the taxpayer's taxable income in the fifth year preceding the loss year generally may be offset by the NOLs carried back to such year. The Act, however, imposes no limit on the ability to use the remaining NOLs to offset income in the other four preceding years.

In addition, the election is generally not available to any taxpayer in which the federal government acquired or acquires at any time an equity interest (or a warrant or other right to acquire an equity interest) pursuant to the Emergency Economic Stabilization Act of 2008 (*i.e.*, most taxpayers that received TARP funds) or to a member of such taxpayer's affiliated group.

Postponement of Worldwide Interest Allocation Rules Until 2018

Background

To compute its foreign tax credit limitation and for certain other purposes, a taxpayer must determine how much taxable income it derived from US sources and from foreign sources and generally must allocate and apportion its deductions between items of US-source gross income and items of foreign-source gross income.

With respect to the allocation of deductions for interest expense, however, all members of an affiliated group of corporations (as defined for eligibility to file a consolidated federal

income tax return) are generally treated as a single corporation, and the taxpayer must allocate the interest expense on the basis of assets rather than gross income. Foreign corporations are generally excluded from membership in the affiliated group.

For a US multinational corporation, the current rules mean that even if its foreign subsidiaries bear their own costs of borrowing, the US parent typically must allocate some of the group's domestic interest expense to the foreign subsidiaries' income. This reduces the foreign tax credit limitation and the allowable credits.

Worldwide Interest Allocation Rules

The American Jobs Creation Act of 2004 amended the Internal Revenue Code of 1986 to permit a domestic corporation to determine foreign-source taxable income of the affiliated group by allocating interest expense of the domestic members of a worldwide affiliated group as if all members of the worldwide group were a single corporation. The provision could allow a US multinational corporation to allocate less of its interest expense to foreign-source income for purposes of the foreign tax credit limitation, thereby increasing allowable foreign tax credits. Certain special rules would apply in the case of financial entities which are included in an affiliated group.

Effective Date Delayed to 2018

As originally enacted in 2004, the worldwide interest allocation rules would have been effective for taxable years beginning after December 31, 2008. The Housing and Economic Recovery Act of 2008 delayed their implementation until taxable years beginning after December 31, 2010. The new Act further postpones implementation of these rules until taxable years beginning after December 31, 2017.

Endnotes

¹ See *Client Alert No. 812*—"Significant Business-Related Tax Law Changes under the American Recovery and Reinvestment Act of 2009," February 18, 2009.

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